

Managing Partner Performance

By Derek Schutz

Now that 2009 has come to an end, law firms are breathing a sigh of relief and looking forward with hopes of a better year to come. As with any year-end, it is also time to dole out partner compensation, and many firms are hoping they were able to stem the lack of demand for legal services with cost-cutting measures to keep their profits per partner above an acceptable threshold. One interesting observation is that although many firms evaluated their employees and their performance relative to saving the bottom line, an in-depth view of partner performance was by and large ignored.

This is not to say that firms are unaware of the effects of more partners vying for their slice of the proverbial “profit” pie. Many firms actually took steps to make changes within their partner ranks, including asking individuals to leave or cutting their compensation to levels more in line with what management felt they brought to the firm. This activity, however, was not the norm; either through lack of motivation, historical precedence or an inability due to bylaws, a large share of firms ignored the impact that underperforming partners have on the health and welfare of their firms.

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PROFITS PER PARTNER

It is important to remember that partners are appropriated a portion of profits for the firm and while a “profit per partner” value is not the only metric viewed when determining the health of a firm, it does provide a threshold that can be catastrophic if crossed. Profit is simply the spread between what a law firm can charge for its output (revenue) and what that output costs them (costs). When the revenue side of the equation is impacted negatively, the logical step is to try to cut the costs side of the equation in order to maximize the spread. While this is a sound concept, it often results in painful decisions and can impact the long-term viability of a firm.

Another way to approach the issue of unsatisfactory profits per partner is to look at the pool to which the profits are being dispersed. The more people who want a piece of the pie, the smaller the pieces of pie become for everyone. What law firms need to be cognizant of is the concept of providing larger pieces of pie to those whose efforts actually increase (or retain) the size of the pie as a whole. In other words, “you eat what you kill.”

This concept has been largely debated recently and looked upon with some derision (including by myself) in the past. However, the reason for this negative connotation is not due to the underlying principal, but rather the definition of what many law firms consider “killing.” Often, working billable hours is considered the “kill” rather than the more valuable aspects of a partner’s role in the firm. If employed in a manner that truly recognizes actions that focus on profit genera-

tion and growth, not simply revenue, this model not only works but drives for a healthier and thriving firm.

So, which partner roles drive value (profits) for the firm that management should factor in at compensation time? While the specifics around the jobs may vary from firm to firm, there are four main functions that partners perform that are vital to a healthy law firm:

- Originating new clients;
- Client relationship management;
- Working billable hours; and
- Firm management.

Since many of the functions required by a law firm can only be performed by partners, it is important to place emphasis on these roles. For example, originating new work, managing clients, and managing a practice group are not activities that associates can (or should) perform; however, much of the billable hours on clients can be performed by associates. Therefore, if a partner compensation model puts an overemphasis on working billable hours, partners may work hours that could be accomplished by others to the detriment of performing other duties, such as originating. Thus, when approaching partner performance, it is important to understand each of the roles above, and understand that individuals will gravitate to actions for which they are rewarded. If your system rewards the hoarding of hours, you should expect to see hours hoarded by partners.

In regard to the often-used term *underperforming partner*, the truth is there is no such concept. It is better to consider them *over-compensated partners*. Take, for example, Partner 1, who brings in no

work to a firm (in any capacity), works no hours, has no mentoring, administrative or other tasks whatsoever. What is an acceptable level of compensation for this individual? From a purely economic standpoint, the answer has to be no compensation. Otherwise, this partner takes profits from other “producing” partners and risks their departure from the firm, lowering the profit available for everyone, which could lead to more “producers” leaving.

Extrapolating this idea further, you can make the argument for any partner at the firm. Take Partner 2, who works 3,000 billable hours but provides no originations, does not manage any clients and holds no administrative or firm management roles. In this case, what is an economically viable compensation level? While this question may have a few more subjective aspects to it (such as: Could this work be replicated by others at the firm? Will we lose a client if those hours cannot be replicated?), the strictly quantitative answer is the value of those hours, less the overhead allocated to the partner in question.

MANAGING TOWARD THE CORRECT BEHAVIOR

Unfortunately, for many law firms, the compensation system itself is mired in a series of complex and convoluted determinations that are difficult to manage, harder to explain, and may reward the types of behavior that are not conducive to healthy partnership. In fact, many partners view the compensation process at their law firms as a black box. This lack of transparency not only breeds malcontent partners, but it has a deeper problem in that it does not drive the correct behavior.

In short, firms need to focus on incentivizing partners to create revenue (and profit) for the firm, either through new clients or through managing existing relationships. The best way to do this is to create a system that rewards partners for behavior that is consistent with driving profit and that utilizes variables that are quantifiable.

A QUANTIFIABLE APPROACH

Once a firm has decided to approach the concept of partner performance and partner compensation, the goal must be to establish a model that applies appropriate levels of importance to each of the roles. Using a model that can be measured and tracked makes the system more transparent and allows individuals to make decisions that improve their own prospects and that of the firm as a whole. The first step in this process is to determine what will be measured and how. Most law firms track and use originations as a basis for compensation, but at what level? Matter? Client? How are they determined? What is the time period you will use? The answer to these questions depends on what metrics are available, the actions you want the results to drive, and how the firm views itself.

For example, Firm A may choose to look at the fees collected on client originations, but only go back five years (any clients who were originated prior to five years ago would not count for compensation). Firm B may decide to use matter originations for the last 12 months and look at the hours originated instead of fees collected. The difference here is in the action that a determination may inspire. Firm A's partners who have older clients may be driven to go out and find new clients for the firm since some of their originations have become “stale.” Firm B's partners may be driven to generate more hours from its existing client base. (Note, this is not a promotion of either of these situations, simply relating how making a choice in how and what you measure may drive different actions) The axiom “you get what you measure” is correct, particularly when it comes to compensation decisions. If a firm measures new client origination and reward based on new client generation, it will get new clients.

WHERE TO GO FROM HERE

In the end, partners are all compensated out of the same pool, and the bigger the pool, the bigger the paycheck for everyone

at the end of the day. The decision of many firms to look at partner performance and truly invest in those partners who are driving value for the firm is a necessary and long overdue step. Simply being a “good” lawyer is not enough to become a successful partner at today's law firms. Law firms must create compensation models that reward partners for behavior that is consistent with owners of a business, not employees. The more transparent and straightforward the model is, the greater the chance of keeping the right partners happy and ensuring a healthier and more stable firm heading into the uncertain future.