

# Law Firm Inc.

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ALM

On Management

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Richard Gary

## Payment Plans

How to compensate your managing partner, and the consequences of a right — or wrong — decision.

It's taken for granted that compensation is the most effective tool available to influence partner behavior, so much so that some law firms spend more time on partner compensation than they do on marketing. They write and rewrite their compensation policies, and spend months interviewing partners, developing recommendations, and considering partner complaints and appeals. All told, in most firms, no subject gets more attention year in and year out than partner compensation.

And yet, when it comes to determining how much to pay the managing partner, firm leaders often struggle to find the right answer. Because the position is highly visible, how firms compensate the managing partner has far-reaching consequences — not only for the person holding the office but for all other partners as well.

### The fundamental proposition

I start from the proposition that the managing partner should be among the firm's highest-paid partners — but should not be the highest paid partner unless justified by factors other than simply holding this position, e.g., some combination of business originations, practice contributions, and other criteria consistent with the firm's compensation plan. In accounting, investment banking, and even professional sports, the chief executive is paid well, but the highest pay is reserved for the “producers.” Law firms should follow this model, too.

### Subjective compensation systems

At firms using a subjective-based system, appropriate compensation is determined by using various factors to evaluate each partner's sustained overall contribution. But it should be noted that a managing partner's role is unique, and therefore, this person's contributions will differ markedly from the contributions of others.

Here are the subjective factors that should be considered in determining the managing partner's compensation:

**Responsibilities and functions.** How broad is the scope of the managing partner's responsibilities? What are the functions that this person is expected to perform? Do they include, for example, operations, practice management, partner compensation, partner relations, lateral recruitment, geographic expansion, overall firm profitability, pursuit of merger opportunities, etc.? Generally speaking, a managing partner's compensation should be proportional to the breadth of his or her responsibilities.

**Time commitment.** What is the level of the managing partner's time commitment to leadership and administration? This will vary widely according to the needs of the firm. Is the firm in a period of crisis or opportunity where full-time leadership is required? Or is the firm in a period of relative stability where a part-time commitment is all that is necessary?

If full-time leadership is required, the firm should take this into account in setting the managing partner's compensation. After all, if the firm wants a partner with outstanding leadership skills to sacrifice his or her practice to promote the firm's interests full-time, the firm should reward that partner.

Note that the managing partner's time

### MANAGING PARTNERS' 2006 OUTLOOK

What are your expectations with respect to profits per partner:

	Responses	
They will grow by more than 5%	96	67.6%
They will grow by 5% or less	38	26.7%
They will be flat	7	4.9%
They will decrease	1	.7%
<b>Total Respondents</b>	<b>142</b>	

source: The American Lawyer, Firm Leaders Survey

commitment is also a function of the individual holding the position. No two managing partners are alike. For some, the challenges of the position are both fascinating and attractive. These people enjoy the position and may even prefer management to the practice of law. For others, the position is one of obligation and duty. These people often delegate as much as possible in order to be able to fulfill their management responsibilities and, at the same time, maintain their practices.

**History.** It goes without saying that the managing partner's compensation should bear a reasonable relationship to the individual's historic compensation level — and, in all likelihood, should be some what higher. No one should take a pay cut to become a managing partner.

**Other factors.** Other factors to be considered include seniority, experience in the position, stature, and achievement of individual and firm goals.

#### **Formula-based systems**

Most firms using a formula-based system determine compensation on the basis of a combination of business originations or client relationships and billable hours. In this case, it is necessary to adjust the formula to accommodate the managing partner's commitment to firm-related activities.

In these firms, nonbillable hours are generally credited equally with billable hours on the theory that the managing partner's billable hours will inevitably (and should) suffer, as this person devotes time to administrative responsibilities.

No "extra credit" should be awarded to the managing partner when calculating business originations. Managing partners should maintain their client relationships while serving in a leadership capacity. It's a good way to stay in touch with client needs generally, and will provide a needed base of ongoing relationships when they inevitably resume practicing full-time.

#### **The goals**

In either subjective- or formula-based systems, bonuses should be awarded to the managing partner on the basis of achievement of individual and firm goals. At the start of each year, managing partners should sit down

## “ The managing partner should not be the highest paid partner. ”

with the compensation committee to negotiate a set of clear objectives — for both the firm and themselves. If these objectives are met, the managing partner should be rewarded, just as other partners are rewarded for extraordinary performance during the year. This is especially true in firms with subjective-based compensation schemes.

#### **The process**

When setting compensation, the outcome is always important, but so is the process. Given the influence that most managing partners have on partner compensation generally, it's critical that their compensation be determined in a manner that's beyond reproach. In order to maintain credibility and a reputation for fairness, they should bend over backwards to avoid the appearance of undue influence.

#### **The future**

In determining the compensation of a full-time managing partner, a firm should take into account the substantial challenges that its managing partner will face when he or she returns to the practice of law. This hurdle suggests a higher, rather than lower, compensation level is warranted — and perhaps even a formal agreement concerning compensation when a managing partner leaves the position. Firms often overlook this factor in setting compensation, but it's critical if firms want the best people in that position.

#### **The "message"**

All compensation decisions send a "message" to the partnership. All partners

compare their compensation to that of those whom they perceive as peers within the firm, and they also look carefully at the compensation of their elected or appointed leaders.

The principal message that compensation decisions affecting the managing partner should send is: "The qualities that will make our firm successful over the long term are superior lawyering, client service, teamwork, and fairness." In practice, that means that the managing partner should not be the firm's highest paid partner unless he or she makes practice-related contributions consistent with these values.

But that does not mean that managing partners should be underpaid. They preside over businesses with annual revenues in the tens — and, in many cases, hundreds — of millions of dollars. What's more, they are accountable, not only to the firm's partners or shareholders, but also to associates and other professionals, administrative staff, and clients. A firm deserves the very best its managing partner can offer and should compensate that partner accordingly.

Notwithstanding the various factors that go into determining the managing partner's compensation, the most important factor in partner compensation generally is whether partners believe the system is fair in terms of both policy and application. And of the two — compensation policy or its application — fairness in application should always take precedence. There is nothing more important to a firm's long-term stability than a shared belief among its partners that they are compensated fairly in relation to each other, and in relation to the firm's managing partner. Firms where partners share that belief have a significant and important competitive advantage over firms where that belief is lacking. **LFI**

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