SMOCK

LAW FIRM CONSULTANTS

SETTING MANAGING PARTNER PAY – IT'S A TWO-WAY STREET

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In introductory courses in Economics, we learn about the *"Four Factors of Production,"* - land, labor, capital and management. *"Land"* refers to physical plant and physical assets. *"Labor"* refers to the efforts of those who produce product or deliver services. *"Capital"* is the money needed to buy physical assets and hire the workers. *"Management"* is the all-important skill of organizing the other three factors to produce a product or service at an optimum profit.

Law firms generally *"get"* the idea that they have to pay for physical assets, associates, partners and support staff. They also *"get"* that they need to have capital to support the business. They generally do not *"get"* that they have to pay for management or, if they do, they have a hard time figuring out how to do it right. In a legal-service environment, most believe that the highest value use of a lawyer's time is serving clients – meeting client needs, charging hours, and producing revenue. Very often, *"management"* is viewed as a sideline and, even when considered, is often confused with *"administration."* This monograph evaluates the ways in which many firms pay their Managing Partners, and proposes a methodology that we believe can and does work in well-run law firms.

OUR AD HOC MANAGING PARTNER COMPENSATION SURVEY

Early in 2008 and as part of a client assignment, Smock Law Firm Consultants conducted an informal survey of law firms on our *"clients and friends"* list, asking them questions about how they compensated their Managing Partners. We limited the survey distribution to firms with 75 or more lawyers. Twenty-eight firms responded, ranging in size from 75 lawyers to more than 1,250 lawyers. The average-size of firms responding was 310 lawyers, and the median firm was 160 lawyers. Following is a summary of the results.

Full-Time vs. Part-Time

Of the respondents, 46% indicated that their Managing-Partner positions are full-time positions. Most of these positions are viewed as *"career-path positions"* in that the expectation is that the Managing Partner will probably never return to the full-time practice of law. The remaining firms' Managing Partners all practice law to some degree.

Pay Level

Firms with full-time Managing Partners value management about the same as those with part-timers at the helm. On the average, full-time Managing Partners are paid about double what the median partner makes and about 80% of what the highest paid partner makes. The standard rule seems to be that very effective rainmakers get paid more than managers. These ratios hold up when one looks only at part-time Managing Partners.

Who Sets Compensation?

In the vast majority of cases, the same body that sets compensation for all other partners also sets compensation for the Managing Partner. The larger firms have a slightly more complex membership for their compensation committees, but the general rule seems to call for a relatively small, elected committee, without *"position seats"* or *"constituent representatives."*

The Compensation Setting Process

About half of the respondents do not have any formal process for setting Managing Partner compensation, other than the *"normal"* process they follow for setting all other partners' compensation. The compensation committee may do some interviewing of other partners, and may interview the Managing Partner. Feedback, if any, usually follows whatever *"sketchy"* practices the firm uses with all other partners.

Pay Structure

The structure of the Managing Partner's compensation tracks the structure of compensation for all other partners. Thus, if all other partners are on a *"points"* system, so is the Managing Partner. If there is a bonus component to compensation, the Managing Partner is eligible for a bonus, but usually based on different criteria than those applied to other partners.

Our overall conclusion from the survey is that many firms have more or less *"punted"* the question of Managing Partner compensation. While some give credit for management time, this practice only recognizes input and not results. Whether or not a Managing Partner is doing a good job is typically left to a committee that deliberates without guidelines or criteria. As one might expect, if business development is valued most highly, part-time Managing Partners can be expected to focus most of their energies on practice development, rather than on effective management and leadership.

MANAGING PARTNER COMPENSATION BEST PRACTICES

While our conclusion is that many firms do a poor job at setting Managing Partner compensation, our survey did look for best practices that might be adopted by firms to improve their processes. Some of the best practices gleaned from the survey include the following:

Effectiveness in Carrying Out Responsibilities and Developing Skills

While there is a belief that Managing Partner compensation should reflect performance in carrying out job duties, most firms have not defined the managerial responsibilities or the skills required of the Managing Partner. The survey results identified those responsibilities and skills.

- **Internal Managing Partner responsibilities** include:
  - Strategic planning and strategic growth
  - Loss prevention, firm ethics, practice quality standards, etc.
  - Firm financial management, including managing to profit targets
  - Human resources policy-making and enforcement, including supervising the planning and implementation of significant changes in firm benefits
  - Supervising the planning and implementation of significant technology initiatives
  - Supervising the planning and implementation of significant marketing initiatives
  - Day-to-day management and administration of the firm, with assistance from non-lawyer administrative staff
  - Generally serving as the *"go-to-person"* on all important firm decisions
  - Getting other partners to work toward the common good of the firm.
- **External Managing Partner responsibilities** include:
  - Serving as the figurehead of the firm and representing the firm in both the legal and business communities
  - Intimate and outward focused involvement in client development, community affairs, charitable events, etc.
  - The chief spokesperson for the firm when it comes to news releases and the media
  - The driving force behind lateral hires, group acquisitions, and mergers and combinations
- A Managing Partner needs to hone those **skills that affect firm performance**, including:
  - Being a good client developer – although this is probably not the most important skill
  - Being a good communicator, especially a good listener – an important skill, as is being able to forge consensus among a bunch of highly independent professionals is also an important skill
  - Having a vision of the future and having the force of personality to get the rest of the firm to share in that vision
  - Finally, having the courage to make and implement tough decisions – this trumps everything else.

The best approach in Managing Partner compensation is to rate how the Managing Partner does in carrying out each of these internal and external responsibilities and how well he/she does in improving those necessary skills. This is a measure of his/her *individual* performance in carrying the job, not the *performance of the Firm*.

Combining Management and Practicing Law

The sticky issue comes in determining how to compensate a Managing Partner who has one foot in law practice and another in management. Most firms struggle with this – a few do it well, but many do not.

Those firms who do the best job at setting Managing Partner compensation where the Managing Partner is a part-time lawyer have a two-stage process.

- First (s)he is evaluated and ranked with all other partners, based upon his/her performance as a practicing lawyer, assuming that (s)he had practiced full-time during the year. Essentially, the question they ask is: "Given the amount of time (s)he has devoted to the practice of law, how effective a lawyer has (s)he been?" If, say, the relative performance of a Managing Partner who spent 50% of his/her time practicing law was equivalent to what one would expect of a middle-level partner, then the "practicing-lawyer" part of compensation would be about half the median-partner pay.

- The second stage involves evaluating the Managing Partner's managerial and leadership performance in demonstrating the skills outlined above, as perceived by both the compensation committee and partnership at large. It also involves assessing how well the firm has done and the contribution made by the Managing Partner to that success. Coming up with a number that reflects that contribution is more art than science. Looking at our survey – as informal as it was – most firms seem to shoot for a total compensation package that would put the Managing Partner in the upper quartile of partner compensation.

Conversely, the survey underscored a few ineffective practices to be avoided, as follows:

- Some pay nothing for the management side (and, in some cases, get nothing as a result).

- Others allow the Managing Partner to treat *"management time"* as though it were billable time – essentially treating the firm as a client. This practice, however, measures input or effort, not results – a Managing Partner can spend a lot of time not doing the job well.

- Another commonly-encountered practice is simply to pay the Managing Partner a flat stipend, over and above what he/she might have earned based on the fruits of his/her law practice.

    - But, this is not reflective of results or achievement.

    - It merely recognitions that *"management must be worth something, so we better pay for it."*

Managing the Process Well

In the midst of hundreds of different variations on managing-partner compensation, those firms that really excel have a process for evaluating and rewarding their Managing Partners for achieving results. At those firms there is a well defined process that incorporates both **accountability** and **communication**.

- The Managing Partner is required to formulate a periodic (annual or biennial) agenda of what he/she hopes to accomplish by way of profit targets, growth, and significant projects or improvements. That's the **accountability** piece.

- Next, the Managing Partner is required to share the agenda with the partnership, a management committee, a board of directors, etc. and get consensus approval for the agenda. That's the **communication** piece – so that at the end of the day, everyone understands and buys into the game plan.

Each year, the Managing Partner's performance in carrying out the agenda is evaluated by a committee of partners that is charged with the responsibility for setting the Managing Partner's compensation. This can be the same committee that sets compensation for all other partners or a separate sub-committee of the board of directors/management committee.

- As part of this process, the Managing Partner is required to prepare his/her own report and self-assessment.

- Some of the evaluation is objective, based on statistical and anecdotal evidence. Were goals achieved, targets met, projects completed on time, etc? Were there unanticipated successes or failures? How did the Managing Partner deal with crises?

- A large part of the evaluation is subjective, however, and considers the quality of leadership, planning, implementation, communication etc.

At the end of the day, the committee has to come up with a number that reflects how well the Managing Partner performed his/her **management job** – not how he/she performed as a practicing lawyer. Ultimately, the most powerful elements of this process are **goal-setting**, **self-evaluation**, **accountability** and **two-way communication**.

Paying for Firm Performance

Recently, *American Lawyer Media* published an interesting article on the roles and compensation plans of Managing Partners in large firms. A key point of the article was that firms should consider paying their Managing Partners like many corporations pay their CEOs – namely, according to how well the overall firm does financially.

This idea certainly has some merit for law firms (particularly in larger rather than smaller firms).

- In most cases, the Managing Partners of larger firms truly function as a CEO, worrying about balancing short-term earnings performance with the necessary long-term investments in strategic growth and acquisitions, new sustainable sources of business, firm identity (i.e., *"brand"*) in the marketplace, strategic technology initiatives, diversity, career development programs, etc.
- In short, they are expected to be true visionaries with the leadership skills to guide their firms into the future on the one hand and to keep profits per partner growing at somewhere between seven and twelve percent a year.

Too much emphasis on year-to-year results, however, can reward a Managing Partner for maximizing short-run profits at the expense of the long-term success of the firm. For example, a large acquisition may dampen partner profits for a year or two, but might well be the best thing for the firm over a five-year period.

The way the process works in Corporate America – this is an over-simplification – is that a committee of the Board of Directors considers long-term stock performance, long-term corporate profits and other factors. They next consult market surveys of what other CEOs make and try to set performance-based compensation within the context of the market for other CEOs in the industry or in related industries.

Managing Partner compensation hasn't evolved to the extent CEO compensation has, largely because comparable partner compensation data are not relatively available, and most law firm Managing Partners are not *"free agents"* like many top CEOs. That said, there is merit in the idea of rewarding a Managing Partner for the long-term economic success and stability of the firm. While market survey data on Managing Partner compensation is not readily available, we believe that the rough guidelines found in our informal survey – 200% of median-partner pay and 80% of top-partner pay – are reasonable guidelines.

FINAL THOUGHTS

In the end, the role a Managing Partner may play in his/her firm, the scope of his/her authority and the firm's expectations will all vary with the qualities and character of the person(s) elected to fill the job and the culture of the firm. The balance between outside and inside focus, whether or not he/she practices law, his/her role in rainmaking, etc. really depend on the skill set of the person and firm expectations. The important thing is to make sure the person and the firm are in agreement as to those expectations, and that they are woven into the process for evaluating performance and setting compensation. This will help protect an *"activist"* Managing Partner from being shot by friendly fire. It also provides a *"burr under the saddle"* to keep the Managing Partner focused on his/her task.

Finally, we believe that firms of all sizes can benefit from having a corporate-style performance-based system – based on the notions of **accountability** and **communication** – for compensating management. It just takes time and thoughtful communication. In the end, the process is a *"two-way street"* – and the important thing is ensuring that process produces results that fairly reflect performance against agreed upon expectations.