

Law Firm Leaders Roundtable On Managing Partner Compensation

What's the ideal arrangement for compensating a managing partner? Should he or she be paid a flat stipend, over and above what they might have earned based on the fruits of their practice? These questions are put to a panel of experienced firm leaders.

by Patrick J. McKenna

If we think about it managing partners preside over businesses that enjoy revenues in the tens – and in many cases, hundreds of millions of dollars and are accountable to the firm's partners/shareholders, other professionals, staff and even to clients. A firm deserves the very best managing partner they can recruit to take on this responsibility. That said, one of the uncertainties that plagues most firm leaders that I speak with, upon first accepting the position, is the issue of compensation. Where should the firm leader's compensation stand in relation to the highest paid partner? Should you pay your managing partner a flat stipend, over and above what they might have earned based on the fruits of their practice? To help answer these questions I recruited a group of battle-hardened firm leaders, from a wide-variety of different sized firms, from single office to truly international, to weigh in with their experiences. What follows is an excerpt from those discussions:

ABOUT THE PARTICIPANTS:

Patrick J. McKenna is a leading international consultant to the legal profession and author of seven books on professional service firm management.

Raymond J. Werner is the Chairman and Administrative Partner at Arnstein & Lehr LLP with 140 lawyers in 9 offices across the US.

Bryan I. Schwartz is Chairman at Levenfeld Pearlstein a 50-lawyer firm with one office in Chicago.

James M. Hill is Executive Chairman at Benesch Friedlander, Coplan & Aronoff, based in Cleveland with 160 lawyers in four offices.

Edwin Reeser is a former office managing partner and executive committee member of a firm with over 800 lawyers, operating internationally in 13 locations.

Fredrick G. Lutz is Firm Managing Partner at Quarles & Brady, a 430-lawyer firm with 6 offices across the US.

Patrick McKenna (Moderator): If you were allowed to design the ideal compensation arrangement, let's say for your successor, taking into account whether that individual was expected to serve full-time or part-time in their leadership role, and given that there may now even be confusion over whether to compensate for management time, what would your view of an ideal arrangement look like?

Ray Werner: Any system must incent the MP to give up a lot of the security blanket that we all have and need for our own security. The trust of and in your partners is crucial. While it is not necessary that the MP be the highest paid partner, it is important that the MP earn compensation that is amongst the highest in the firm. If the MP is not able to be compensated at a high level, you have the wrong person.

There must be some success factored into the MP's compensation. If the firm reaches goals, however measured, the MP should be rewarded. This assumes of course that the goals are reached because of, and not in spite of, the MP's involvement.

Bryan Schwartz: The managing partner's performance should be measured over a three year period with a base that is amongst the top three tiers in the firm with a bonus or loss depending upon how the firm, as a whole, performs on achieving its firm and individual goals.

Ed Reeser: I believe that the managing partner's compensation needs to be tied to the performance of the firm as a whole. Thus...the average, or median . . . think carefully about the difference, compensation level is the starting place. There may be adjustment from there for performance as a working lawyer, but care must be exercised in this.

Patrick McKenna: So, do I hear you all saying that there would be some kind of bonus consideration for meeting certain performance results? Would the firm leader be required to submit a formal projection of what they hoped to accomplish by way of profit, growth or the completion of significant projects?

Fred Lautz: I have a system that I think works pretty well, provided you have a compensation committee that can exercise some judgment.

The system begins by looking at the MP's compensation rating among all equity partners at the time he or she assumes the position. Say the MP was the Xth highest paid partner at that time. A band is then established each year from the X-5 (or whatever constant would be appropriate based on the number of equity partners in the firm) highest paid partner to the X+5 highest paid partner. The midpoint of that range becomes the starting point for the MP's compensation for that year.

Each year the MP provides a plan with short and longer-term goals and objectives, and an assessment of his or her progress on those goals and objectives during the prior year. It is of course important that the goals and objectives be developed in a collaborative process so that they are well aligned with the firm's strategic direction and business plan.

The compensation committee evaluates the MP's overall performance based on evaluation input from people who interact most closely with the MP – and, in our system, any other partner who cares to provide an evaluation, and its own assessment of the MP's performance against those goals and objectives. The committee then determines how much, above or

below the starting point, the MP's compensation should be for the coming year. They also determine an appropriate bonus for the MP for the past year based on their overall assessment of his or her performance.

It isn't perfect. It assumes that the MP, had he or she not given up an active practice, would have stayed in the same relative position in compensation. That may or may not be a reasonable assumption. It also does not effectively account for lateral partners joining who may enter at a compensation level above where the MP would have been by that time, nor does it account for the departure of partners above the MP in compensation. That is why it is important for the compensation committee to have the discretion and good judgment to tweak the parameters as the years pass and developments occur.



Patrick McKenna: I recently conducted a survey wherein 92 law firm leaders responded, all from firms of over 100 lawyers in size. One of the statistics that was striking was that across the board, with firms of all sizes, only 9% of the respondents claim that their management / leadership efforts are currently a full-time activity. I suspect that this may be the consequence of our experiencing prolonged recessionary conditions. This was one of the more surprising results of this survey. In the same survey I conducted in 2004, I learned that approximately 24% of the managing partners were focusing on their management / leadership efforts as a full-time initiative. Do you believe that there is an increasing tension between managing and billing with today's law firm leader? What is the best way to handle the individual who has one foot in firm management and the other still in law practice?

Bryan Schwartz: A law firm is a real business and we need to stop running a firm like hot dog stand where it is all cash in vs. cash out and then split the profits based upon who killed the most meat in the store at year end. It would help if firms made the most capable person the managing partner rather than the head meat killer who needs his or her ego massaged. This is neither a job for an ego-centric person nor the faint of heart.

And a managing partner must absolutely insist on professional training, because no matter how good a lawyer that person may be, they know absolutely nothing about running a law firm. If you are just going to follow along with "what we always did that helped us get

here" just put a bulls-eye on your back and get ready to take the bullets. Things need to change and you need to know how to do that.

Jim Hill: Bryan is exactly on point. The MP faces the problem in many firms of being asked to run a multimillion dollar business, deal with problem attorneys, deal with clients as an emissary, be strategic and get trained to run a business. In addition in many firms the MP is asked to bill a significant amount of hours, bring in business of significance and do all of these things while bringing up revenues per lawyer. So, each firm has to figure out what makes the most sense for it, given its size and its strategy. Usually the MP does have great business development and client relationship skills, so where do you sacrifice and doesn't the MP sacrifice also?

Ed Reeser: If the very highest and best purpose for this professional for the firm is working and billing and collecting on cases . . . that is what they should be doing. Management should not be for the biggest billers who then do diddly in management. It should be for the best managers / leaders. And their calling should be to the best interest of the firm as an institution, not to the personal best interest of the half dozen most powerful partners.

Bryan Schwartz: And yet, when a managing partner does what is best for the firm rather than merely what's popular, there are always a few (disgruntled) partners waiting with their own stories about how they were victimized while you held the steering wheel

Ed Reeser: This already is a tough row to hoe, no question. But start at the average / median, adjust appropriately as a base, then "performance" enhance the compensation on a template of achievements for the firm. One of those is NOI for the partners. But there is more. Arriving at a consensus of what the firm needs to do is key. Then . . . did he / she get us there or make progress? What is it worth? etc. That should go to a committee, and it should include junior as well as senior partners. This is about leadership, accountability and results. Mark clearly what they are, pay for what you get, don't pay for what you don't.

Bryan Schwartz: Ed please take this comment with due respect. I like all of your ideas except for the "pay the managing partner based on what the firm does" approach. I have given a lot of thought to this over the years because my partners always defaulted to this approach as the only logical solution.

There is some merit to the approach on the surface in terms of "alignment" of strategy and systems. Yet, I feel this is a stock market approach and focuses the managing partner, either actually or worse, as a perception, of being short-term focused for his or her own benefit. A managing partner must rise above his or her own compensation and make decisions for the benefit of the firm unfettered by their personal compensation components. "Why did he pay that expense next year, was it to pump up NI"? "He received 7% of that bump didn't he"? Further, what if the managing partner is tremendous, but stuck in a recession and needs to make decisions that will hurt net income in the short run but will position the firm appropriately in the future? Will the managing partner do what is right even if it is against his own monetary interest? I do not think that this is good alignment. If we have learned anything from our counterparts in Corporate America, short-term thinking is not a good approach. People running firms should have 30% in the present and a 70% focus on the long-term to offset the rest of the partners who are 90% in the short-term and 10% in investment zone.

I struggle with the "pay as the firm goes approach" and many scholars in Corporate America have been violently against it because of what we are seeing today - it leads to unfettered greed and an appearance of impropriety. Just one other opinion.

Ed Reeser: Bryan, your comment is most appreciated and accepted in the same team spirit with which it is offered! And, I could not agree more with the critical challenge of avoiding leadership / management manipulation for self-interest and overly focused short-term results orientation.

But, we have both of those cloaked all over the current management systems like a dark mantle of disease already. The pressure to deliver distributable cash NOW comes from the senior partner ranks who have labored long and hard and have limited years before their time is over, from big dog lateral partners recently acquired, from the middle class "engine room" of partners who are growing their books and have paid fifteen, twenty or more years of dues as "net contributors" to the profit pool, and from the youngsters who have new house mortgages, young kids in school. Basically everybody is all over the MP to give "more, more, more." So, what I am trying to say is, we are in that bucket already, and a method of accountability that is driven by results, if properly crafted (and that is the devil in the detail), can facilitate a better solution rather than a worse one.

The budgeting process is annual. It includes revision and adjustment to changing conditions, sets goals and is approved by the firm. Those include important investments in the firm that are longer term. 100% of the comp does not have to be firm performance dependent, but some of it has to be, and it has to go up or down with results. Maybe it is 20%, maybe it is 50%. But again the reality is that all partners go up and down, or all of them should, with results, because they are partners in the enterprise. Expectations are set in real time annually, so condemnation to a diminished performance income due to recession does not have to be any more painful than it is for the body of the partnership, nor should participation in rapid increases due to cyclic upswings be any richer. Riding the wave crest / trough of the economy is to be separated to the extent it can.

One of the best tests is to have all of the office managing partners, group practice leaders, and management committee members who are responsible for putting the budget together, take the following challenge. If we fail to achieve the budget for this year, we will all collectively put at risk up to X% of our net income before the rest of our partners share in that shortfall. (Perhaps that is 5%, perhaps it is 20% but it has to be meaningful.) That way one gets a very solid response to the reality of the budget instead of "take X attorneys at Y average rate times Z billable hours, less costs extrapolated from last year, less historical post billing adjustments equals forecast NOI and thus our PPP is . . ." If the team won't sign on for that, it tells you it is time to redo the budget, and it tells you something about the team.

Some of the best runs in pro football that I ever saw, involved Barry Sanders just getting back to the line of scrimmage. Some of the best management performances have been in cutting shortfalls from what could have been 20% to 5%. And some of the worst have been in delivering profits of 10% because of what was done to the firm to achieve it. I totally agree with you on this. All I can say is that if you have a leader who does that, the fundamental problem is not with the system, but with the leader we chose, or who was chosen for us. He or she should have the character and commitment to the firm's long-term interest as part of their sacred duty and no system can force that to happen. The right leaders, with a lot of help from their partners, can make good decisions, strengthen the firm, and enhance profits and stability. The wrong leaders, by themselves, can destroy a firm

almost single handedly within a couple of years. That is the reality we now face more starkly than ever before, as the last half dozen major law firm failures shows.



Patrick McKenna: According to my research only some 28% of law firms have any kind of formal, written agreement in place, with compensation protection, governing how, as a managing partner, they will return to active practice following their term in office. When we think that the typical firm leader has likely given up some of their best revenue-generating years for the firm and a good portion of their personal client base, should they not at least have a defined 'parachute' that should allow them to ease back into rebuilding a solid personal practice?

Bryan Schwartz: As long as that managing partner showed up and gave a yeoman effort, the managing partner should have a soft landing where there is a transition back into the practice for two years and where that person's compensation cannot be lower than average of the last three years of compensation of that person's term. Remember, the people who put that managing partner in office will not be the same people who replace that person so this deal should be in writing.

Jim Hill: Clearly protect the MP's compensation for two or three years after his tenure (we do that) but more importantly make sure you, as a firm, understand what you want your MP to do during his or her tenure. And make it clear to your MP.

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