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Is Your Partner Compensation System Outdated?

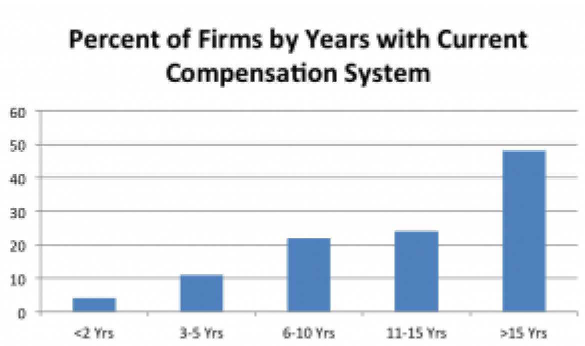
By Michael D. Short on June 12, 2013

LawVision Group Partners speak regularly about the lessons learned by the legal industry from the recession. It's an important list and one of our key observations is that "Most compensation systems are revenue driven, which renders them outdated"**.** By this, we mean that prior to the recession there existed a fairly strong relationship between the growth rate in revenue and profits. Most firms recognized this clear relationship by making revenue generation a key factor in compensation setting. However, over the last five years the revenue-profit relationship has weakened significantly due to client pushback on rate increases coupled with an uptick in fixed fee arrangements (many of which aren't executed at margins comparable to historical levels). Law firms have countered with an increase in the variety of business models. Some use a-traditional staffing models (e.g., contract lawyers; staff attorneys) while others would never consider such options. Some are quite effective with alternative fee arrangements, while others cannot move away from a pure time and cost model. Lawyers who use profitability analyses understand that comparable revenues do not produce the same profitability levels from one model to another, which drives our conclusion concerning outdated compensation systems.

Outdated compensation systems are fairly easy to spot. They often include characteristics or scenarios such as:

1. A narrow focus on hours, billing rates, and revenues when evaluating Partners' relative contributions;
2. Limited management of partner pricing decisions, including alternative fee arrangements;
3. Two Partners who generate the same revenue and are paid the same amount, even though their relative support needs/leverage to generate the revenue vary significantly ; or
4. Two Partners who are paid the same for comparable revenue generation with comparable business models, yet one is contributing a significant amount of investment time (e.g., business development, lateral recruiting, young lawyer development) to the firm while the other goes home every day at 6:00.

From our soon to be published 2013 Partner Compensation System Survey, which currently includes data from over 100 law firms, we can start to test the alignment between current compensation systems and the business of law as it exists today. A starting point is the number of years each firm has used its current system. The results are surprising and, at first glance, suggest that very little "change" is happening right now.



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While the preceding chart suggests minimal evolution, the results can make sense given that the vast majority of survey participants use some type of subjective compensation system, which is flexible by design.

A deeper look into the data, supported by conversations with select survey participants, suggests that while many overall structures remain intact, a fair amount of “tweaking” is happening and the process for allocating profits is, in fact, evolving away from just pure revenue generation.

For example:

- Over 40% of participants indicate that matter level profitability has at least a modest (or higher) impact on a Partner’s profit allocation;
- Over 60% indicate that Partners generally know about their firm’s strategy and their respective levels of support for the strategy are reflected, to some degree, in their compensation allocations; and
- Over 40% have a minimum target for investment time (i.e., non-billable hours) for Partners.

These data points are promising and suggest that important progress is underway, which is not surprising given the pace of change in the legal industry over the past few years. Such “tweaks” can result in significant competitive advantages, if implemented properly.

We think that within a few years our initial premise (“Most compensation systems are revenue driven, which renders them outdated”) will need to be removed from this list because most of the firms that are not already moving in this direction will either a) have reacted to the competitive pressures to move in this direction, or b) be out of business.

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None of the survey data points referenced in this article may be reproduced or referenced outside of this article without the written consent of The LawVision Group.

Detailed survey results are made available only to participating law firms. The survey is free for the All Firms report. Contact Mike Short (mshort@lawvisiongroup.com) for a data form if you wish to join the survey.

In conjunction with this survey, we will host a series of Partner Compensation System Workshops in Atlanta, Chicago, Las Vegas, Houston, and New York City during September and October. Space will be limited for each of these highly inter-active one-day sessions. Please watch our website (www.lawvision.com) for further details.