aging them to take responsibility for their practice's success (and the firm's success). They must make the process work by giving as much attention and seriousness to reviewing the action plans as they do to the monthly financials. If they do not, the system will wither away as yet another bureaucratic exercise.

One part of this system is critical: Follow-up. The system is about negotiating "contracts for action." What makes it work is the fact that the coach will be coming round to see how things have worked out. Not a year from now, but in three short months (the short cycle is essential to breed the sense of urgency that leads to action). If the follow-up meetings do not take place as scheduled, then the whole approach falls to the ground. If management doesn't take the process seriously by visibly monitoring what has been agreed to, the level of activity will grind to a halt.

The coaches have a final, perhaps most important role in making the system work. They have the responsibility and the duty to cross-fertilize ("Group X has tried this: Do you think it can work for you?") and to find new linkages ("You guys seem to be thinking along the same lines as one of our other teams—why don't you talk to them and develop some joint activities?"). By capturing and sharing the best ideas from each team, they can, over time, develop the firm's accumulated experience on "what works." By encouraging and supporting continued experimentation in each of the four key areas, they will help to breed a flexible, adaptable, responsive organization—one that is constantly trying new things and responding to the marketplace.

PART FIVE

PARTNERSHIP MATTERS

- Receive guidance in setting realistic but stretching personal goals for "growing their asset" and making a contribution to the firm

In what follows we shall describe a process designed to accomplish these goals.

STEP 1. SPECIFYING PERFORMANCE CRITERIA

The first essential element of any effective performance counseling system is a shared understanding of what aspects of performance the firm wishes to stress. There is often much ambiguity here. In my view, the key performance indicators, for which all partners would be held accountable, should be made up of the following six categories:

1. Profitability of work supervised
2. Client satisfaction on work supervised
3. Coaching on work supervised
4. Contributions to practice development
5. Contributions to the success of others
6. Personal growth (career strategy)

The first three categories, it will be noticed, relate to the partner's performance in managing and supervising client work. Taken together, they signal that any partner handling a client matter has three responsibilities: to the client (client satisfaction); to the firm (profitability); and to those who worked with the partner on the assignment (skill building). Not coincidentally, these three performance indicators coincide with the three traditional goals of most professional firms—(client) service, (professional) satisfaction, and (financial) success. (See Chapter 1, A Question of Balance.)

Note that the financial measure being proposed relates to the *overall profitability of the client assignments* that the partner is responsible for, not just his or her *personal* billings. Systems that stress a partner's personal numbers (rather than the aggregate of what he or she is responsible for) tend to lead to "hoarding" of work and a lack of attention to efficiency and productivity. There is little virtue in partners managing engagements so that their own numbers look good if this leads (as it often does) to poor management of the efforts of other professional staff involved. (See Chapter 4, Solving the Underdelegation Problem.)

Even in firms that *do* focus on the total client billings rather than personal numbers, there is frequently a problem. In many firms' reward systems, one frequently sees reference to performance indicators such as "supervising an extraordinary volume of fees." This indicator can be dangerous, since it is not result oriented or performance oriented. The issue should less be one of what *volume* you manage than what results you accomplish with that volume—profitability, client satisfaction, or skill building.

To avoid this problem, firms should calculate a full profit and loss statement for each client assignment, specifically calculating the costs of the resources, partner and nonpartner, that were consumed in conducting the assignment. At the end of the year, these can then be aggregated to provide a figure on the total profitability of each partner's work. (See Chapter 3, Profitability: Health and Hygiene, for a discussion of profitability measures.)

Client satisfaction can be measured on a systematic basis by using feedback questionnaires. If done routinely, these can be aggregated annually, to provide a "score" on client satisfaction, by partner. (See Chapter 8, A Service Quality Program.) Similarly, the use of routine "upward feedback" questionnaires from junior professionals on all client assignments can provide a metric on each partner's performance in coaching. (See Chapter 4, Solving the Underdelegation Problem.) Through the use of these systems, quantitative indicators of all three engagement performance areas can be obtained.

It should be noted that this system of simultaneous accountability for profitability, client satisfaction, and coaching explicitly discourages hoarding of "client responsibility." In some firms, particularly those where emphasis is given to volume, partners compete for client responsibility because it increases the "bulk" of their practice. Under the system proposed here, volume is no guarantee of good performance. A partner who accepts responsibility for a client assignment also accepts an accountability to perform in three measurable areas. Accordingly, partners will accept (or keep) this responsibility if and only if they think they can execute and supervise the work well. This should give the firm greater flexibility in making sure that work is assigned to appropriate partners.

The remaining three performance categories (practice development, helping others, and self-improvement) need to be judged, not measured. This is particularly true of the "contributions to practice development" category. Many firms attempt to quantify this performance by assigning "origination" credits to specific individuals who brought in specific pieces of new business. Such systems are fraught with problems.

First, origination credit systems tend to reward the *volume* of business brought in (i.e., the top line) rather than either its profitability (the bottom line) or its strategic desirability. Consequently, an incentive is created to bring in any work, rather than the types of work that will truly develop the practice. A second flaw of quantified origination credit systems is that they interfere with (if not destroy) teamwork in practice development. Credit usually goes only to those who "sell and close," leaving little incentive to participate in other necessary practice development activities such as writing articles, participating in seminars, and so on. (See Chapter 12, Managing the Marketing Effort.)

In the typical professional firm, it is usually easy for an executive or compensation committee to tell who has contributed to and been effective in practice development, even if there are no hard statistics on this. By making the system judgmental, there will be a greater likelihood that individual partners will find a way to contribute to the overall effort, and that rewards for practice development activities can take into account not only the volume of business won but also its value to the firm. By explicitly including this criterion in the performance counseling system for *all* partners, a signal will be sent that, one way or another, all partners should contribute to developing the practice. Some may never "sell," but they may write articles, give speeches, nurture existing clients, or any of a myriad of other activities which support the growth and development of the firm.

The fifth performance category described above was "contributions to the success of others." One of the eternal risks in any performance appraisal and counseling system is that it encourages an excessive focus on individual performance and destroys teamwork. To counteract this, each partner should be asked to point to specific ways in which he or she has contributed to the success of others. A partner who cannot meet this criterion should be deemed as having failed to meet his or her obligations as a member of a firm.

The final category is self-improvement. Every partner should (on a look-back basis) be able to show some way in which he or she has

grown as a professional, and (on a look-forward basis) have a plan for growing his or her asset.

STEP 2. DESIGNING THE COUNSELING PROCESS

SELF-EVALUATION

The process should begin with the firm sending to each partner the quantitative information it keeps on partner performance (preferably including financial and nonfinancial scorecards, as described above) with a note saying:

> Please prepare a self-evaluation of your accomplishments this year. As you prepare your review, please examine the enclosed quantitative information on your activities. If you believe any of this is in error, or in any way misleading, please feel free to comment.

The firm should include the "official" statistics that it collects on that partner (perhaps also a listing of new business that the partner assisted in winning). It is important that data be provided not only for the latest year, but also for at least one preceding year. This is necessary to ensure that "good performance" is taken to mean *improvement* and not just sustaining a given level of result. To do otherwise will only encourage "cruising." Counseling discussions should focus upon year-on-year changes, not just the latest year.

The firm should also send the goals and action plans from the partner's previous counseling session. It is remarkable how frequently past plans are filed and forgotten. This undercuts the credibility of the performance counseling process. The simple gesture of saying "We haven't forgotten the goals you set two years ago, here's what you said and what we agreed to" conveys a powerful message about the seriousness of the process.

Figure 22–1 provides a format for the partner self-appraisal. It will be noted that the partner is invited to comment on all six performance areas.

STEP 3. IMPLEMENTING THE PROCESS

The partner is now ready to meet with the counselor. But who should this be? In a small firm, all partners could be counseled by a single compensation committee chosen for that purpose. In larger firms, this

FIGURE 22–1

Partner Self-Evaluation

Please describe and review your principal accomplishments in the past year. Your review should focus more on accomplishments (results achieved) and less on a description of activities (what you did). If specific goals were agreed on in a previous counseling session, please relate your comments to those goals. You should address the following performance categories:

1. PROFITABILITY
Please comment on your contributions to firm profitability through wise engagement management, control of billings, accounts receivable, work-in-process, and other financial matters.

2. QUALITY OF CLIENT RELATIONS AND SERVICE
What special accomplishments have you achieved in providing outstanding service to clients, either through technical achievement or relationship management?

3. COACHING AND OTHER CONTRIBUTIONS TO SKILL BUILDING
Please comment on your contribution to building skills in others through your supervision of more junior professionals on your engagements.

4. PRACTIVE DEVELOPMENT
Describe your accomplishments in contributing to the development of our practice, through assisting in developing new work from existing clients, new clients obtained, or any other activities advancing the reputation of the firm. Include here your accomplishments in community activities, any speeches, participation in seminar panels, publications, etc., and any civic service, social club, or other outside activity which you wish to include.

5. GOOD CITIZENSHIP
Please comment on any achievements in the area of firm, office, or practice contributions, such as participation in firm recruiting, committees, or other nonbillable assignments you have performed. You may also want to refer to ways you have contributed to the success of the firm not otherwise covered above. In particular, please identify what you have done in the last year that the rest of the partnership has benefited from. The following list of possibilities may help:

1. *Made intellectual/technical contributions used by others*
2. *Transferred my skill to other partners and/or juniors*
3. *Made methodology improvements used by others*
4. *Increased market awareness of our practice*
5. *Brought in work for others to work on*
6. *Successfully cross-sold my partners to my clients*

6. PERSONAL DEVELOPMENT
Review the ways you judge that you have improved your knowledge and skill in the past year. What has made you a more valuable professional? You may wish to comment on:

- *Increase in technical knowledge and skill*
- *Industry knowledge*
- *Supervisory and management skills*
- *Client counseling and relationship management skills*

is impossible, and the counseling must be done by practice leaders—those in charge of a discipline, an office, or a practice area. In fact, this approach is preferable. The job of being a practice leader carries with it the responsibility of helping other partners in the group to succeed. Indeed, that's almost the definition of the role. Counseling and performance appraisal are, therefore, central to the practice leader's function. A compensation committee may be appropriate to take the results of the counseling and translate them into compensation awards, but the counseling itself is a *managerial* function.

FORCED RANKING

Obviously, the counselor must also prepare for the meeting. A good discipline is for the reviewing partner to form a *tentative*, beginning opinion on where the reviewed partner falls *relative to all other partners* on each of the six performance categories. An effective way to do this is to place the partner in one of four levels in each category: superior (top 25%), good (upper 50%), acceptable (lower 50%), and needs improvement (lower 25%). This "forced ranking" is often emotionally difficult (no one wants to tell others that they are below average) but the courage to be honest is the essence of good counseling.

The partner should also be invited to rank himself or herself on this scale for each of the six categories. In the meeting between that partner and the counselor they would discuss and compare their evaluations. Differences in the partner's self-perception and the reviewing partner's evaluation would be discussed *and documented* (for review by the compensation committee).

The virtue of documenting the two ratings (one by the partner, one by the counselor) is that the partner has a right to know as soon as possible if the reviewing partner's judgment is different from the partner's own self-evaluation. Although it might appear potentially confrontative, the documentation of ratings means that the partner being reviewed has the comfort that what he or she has been told in the counseling session is the same as what is being forwarded to the compensation committee. Any differences in perception that remain after the counseling session, if put in writing, become valid input to the compensation committee. This process has the virtue that it guarantees the partner feedback on his or her performance and it forces differences in perception to be brought out for discussion.

If the firm uses a structured form for counseling sessions (in general, a good idea), it can be productive to include a section which rates not only accomplishments but specific skills. For example, the form could include the following skills:

- *Communications skills (ability to express thoughts in a logical, fluent, and concise manner)*
- *Counseling skills (tact, the ability to explain, to persuade others in a nonconfrontative style, see the other person's point of view, keeping client informed, listening well, etc.)*
- *Creativity and innovativeness*
- *Planning and organization (ability to get things done)*
- *Leadership (motivation of subordinates, effectiveness in delegation)*
- *Cooperativeness and team play*
- *Drive, self-motivation*

Both a self-rating and a feedback rating could then be made on these items as well as the six categories described above. If a counseling session is to be constructive, the suggested areas for improvement need to be as specific as possible. By providing the opportunity to point out the need for improvement in specific skills, the partner can only benefit.

An overall evaluation category should be included on the form. This is a reasonable expectation for a partner to have and is needed to ensure that no misperceptions remain about what the performance review implies for the remainder of the compensation-setting process. It should serve to reduce (but never eliminate) the number of "surprises." (Great performance review, no compensation increase!)

CAREER PLANNING

The next stage of the counseling discussion is the "career planning" portion. Career planning ("What's my role in the firm?") cannot and should not be separated from the performance evaluation process ("How am I doing?"). Rather these need to be two portions of the same process. One way of doing this is to include a section in the partner counseling process that explicitly asks the partner being reviewed (and the reviewing partner) to engage in career planning for that partner, that is, to identify which "career" track offers that partner the greatest opportunity to make a contribution to the firm.

This is seeking an answer to the question "What, specifically, do you wish to be famous for?" Possible options that could be included as career tracks are:

- Technical expert in a particular service area
- Industry expert
- Superior client counselor
- Superior ability to get things done through others
- Special abilities in practice development
- Special ability to work with certain types of clients (e.g., Fortune 500, entrepreneurs, high net worth individuals)
- Superior ability to transfer skills to others

Together, the counselor and the partner can think through what that partner could do to make himself or herself "special in the marketplace." Forcing a discussion on career plans will make the counseling process more long-term, and will signal to all partners the need for them to develop some form of special skill or focus that will make them different.

GOAL SETTING AND ACTION PLANNING

The final, and most important phase of the counseling process is goal setting and action planning. This could be enhanced by including in any documentation a section that establishes clear priorities for improvement among the possible goal categories. Firms have had great success with rating systems that "force" a ranking among possible goals and success criteria. For example, the forms could ask partners to do the following:

> For the 6 categories of achievement place a "1" by the strongest category and a "6" by the category most in need of improvement. Then place a "2" by the next strongest category and a "5" by the category needing the next most improvement. Place a "3" and a "4" in the remaining categories. Use these rankings to choose priorities among your goals.

It is important to force the discipline of designing (and documenting) concrete action plans by requiring that every action item must show a due date, a tracking measure (i.e., a milestone to show whether the action has been performed or not), and an estimate of time required. This discipline helps to highlight ambiguous goals ("become better known") and also to reveal actions that might be infeasible because of time limitations. The objectives and plans thus created form the beginning of the appraisal system for the following year.

CONCLUSION

The test of successful counseling is simple: Does the partner being reviewed know *specifically* and *precisely* what to do to improve his or her performance in the coming year? If so, then the counselor has done the job properly. If not, then the counseling has failed, and so has the counselor. Accordingly, I consider it a good discipline for the counseling process to end with a statement signed both by the partner and the counselor affirming that the partner does know where to go from here.

The design of an effective counseling and appraisal process is not a difficult task. Good implementation is difficult because counseling is a relatively time-consuming activity that requires a significant commitment (and no little skill) from those charged with managerial responsibility. They (and the firm) must accept (and believe) that the job of a manager is to help other people succeed—and that the counseling process is a major instrument in making this happen.

CHAPTER 23

THE ART OF PARTNER COMPENSATION

Partner compensation is the most troublesome topic in professional service firm management. A firm may live happily with its system for a long time, but when the topic comes up—and it inevitably does—the ensuing debate can be the most bitter and divisive the partnership ever faces.

The issues are indeed profound. In the division of profits, what is an appropriate balance between recognizing current performance versus long-term contributions? Who should get more: the big business getter or the most creative professional? The partner who trains associates well or the one who works the most billable hours? The leader of a large department or a pioneer in a new practice area? Most important, who, in a partnership of supposed peers, should make these decisions? Partners, after all, are owners, not employees.

At least as important as dollars and cents are the signals communicated, or at least perceived to have been communicated, through compensation decisions. These messages—about what gets rewarded and about the relative status and respect accorded each partner—affect not only the firm's culture and atmosphere, but also, by influencing how partners choose to spend their time, its strategic direction.

Many firms postpone evaluations of their compensation system as long as possible, attempting to handle problems case by case. In my view this is dangerous and unwise. When working with professional service firms on *other* management issues such as marketing, client service, or coaching of junior staff, I continually encounter one major stumbling block in improving effectiveness in these areas. At some point in every discussion, one or more partners will say, "Yes, I can see we would be better off if we did these new things. But how will that affect my compensation? If I get paid for doing other things, I'm not going to give much attention to these new topics." As a result of this reaction and reasoning, the firm finds it hard to make progress on important business issues. All too often, because of the obsolescence or rigidity of the compensation system, conservatism prevails, and the firm finds it hard to implement strategic initiatives.

THE SENIORITY SYSTEM

Historically, in most professions, partner compensation has been closely tied to seniority. Some firms do this explicitly, using a lockstep model: Increases are set by a formula in which the only variable is how long an individual has been a partner. Other firms may say they decide compensation on a number of factors, but seniority nevertheless often dominates the process. (I have analyzed compensation results for numerous firms, and more often than not the weight statistically given to seniority is *much* higher than generally acknowledged or intended.)

There are two ways to justify a seniority-based system: First, the senior partners' past efforts have contributed to the firm's current profitability, and second, their greater experience makes them more valuable to the firm now. Both are testable propositions, however, and should not be *assumed* to be true. Some partners' past contributions may long ago have ceased to benefit the firm, and the incremental value of extra years may be slight.

Moreover, past contributions and greater experience are two quite distinct rationales. The former is an "equity" claim, with equity ownership having been built up by past contributions, while the latter asserts the greater *current* worth of a senior partner. The latter, if adequately demonstrated, is more readily acceptable to younger partners. The equity interpretation is harder. In a corporation, equity is built by making contributions to support certain fixed financial assets. In a professional firm, equity contributions primarily mean building up the assets of goodwill, skill, and reputation. In a competitive, transactional marketplace, these assets depreciate rapidly, and claims for "equity returns" are less valid.

Perhaps the greatest benefit of the seniority system is that, by deemphasizing year-to-year performance, it avoids the whole problem of trying to weight the various forms of performance. It thus has the virtue of being easy to administer—as we shall see, an important consideration. Its most commonly cited weakness is that, in failing to reward superior professionals, the firm risks losing these productive people. In a competitive environment, in which lateral moves of partners are commonplace and younger professionals are less willing to wait for (increasingly uncertain) future rewards, the danger is particularly acute.

While this may be the most visible problem of the seniority system, it is *not* the most important. Far more significant, in my experience, is the fact that the system fails to recognize and reward differences in performance among partners of *equivalent* tenure (at all levels) and thus creates an environment that can be extremely discouraging to a number of partners. "Why," they ask, "should I strive for outstanding performance, when such efforts are neither rewarded nor even acknowledged?" Such reactions are particularly likely in firms in which, because departures from the seniority system are avoided, poor performance is not confronted.

In the world of professional services, there is a fine line between the good and the excellent. It is, however, upon such distinctions that reputations and profits are built. Once partners stop striving for excellence and settle for competence, the firm has entered a period of inevitable decline.

In spite of the problems of the lockstep system, some of the most prestigious and successful professional firms continue to use it. Such firms assert that by avoiding discussions of partners' relative contributions, they preserve collegiality and can focus attention externally, on winning and serving clients, rather than internally, on intrafirm politics. Instead of financial incentives, these firms depend on such mechanisms as firm culture and "social control" to motivate partners to work at their peak and to accept various roles in promoting the long-run health of the firm. If a partner's slice of the pie is predetermined, all that remains is an incentive to work to increase the size of the pie—a welcome coincidence of individual and firm interests.

Lockstep systems appear to have survived mostly among firms that have not suffered declines in overall profitability. When there is more than enough to compensate everyone well, there is less pressure to compare and evaluate individuals. Few firms, however, have the twin blessings of a bountiful environment and a homogeneous group of bright workaholics.

PERFORMANCE-BASED COMPENSATION

As many firms have discovered, the path to a performance-based compensation system is fraught with difficulties. Not the least of these is a general discomfort about assessing each partner's performance. Partners, it is felt, should deal with each other as peers; performance appraisals are something one engages in with employees, not with those who are, in a real sense, owners. I believe this view is misguided. As the manager of a successful professional service firm observed to me:

> You have to be tougher on partners than nonpartners. If you believe that partners' performance is more critical to the firm than juniors', then you must hold the partners at least as accountable. Most firms have elaborate performance appraisal and reward systems for their young professionals. Why not for partners? To believe that all partners can be trusted to perform well forever without being held accountable flies in the face of reality, particularly in a large firm. And if you are overpaying one partner, it comes straight out of the pocket of another partner, and therefore it is not to be treated lightly.

Even firms attempting a performance-oriented compensation system often try to minimize its explicit appraisal aspects. This is a serious mistake. Once one departs from a strict lockstep system, performance assessment and compensation decisions are inextricably intertwined: They are two sides of the same coin. The issue is not whether performance appraisals can be avoided—they cannot —but whether they are done thoroughly or superficially.

MEASUREMENTS AND JUDGMENTS

In order to avoid "subjective" assessments of partners' work, some firms divide partnership profits solely according to measurable criteria: business origination, hours billed, total hours or dollars super-

vised, percentage of time or dollars written off or uncollected, and so on. Even more extreme, some firms attempt what might be termed a "profit center" approach, whereby all expenses are allocated among the partners, creating a "profit and loss" statement for each partner, compensation awards being made accordingly.

Such methods almost always lead to the sacrifice of mutual cooperation among partners and fail to recognize that many important contributions can't be measured. Consider the partner who is diligent in referring business to other partners at a cost to his own billable-hours total. What of the partner who spends time training juniors? Or the partner who solves troublesome administrative problems? As sophisticated as accounting methods have become, no system can successfully capture and encourage all of the kinds of behavior required. Measurement-oriented (or "formula") approaches also work against the efficient delivery of professional services. Partners who are too busy or overqualified should pass on work to others, using younger partners or associates where appropriate—but if numbers are all that count, there are real reasons to hoard work rather than delegate it.

Measurements are inherently short-term oriented. How do you account for the partner who develops a new practice area that will add to firm profits for years to come, or who established the firm's strong reputation in certain types of matters, or who strengthens the firm by being an excellent coach? Each has contributed more than will show up in this year's numbers. Whenever compensation is based too heavily on current contributions, investments in the firm's future will suffer. Partners will strive to "look good" today. Yet as the professions become more competitive, the future must be planned for, invested in, and worried about. Clients are less loyal, and time and effort must be spent in developing new specialties and penetrating new industries and geographic areas—at the expense of today's billable hours and origination credits.

It follows that, like most important decisions in a professional service firm, decisions about compensation must result from a *judgment* process, not a *measurement* process (although, to be sure, judgments should be formed with knowledge of whatever statistics are available). The ways to improve a measurement system are usually obvious. How does one improve a judgment system?

of how they're chosen, the members of these committees merit their colleagues' respect and trust. The words that one management consultant used to describe the members of his firm's compensation committee summed up a view we heard repeatedly: "The most trusted and least apparently self-interested partners are on [it]. There is a set of decision rules, but within that there are judgments. At the end of the day, it is a very trusted committee [and] that seems to work."

Accomplished stars expect and are expected to participate, from time to time, on one or another of their firm's committees. In addition to giving partners a voice in shaping the firm, these committees serve as an important vehicle for building consensus. If the members of a committee make a decision or agree to a proposal from the firm's leader, they can become its ambassadors with their associates throughout the firm.

McKinsey recently finished a strategy development process lasting a year and a half that intimately involved every partner in the firm. A task force of seventy partners selected by Rajat Gupta, the managing partner, designed the initiative, and together the rest of the partnership, including alumni of the firm, participated in a series of workshops to discuss, evaluate, and refine the firm's strategy.

"We had a dialogue together," Rajat Gupta told us. "Everybody now understands why different people think differently, whether it's a result of their immediate environment or whether it's the position in the life cycle of where they are in their careers, or their position about the particular client they are serving and what's happening in their industries. There's a much greater understanding and tolerance, even appreciation, of the diversity of the firm."

The process resulted in a series of new initiatives. One is a guiding principle McKinsey calls "100 percent Cubed," which means the firm is committed to delivering 100 percent of the firm, 100 percent of the time, in 100 percent of the world. As a result of the iterative, inclusive process, all of the partners "own" the idea and have a personal stake in its success in their specific offices, teams, and individual work within the firm. The key was that each partner felt involved and contributed.

Committees also help spread the work of governing the firm. In a world of time-pressed producing managers, the old adage "many hands make light work" is apt. The way Bob Hallagan, vice chairman and former CEO of Heidrick & Struggles, describes the firm's approach to its committee structure is representative: "When driving a firm like a partnership, people must be led not managed. At Heidrick & Struggles we first painted a future vision of the firm that everyone was excited about. Once we gained their enthusiasm, we broke the vision down into absolute key success drivers and established committees to drive the programs. The committees get everyone involved and feeling part of the success."

Last but hardly least, the fact that these committees exist creates a counterweight to the power of the firm's leadership. A partner at McKinsey explained the logic: "The line organization is the managing director and the office heads, but committees elected by the partnership are there to be a sort of check-and-balance that promotions and partner compensation are all done fairly and equitably, and that the right decisions are made." In the event that the firm's leader or those she appoints to leadership jobs misuse their positions, or move in directions that are inconsistent with the views of their partners, the committee structure provides a remedy. Perhaps most important, the mere existence of these committees reminds each firm's leader that it is a democracy—that his power ultimately rests on the support of his partner-peers.

Committees aren't the only sign of democratic process, however. Formal partnership votes on issues such as admission to the partnership, leadership succession, or a change in the firm's form of ownership are also common. Often such votes are required by the partnership agreement or the firm's bylaws. But the leaders of these organizations also have to develop a sixth sense about what should be put to a vote. The reason: Only a small proportion of the senior stars can serve on a committee at any given time, and yet everyone expects to be informed about and involved in major issues nevertheless. As Hank Paulson, CEO at Goldman Sachs, put it, "We'd vote on anything big, whatever that means, and we'd all know it when we saw it. . . . We'd rather not define it and we haven't bureaucratized any of that stuff."

compensation policy, including a detailed description of the information-collecting process, should be updated and circulated every year.

However, in contrast to what seems a widely held view, the committee need not give different criteria the same weight in every partner's case. Indeed, I would argue, it cannot. As professional firms mature, individuals and groups contribute in different ways. One group may be looked to specifically for generating business; another to specialize in a new area in which billable hours and revenues are small in the short term; another may act as a service department to the rest of the firm. Looked at another way, the form of contributions can be expected to change with time, with, for example, more emphasis on billable hours earlier in a partner's career and more on business getting or management later on.

In such an environment, a rigid formula—"hours count 60 percent, new business 30 percent, and profitability 10 percent"—is unworkable. The firm may believe that business development and billable hours are more important than development of associates and should indicate that, but it would be a mistake to apply the rule uniformly—no one would bother with associate development. What is required is a process of "management by objectives," whereby each individual, in consultation with the executive committee, agrees to a set of objectives for the forthcoming year, and is assessed accordingly. This approach clarifies what is expected and, by forcing each partner (and hence the firm) to contemplate goals, encourages active planning rather than opportunistic, reactive behavior. In a professional world that increasingly requires strategic thinking, this is no small thing.

The management-by-objectives approach also allows the compensation committee to evaluate every activity. If a partner is responsible for recruiting, then his or her performance can be evaluated in that context. If a branch manager devotes a lot of time to managerial duties, then the evaluation depends on how well those duties were executed. In this way, a firm can avoid "position pay," that is, increasing compensation to reflect a job title. A manager's job is to make others productive and the firm profitable. If he or she succeeds, then he or she should be rewarded handsomely; if not, the reward should not be automatic. (Incidentally, one of my guiding principles is that any professional firm paying its managers more than its top producers is in trouble. Top producers shouldn't be attempting to become managers to increase their pay and status. Glory, and dollars, should always flow to those who excel at client work.)

Compensation adjustments should be based on relative *improvements* in performance, not on absolute levels. A partner whose clients were billed \$2.3 million this year, down from \$2.9 million the year before, probably deserves less of a raise (if any) than one whose clients were billed \$1.5 million, up from \$700,000. To do otherwise would encourage "coasting." While this may seem obvious, in numerous firms I have studied, a partner with high billings is highly rewarded, regardless of changes from the previous year. (In part, this happens because compensation committees are flooded with numbers and thus fail to analyze past years' statistics thoroughly.)

Finally, it is essential to note that in any firm, an inflexible compensation structure is likely to become moribund over time. In one era, business getting may be particularly important; in another, the priority may be improving the profitability of the firm's existing work. As the partnership's strategy changes, so should the weighting of performance criteria. As long as the changes are announced and discussed before they are implemented, reevaluation is to be commended rather than avoided.

GOOD JUDGMENTS ARE INFORMED JUDGMENTS

One of the most common complaints about judgment systems is that the judges are incapable of arriving at an equitable decision because "they just don't have the facts" or they misinterpret those they do have. In compensation systems, this is often a valid cause for complaint—and certainly the single greatest cause of mistrust of judges. Fortunately it is easily addressed. The compensation committee must be vigorous in collecting as much information as it can, from as many sources as it can, seeking not only the "hard," measurable facts (which frequently are less hard than they appear) but qualitative descriptions as well: what each partner has accomplished during the year, what help he has provided to other partners, how useful he has been as a coach, and so on. The committee should not be afraid to solicit opinions, so long as they are treated as such.

There are a number of ways to accomplish this. First, send every partner a summary of his or her statistics and invite comment on any possibilities for misinterpretation. What should the committee members know about that partner's significant triumphs and regrets?

While face-to-face meetings between partners and members of the compensation committee are not unusual, many firms do this only on the individual's initiative or target those in trouble. Such meetings should not be so restricted: The committee should conscientiously ensure that *every* partner meets with one of its members. Not only can partners provide explanations, they can also reflect on the past year, discuss what they had set out to do and frequently adjust plans for the coming year. Among firms that adopt this practice, I never fail to hear praise for it.

Another important source of information on a partner's performance is the opinions of other partners. In a small, homogeneous firm, where partners practice in similar areas with similar types of clients, the compensation committee can easily assess all partners accurately. However, in a large multidepartmental or multisite firm, it is not surprising that partners worry that the small group of committee members may not be qualified to judge every partner's contributions. The greater the distance between the judges and the judged, the less trust and confidence exists.

Certainly the assessments of departmental and branch office heads should be solicited; this is a common practice. Yet judgment by informed peers can be far more extensive. At a number of well-run firms I have studied, the committee invites, either by memo or in interview, all partners to answer the following: "With which other partners have you had professional contact in the last year? For each, based on your involvement, how would you rate his or her performance and contribution to the firm? In what ways does he or she excel? In what ways that we may not otherwise know about has he or she contributed to the firm's success? For what should he or she be complimented? If you could encourage this person to do one thing differently, what would it be?"

This approach may be daunting to firms that have never tried it, but it gives the judges an accurate reading of how a partner is perceived by his or her peers and it uncovers essential information, favorable and unfavorable. Knowing that all opinions will be treated as confidential in the committee and that no one opinion will be accepted without cross-checking, partners are likely to offer sincere opinions on the merits, strengths, and weaknesses of others. It is a time-consuming process, but well worth the cost.

ARRIVING AT DECISIONS

Equity requires that, whatever a firm's rules are, they need to be applied in a consistent manner throughout the firm. This is often more difficult to accomplish than it would seem. In a mid-sized firm of, say, thirty partners, a compensation committee may be faced with a spreadsheet with ten to fifteen columns of data (origination, hours, etc.) for each partner, and must somehow absorb all of this data to arrive at thirty decisions that reflect consistent treatment of each of the factors of interest.

In my research and consulting experience, I have found that many firm committees will attempt to process this vast amount of data in a very "impressionistic" way, attempting to absorb simultaneously the confusion of messages contained in hundreds (if not thousands) of numbers, in addition to trying to bear in mind important qualitative considerations. Even with the best of intentions, this rarely results in complete consistency or an observable logic in the overall set of decisions. Because of the unstructured approach taken to the analysis of the information, it also tends to be more time consuming than it needs to be. Decisions of this importance and complexity cry out for a more formal analytical approach.

In fact, quantitative tools are available to analyze such data. (See Chapter 24, Patterns in Partner Compensation.) Many firms state that, in arriving at compensation decisions, they consider more than a single year's performance and reward superior performance over a period of time. However, it has been my experience that, because of the unstructured decision-making process, few firms in fact reexamine past performance statistics and rely instead on what is often an imperfect, impressionistic memory of previous years' performance. It should be stressed that a formal approach to analyzing the measurable aspects of performance does not preclude the application of important qualitative judgments. It merely ensures that this is done in a conscious, consistent manner.

EXPLAINING THE DECISIONS

Having gone through this thorough performance-appraisal process, the compensation committee would be foolish not to let the partners know how they fared. To conclude with the simple announcement of each partner's take is to invite discontent. Feedback must be given and decisions must be explained (preserving, of course, the confidentiality of specific opinions expressed to and within the committee).

This cannot be overemphasized: If the reasoning behind a judgment is explained, it is more likely to be accepted. Moreover, feedback encourages excellence. Even where compensation awards are accepted as equitable, a natural follow-up question is, "What do I have to do to do better next year?" At firms that provide no feedback, partners are left to guess at—and, possibly misinterpret—the compensation committee's intended message.

DISCLOSURE

Despite what is becoming common practice, I believe disclosure of every partner's compensation to all other partners has as many risks as benefits. It is understandable that firms choose to do this: These are, after all, partnerships of owners, in which democracy and collegiality are highly valued. Yet if everyone's compensation is disclosed, the temptation to compare is well nigh irresistible. And this game, as everyone readily concedes, is destructive. Andrew Grove, in his book *High Output Management*,[1] observes that if people are concerned about their absolute level of compensation, then they can be satisfied. However, if their focus is on relative standing, then they can never be satisfied.

Disclosure certainly discourages the cooperative behavior required in most professional practice. Opportunities for misunderstandings and resentment are high. The process by which qualitative judgments were reached is hard to explain simply, yet if only measurable data were disclosed, partners might interpret decisions solely in those terms. Another difficulty is that justifications are frequently sought not only about oneself but about others—"Why did he get more than I?"—and this might require disclosing the personal circumstances of others or opinions given by third parties.

Disclosure also makes it difficult to implement the hardest decisions—dealing with the less-than-productive partner or one with personal problems. Compensation awards can become symbolic of status, of a place in the pecking order. Thus, reductions in compensation affect the partner's public image—an unnecessary compounding of punishments.

Owners *can* be kept informed without knowing *everything*. A summary, aggregated by broad age groupings, specialty, or some other category, can give partners a full understanding of the range and distribution of compensation and where they stand within it. (See Chapter 24 for one method of doing this.)

Clamors for disclosure are themselves symbolic: What is really being sought is reassurance that the judges are objective, fair, and consistent. Along these lines, there is one aspect of disclosure that must not be overlooked: How the compensation committee has dealt with itself. Here, some disclosure *must* take place, in either aggregate or detailed form.

BALANCING PAST AND PRESENT

I argued above that seniority, per se, is a poor and increasingly untenable basis for awarding partner compensation. This should not be interpreted to mean that past contributions to the firm's success should be totally discounted. Indeed, firms must be very careful not to become too short-term oriented in compensation. One of the most common misunderstandings I have found among professional firms is a belief that the alternative to a seniority-based system has to be a cut-throat "last year's performance only" approach.

This is an overreaction. In the professions, superior performance is evident only over an extended period of time, and should be so appraised. A given year's compensation decision should be seen as one of a *series*, not as a game to be won or lost each year, with no view to past or future. Rapid changes in anyone's compensation, except where there is a clear consensus that they are merited, are extremely disruptive—as are, at the other extreme, fine distinctions made on the basis of small differences in a single year's performance.

One way to balance past and present is to think of compensation awards as a smoothed, moving average of performance, updated every year as new evidence comes in. In order to accomplish this, a firm may choose to make compensation decisions on the basis of statistics covering a three-year period rather than a single year's time. Each year the three-year cumulative totals for each partner are updated by adding in the most recent year's results and dropping those from four years ago. Thus, a good year will continue to show up in the data for an extended period of time, but not forever. Similarly, the impact of one good (or bad) year will be dampened when added in with four average years. If performance improves each year, the partner will have a gradually rising share. If it consistently declines, so will his share. (Incidentally, this device thus deals naturally with the gradually retiring partner.)

A second device—one gaining favor among the professions—is what I have come to call the "two-pool system, in which some large percentage of the profits is distributed (prospectively) based upon long-term considerations, while a smaller pool (say, 5 or 15 percent) is distributed (retrospectively) in recognition of outstanding contributions in the current year. These special awards are clearly outside the long-term compensation structure, so that a single year's "bonus" does not become part of the recipient's longer-term expectations.

COMPENSATION AND STRATEGY

In spite of the tactical and pragmatic advice offered above, there is ultimately only one test of a compensation system: whether or not it encourages the full range of behavior needed for the firm's success. If partners are spending their time wisely and energetically on things that benefit not only themselves but also the firm, then the system is working. If an individual's best interests don't coincide with the firm's, the system needs an overhaul. To apply this acid test, one first has to understand what makes the firm succeed. What *are* its best interests? As many firms have discovered, this requires careful thought. Compensation decisions cannot be made in a vacuum: They are an integral part of what defines the firm. Sorting out these complexities is an art, and is likely to remain so.

CHAPTER 24

PATTERNS IN PARTNER COMPENSATION

It is remarkable how frequently professional firm compensation systems fail to accomplish a simple goal—motivating partners to focus on those aspects of performance that will make the firm successful.

The problem is not that the firm's compensation committee necessarily rewards the wrong things (although some do that). The issue is that the typical partner often doesn't know what is being rewarded, or doesn't believe what is said by the compensation committee about what has been rewarded.

Official declarations of policy don't solve the problem. Most firms have a statement of compensation principles of the form "Among the numerous factors taken into account are . . ." (followed by a laundry list of quantitative and qualitative performance indicators). These declarations are uniformly ambiguous and rarely meet the partners' need to know what factors were actually used and with what weights.

It is perhaps a sad fact, but nonetheless true, that most partners are not prepared to take on faith that the compensation committee has done what it says it has done. When it comes to compensation, issues of trust, credibility, and confidence abound in professional firms. This is a serious business issue. If the partners misperceive what is being rewarded, then they will focus their attention and efforts only on the things they think are rewarded, and fail to focus on other important performance areas that will affect the success of the firm.

So how can the compensation committee convincingly communicate what it has done? Simple disclosure of compensation results alone will not do the job. Even if I know what each and every partner in my firm made this year, it is not a simple task for me to deduce what has been rewarded unless I am intimately familiar with each and every partner's performance. This is difficult in a small firm, and impossible in a large firm. Even if, as a partner, I am given a spreadsheet (or, more likely, a thick, bound document) containing all the information used by the committee, it will be difficult to detect patterns in the numbers by staring at voluminous columns of data.

What is needed is an approach that demonstrates unequivocally what has been rewarded, clearly reveals how much reliance has been placed on quantitative factors, and how much on qualitative factors, and yet can preserve (where necessary) the confidentiality of specific individual partner data.

Fortunately, such an approach exists—a "Compensation Committee Report" that makes use of graphs and some basic statistics. To illustrate the approach, let's examine a fictional firm of thirty-two partners that collects quantitative (descriptive) data on its partners in six areas:

a. Age (an indicator of seniority)
b. Personal billing rate
c. "Grade" for contribution to business development
d. Total dollars billed as client partner
e. Percentage of standard fees billed and collected ("realization rate")
f. Personal billable hours

Of course, numerous other qualitative factors are taken into account by the committee of our fictional firm, but it is only for these factors that there is quantitative data. With this information in hand, the committee goes off into its deliberations and, using its best judgment, develops a schedule of "points" (or profit shares) for each partner. The committee then issues a report showing the graphs illustrated here. We, along with the partners in our fictional firm, will examine them one at a time.

Figure 24–1 shows the relationship between points (profit share) and age. (On this, as on all of the graphs, each "dot" represents an individual partner.) Did seniority play a role in the committee's decisions? As any reader can see from the graph, there is a general rising trend—older partners tended, on average, to get more points. However, it can also be seen that there is a significant degree of "scatter." This factor was not treated by the committee in a formulaic way.

A partner who cares to examine the evidence carefully might note that the "seniority effect" (the upwards trend) is quite marked between the ages of, say 35 and 41, but after that age there is no clear pattern. What the committee has appeared to do is give attention to seniority in the first few years of partnership, but rely on other (performance?) factors after that.

Is this pattern appropriate? That's for the committee and the partnership to decide, according to their compensation philosophy. However, by showing the graph, the partners can at least see what has been done.

The statistic at the top of the graph is a measure of the strength of the relationship, that is, how tight a fit can be seen between the two factors (points and age). A figure close to 0 percent would mean that there is no observable relationship between the two factors. A figure close to 100 percent means that the two factors tend to be highly correlated. The specific number (known formally as the "R-squared statistic" and a standard feature in most spreadsheet programs) can be used to answer the question, "How much of the variation in one factor (e.g., points) can be "explained" by the other factor (e.g., age)?"

In this case the answer is 39 percent, which means that age seems to "explain" 39 percent of all differences in point holdings, leaving 61 percent to be explained by other factors. This may overstate the case. It could be that what's really going on is that (say) it is billings that really drives point holdings and since older partners have higher billings, the "age (or experience) effect" is deceptive. Fortunately, we have more than one graph, and can test that hypothesis. We can state with confidence that the "age effect" is not more than 39 percent.

Of course, this analysis says nothing about the *actual* reasoning process used by the compensation committee. In saying that there is a correlation of (up to) 39 percent between age and points, we are say-

FIGURE 24–1

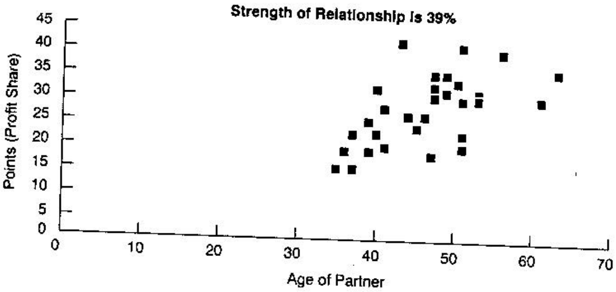


FIGURE 24–2

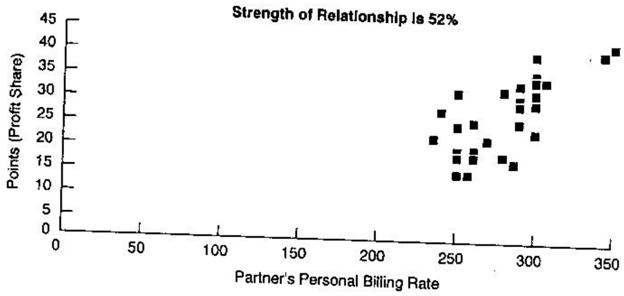


FIGURE 24–3

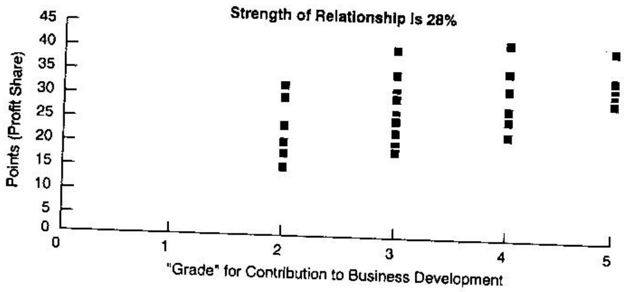


FIGURE 24–4

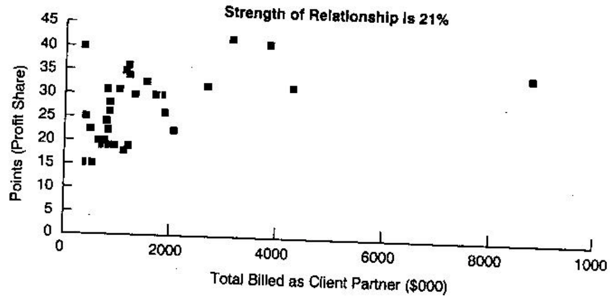


FIGURE 24–5

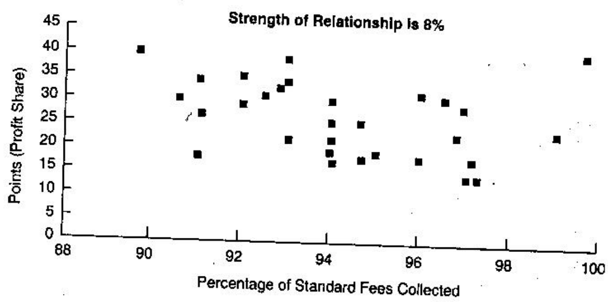
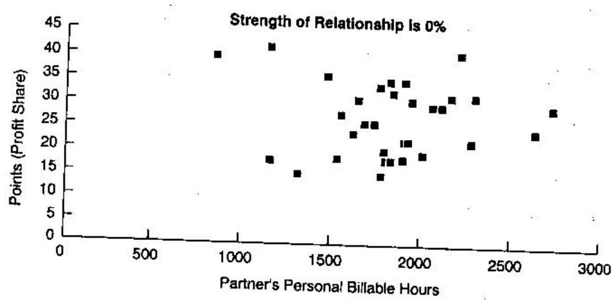


FIGURE 24–6



ing that the committee has acted *as if* the weight given to age was this amount. We are not analyzing their decision process, but the *consequences* of their decisions. We can say nothing about their decisions on individual partners, but we can say a great deal about the trends, generalizations, and patterns that emerge from their decisions.

Next, we turn to the partner's personal billing rate (Figure 24-2). Again, readers can draw their own conclusions. I see a clear trend, with a reasonable degree of scatter. Clearly, high-rate partners in our fictional firm tend to receive more points.

Is it appropriate that billing rate be so correlated with point holdings? Again, that's for the firm to decide. Our purpose here is simple—to disclose what has been done. However, if the firm sets its partners' billing rates by the market (i.e., individual billing rates reflect the value of the partner in the marketplace) then it is entirely appropriate that high personal billing rates should be reflected in higher point holdings—the most valuable professionals are being rewarded more highly.

Figure 24-2 suggests that billing rates "explain" 52 percent of the differences in points. However, we must be careful, since it is probable that older partners also have higher billing rates and there is therefore some "overlap" going on. For this reason, we cannot add together the 39 percent from the age graph and the 52 percent from the rate graph.

Fortunately, there is a method for dealing with this. In most spreadsheet packages there is another statistic (called "multiple regression") which will eliminate overlap and tell us how much of the differences in points can be explained by the two factors of age and rate taken together, without double counting. In this case, the answer it gives is 59 percent, meaning that after eliminating overlaps, age and billing rate together can "explain" a total of 59 percent of the differences in point holdings. One way of interpreting this is to say that if age alone can account for 39 percent of differences in point holdings, then adding in billing rate can explain an additional 20 percent (59 minus 39) of the differences.

Let's turn to "contributions to business development" (Figure 24-3). This is a "quasi" quantitative factor. Our fictional firm collects information on each partner's business development efforts and results and assigns a grade for their overall contribution, on a scale of 2 through 5, with 5 being the highest grade. (They intended to use a 1 to 5 scale, but in practice never assign a 1.)

As can be seen, there is also a rising trend here. On average, a higher "score" for business development will result in higher points. As always, we must look not only at the trend but the amount of scatter around the trend. There is a significant amount of scatter, revealing that the business development grade influenced compensation, but did not determine it. By itself, it appears to "explain" 28 percent of differences in points.

As before, we must be careful of overlaps. It is possible that high-billing-rate partners are also the best at business development. The "multiple regression" statistic referred to above can be applied again and, this time, reveals that taking the three factors of age, billing rate, and grade for business development into account simultaneously will "explain" a total of 74 percent of all the differences in points. This is up from 59 percent for age and billing rate alone, implying that business development performance explains 15 percent of the differences in points that age and billing rate cannot explain.

Figure 24-4 shows that "Total Dollars Billed as Client Partner" played some role in compensation setting (there is somewhat of a rising trend), but that it was probably not a dominant influence (there is a lot of scatter). While the relationship seems to have a strength of 21 percent, there is a lot of overlap with other factors: Adding this factor to those we have already considered only adds (according to the nongraphical analysis) an incremental 2 percent to the 74 percent we have already explained.

The last two graphs are revealing. Figure 24-5 shows that there is a barely observable relationship between points and the percentage of standard fees collected (the "realization rate"). (If anything, it seems as if there is a slight trend downwards.) It would appear that "good profitability management" was not applied across the board as a factor in determining points. This does not prove that the compensation committee did not take into account this factor in individual cases. It does show that they did not apply a consistent pattern across the range of partners.

Finally, Figure 24-6 reveals that our fictional firm did not, for better or for worse, place much reliance on a partner's personal billable hours in setting compensation—there is no observable trend. (While unusual, this may be an appropriate finding. If too much emphasis is given to individual partner hours, there might be an incentive to hoard work that should more appropriately be done by others.)

We have examined each of our available quantitative factors. Can anything be said about the *qualitative* factors used by the committee? At least this: If one takes together simultaneously all of the six quantitative factors, then a total of "only" 76 percent of the differences in points can be explained. (This result comes from the "multiple regression" statistic referred to earlier.) Therefore, we can conclude that the compensation committee relied on qualitative factors for 24 percent of its decision making. We cannot tell whether these other factors were sensible (quality of work, associate training, cooperativeness, etc.) or not (politicking, arbitrariness, etc.) But we have shown that our fictional firm's system is not purely a formula driven one. Is 24 percent weight given to judgment too much or too little? As always, that's for the firm to decide. But at least the partners know.

For better or for worse, the ambiguity of "What's rewarded around here?" has been significantly reduced. Of course, it has not been eliminated. There is still that 24 percent judgmental component that we cannot explain. (Although it is worth noting that the device used in awarding a "grade" for business development can be applied in other judgmental areas such as associate coaching, thereby turning a judgmental factor into a quasi-quantitative one.)

There is also a degree of ambiguity left because of the overlap between performance factors. If, for example, "billings as client partner" and "personal billing rate" tend to move together, which is really being rewarded? It's not easy to say precisely.

However, progress has been made. With six simple graphs (and a few statistics) we, and the partners of the firm, have a pretty good fix on what's been done in this firm. I can easily tell, as a partner in this particular firm, that I'd be better off focusing on my billing rate and my contribution to business development as a means of getting more points, and should worry a little less about my billable hours. I may not like those conclusions, but I now know what is given attention and what is not. And I don't have to rely on believing or trusting the compensation committee.

It should be pointed out that the graphical/statistical approach to disclosure of compensation awards still permits a significant degree of confidentiality to be preserved if the firm so wishes. The "dots on the page" do not identify which partner is which. Accordingly, the approach can still be used by those firms with policies against disclosure of individual partner compensation. (There will be the potential for a

breach of confidence in a small firm where one or two partners are "away from the pack" and hence show up as readily identifiable on a graph.)

However, many firms who do follow a nondisclosure policy do so because they fear misinterpretation of the results (i.e., questions of the form, "Why did X get more than me?"). If they provided the type of analysis recommended here, where the overall patterns of compensation are made clear, there would be fewer disadvantages to disclosure of compensation.

Naturally, any compensation committee would want to review this analysis before disclosure to the partners. I can hear the conversation now: "Did we really intend to give little or no weight to the profitable management of matters (the realization rate)? Of course not! That's not the signal we intended to send. We thought we were taking it into account in our individual decisions. Yet when you put it all together, there is no pattern. Perhaps we should review the decisions again!" In this fashion, the graphical (and statistical) analysis, used on a "trial balance" basis, can become a useful decision-making tool within the committee to ensure that the pattern of its decisions sends the right signals to the partners.

Naturally, there are many possible enhancements to this approach. Some firms may wish to analyze how the percentage change in points relates to performance factors, not just the absolute level of points. Others will want to examine performance data over a period of time (say, a three-year average) rather than just the latest year. Many such enhancements are sensible. The key issue, however, is sharing the analysis with the partners. A compensation committee has not done its job until it can show (not just tell) the partners precisely "what is rewarded around here."

CHAPTER 25

PIE-SPLITTING

In 1983, I decided to conduct a simple study of compensation practices among law firms to see how different firms would deal with different types of partners. Although the results are both old and from a single profession, I still get comments from clients about the survey and hear that they still use it to test views within their firms. So I have decided to include it here.

With the assistance of Steven Brill, the editor of *The American Lawyer*, and Bruce Heintz, a law firm consultant, I invented seven archetypal partners of a fictional firm and provided statistical and descriptive information on each (see Table 25–1). Those who participated in the study were asked to indicate for each archetype what the likely range of compensation (high and low) would be in their firm relative to the compensation of an average partner.

Each of the archetypes can be given a brief label:

A is the average partner,
B is the rising young superstar,
C is the unproductive older partner,
D is the individualistic solo operator,
E is the hardworking "back-room" lawyer,
F is the executive committee member actively maintaining a practice,

LE 25-1

Archetypes: Eight Partners of a Fictional Firm

	Partner A	Partner B	Partner C	Partner D	Partner E	Partner F	Partner G	Partner H
	The typical lawyer	*Young and entre-pre-neurial; has built a loyal group of as-soci-ates around him.*	*Seems to have run out of gas; suspect some per-sonal prob-lems at home.*	*A prima donna solo oper-ator; likes high visi-bility cases; a little too glib.*	*"Journey-man" lawyer; works hard, but brings in little busi-ness; relies on oth-ers; a "partner associ-ate."*	*Execu-tive com-mittee member; tries to do ev-erything; major force in the firm.*	*Man-ages branch office, which has poor profit-ability.*	*Major rain-maker; passes on cli-ents and work for others to han-dle.*
le s ced	100	141	74	105	115	92	95	35
ill- Hours ced	100	152	51	92	60	243	156	150
rs nged	100	198	33	45	55	129	90	112
-off rmance	100	120	50	102	101	150	63	132
led rs	100	105	59	40	93	121	80	108
ctions nce	100	110	72	50	95	115	83	103
ess ng	100	200	25	73	15	175	74	312
g Rate	100	64	129	104	103	112	108	139
	38	34	55	42	41	49	49	60

TABLE 25-1 (CONT.)

Department	Corporate	Real estate	Probate	Tax	Litigation	Corporate	Corporate	Corporate
Quality of Legal Work	Average	Excellent	Average	Excellent	Average	Above Average	Slightly Above Average	Average
External Respect in Community	Average	Excel-lent	Not Known Outside	Very Visible	Not well-Known	Very Well-Known	Thought to be Well-Known	Superb
Cooperative-ness with other partners	Average	Not Good: Some-what Territo-rial	Very Coop-erative	Not Very Coop-erative	Very Willing	Very Well-Liked	Not Per-ceived as Co-opera-tive	Not Coop-erative
Ability to Develop Associates	Average	Out-standing	Poor	Poor	Average	Out-standing	Not Enough Evi-dence	Not Good
Committee Work & Firm Management	Average	Not Much	Willing But Rarely Chosen	None	Will Serve When-ever Asked	Exten-sive	A Great-Deal	Used to be In-volved But Not Any-more
COMPENSATION	100	?	?	?	?	?	?	?

All numbers shown (except for age) are expressed as percentages of the average for all the firm's partners. Figures above 100 represent superior performance: Thus, for example, Partner D worked 5 percent more billable hours than the firm average, but 8 percent fewer nonbillable hours. When it came to the amount of work performed for his clients but not billed (unbilled dollars), Partner D's performance was only 40 percent, far less than the firm average. Similarly, his performance on collections was 50 percent: He took twice as long to collect as the average partner.

G is the struggling branch manager, and
H is the major rainmaker who doesn't put in many billable hours.

Table 25–1 gives a more developed picture of each. Before reading on, you may wish to complete the survey, by filling in what compensation each archetype would receive at your firm, compared to the average. Alternatively, you may wish to circulate the survey among all of your partners, to determine the degree of consensus that exists concerning what should be rewarded at your firm.

In my survey, forty-six firms sent usable responses, a response rate of approximately 20 percent, which is low but not unreasonable for surveys of this kind. The responses yielded some provocative findings.

In spite of low billable hours and textual hints of noncooperativeness, partner H, who combined seniority and major business-getting ability, would receive the highest compensation in most of the respondent firms (Figure 25–1). This is understandable: Bringing in business is often the most highly valued characteristic in awarding partner compensation.

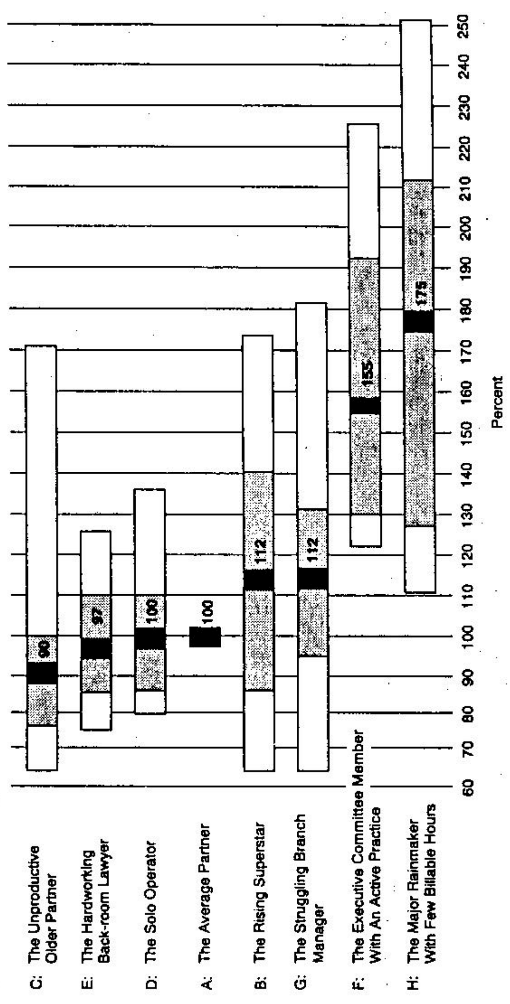
But the message contained in the survey responses is more complicated: While most firms would award partner H more than the other archetypes, they differ drastically in how much more. The median award for partner H was 175 percent of the average partner's compensation, but a quarter of the firms would give H less than 25 percent more than the average partner's compensation, and a tenth would give less than 10 percent more than the average. Three firms even reported that they would assign *less* than the average partner's compensation to partner H! At the other extreme, a tenth of the firms would assign partner H more than 210 percent of the firm average and, for a quarter of the firms, the share would be more than two-and-one-half times the average partner's compensation.

The range expressed in these results is truly astounding. Ignoring the bottom and top tenths of responses, we see that partner H could receive anywhere from 110 to 250 percent of the firm average.

FIRM SIZE DOESN'T MAKE A DIFFERENCE

How partner H (or any of the other partners) is treated does not appear to be related to the size of the respondent's firm. Analyzed by firm size, the survey responses showed the same basic pattern as they did when

FIGURE 25–1
What You Make Depends on Where You Work



taken as a whole. Within each size group, the awards to partner H centered on the 160 to 190 percent range, but there were dramatic swings within each group that swamped any statistical differences between the groups. For example, one small firm (fifty lawyers or less) would give partner H only 62 percent of the firm average, while another would award 262 percent. Among the largest firms (150 lawyers plus), answers ranged from 115 percent to 250 percent. (The absence of a statistical relationship between the size of the firm and the compensation decision holds true for all of the archetypes, not only partner H.)

A similar story is revealed when the responses are analyzed by form of governance. Of the firms responding, 72 percent identified themselves as electoral democracies, while 22 percent said they were ruled by an oligarchy of powerful partners and 6 percent described themselves as benign dictatorships. For none of the archetypes could a statistical difference be found between what the democracies would award as compensation and what the others would award. Again, the main message from the data was one of huge variability between firms. The same conclusion holds true for different methods of choosing a compensation committee: There were no statistically significant differences between the 68 percent of firms that elected their committee, the 15 percent that appointed it, and the 17 percent whose compensation committee was hereditary.

Could the wide range of answers for the different archetypes be due to an uncertainty on the part of the respondents as to what each archetype would receive in their firm? It appears not. For each archetype. respondents were invited to indicate a "high" and a "low" figure, to allow for factors affecting compensation that were not accounted for in the exercise. The vast majority of firms gave estimates that ranged no more than 20 percent from the high figure to the low, and very few firms (less than one in ten) exceeded a 30 percent range. Thus, it seems that most respondents felt that they had sufficient information to place the archetypes reasonably and accurately within their own systems.

THE OTHER RESPONSES: WHO GETS HOW MUCH?

We have discussed partner H. What of the remaining partners ?

As anyone familiar with law firms would probably guess, the partner most highly rewarded after partner H was deemed to be partner F: the executive committee member who works close to the firm average

on billable hours, more than double the average on nonbillable hours, and has "origination credits" 75 percent above average. The median award given to this individual by the forty-six firms was 155 percent—50 percent of the respondents would give less than this, and 50 percent more. As with partner H, the range of treatment of this hard-working executive committee member by different firms was dramatic. One-quarter of the firms would award less than 130 percent of the firm average, while one-quarter would assign partner F more than 190 percent. Ignoring the top and bottom 10 percent of responses, we find a compensation range of 120 to 225 percent of the firm average. Even though firms might have significantly different averages, this is again an incredible range.

It is interesting to compare the relative treatment of partners H (the "big rainmaker") and F (the "major force of the firm"). Even though the median awards to F and H vary by only 20 percent, there was significant disagreement among the forty-six firms surveyed as to which of these two should receive the higher compensation: 54 percent gave more to partner H, but 46 percent gave more to partner F. The exercise was designed to explore these different reactions. Business getting is important, and partner H excels at this (as well as being more senior). However, billable hours and firm management, partner F's relative strengths, are also important, and he has a respectable business-development statistic. As expected, the different firms split about evenly on the matter of who is more valuable to the firm (if, indeed, a single year compensation award can be interpreted in that light).

Most firms agreed that the older rainmaker and the middle-aged executive committee member would receive significantly more than any other of the archetypes. However, the same trade-off between business getting, firm management, and seniority was revealed at the next level. After H and F, the next two most highly rewarded partners were B and G. Partner B was our fictional firm's rising young superstar, with billable hours 41 percent above firm average, origination credits (and supervisory responsibility) double the firm's norm, and nonbillable hours 52 percent higher than average—all at the tender age of 34. In contrast, partner G, the branch manager, underperformed all of the firm's norms except two: nonbillable hours (presumably management activities) and age (49, compared with the average of 38).

Who gets the greater share? Half of the firms in the survey chose the superstar, and half the more senior branch manager. In each case, the median award was 112 percent of firm average, although as before, the variation exhibited among the forty-six firms was large. The young superstar would earn more than the average compensation at 29 percent of the firms surveyed, while another 29 percent would give her or him in excess of 140 percent of average (with some ranging up to the 190 to 200 percent range). Similarly, more than one-quarter of the firms would give the branch manager less than the firm average, and an equivalent percentage would award him or her more than 135 percent.

Moving down the rankings, we find D and E our next interesting pairing, both of whom were awarded compensation close to firm average. Partner D—the "prima donna solo operator"—worked an average number of billable and nonbillable hours but had origination credits some 27 percent below firm average. By comparison, one would expect A, the average lawyer, to be more highly valued because of A's superior business development record. However, 55 percent of the firms would give partner D at least 100 percent of firm average (partner A's reward), 34 percent would give at least 10 percent more than A, and 17 percent would award at least 25 percent more than A. Presumably, D's age (42, compared to A's 38) accounts for this difference.

Most firms ranked partner E, the journeyman back-room lawyer, significantly below partner D. The majority of the firms would award E less than firm average, and 15 percent would give less than 87 percent of firm average. Another 25 percent, however, would give E 110 percent or more. Partner D's comparative strength is business getting, although he is below average in this and exhibits a poor collections performance; E works more billable hours, has better collections and write-off performances, but has significantly fewer origination credits. As noted, most firms would give D more than E, but not much more. The median compensation for D was 100 percent of firm average for E, 97 percent.

Finally, the majority of firms in the survey agreed that the lowest-rated partner was archetype C, the 55-year-old lawyer working only 74 percent as many billable hours as the average partner and scoring below the average on every measure except age and billing rate. The median firm in the survey would award this partner only 90 percent of the average partner compensation. (So much for seniority!) However, as in all previous cases, the range of awards among the forty-six firms was dramatic. A tenth of the firms in the survey would award less than 65 percent, while another tenth would award at least 170 percent

(presumably due to seniority). Almost half the firms would give partner C at least as much as partner D or E, and (to my eyes) an amazing one third of the firms would give C more than the young superstar, archetype B!

NO CONSENSUS

Clearly, the most significant lesson to take away from this study is the single word "confusion." The most important parts of the table of results are not the relative rankings of H, F, D, or E, but the amazing differences exhibited in the pie-splitting practices of different firms, in particular the relative weights they give to the factors of seniority, business getting, billable hours, management responsibilities, and collections performance.

Variations in the criteria firms use in splitting the partnership pie are understandable and, indeed, desirable. Different strategic positions in the marketplace require different compensation systems. A firm with a large institutional client base and with multidisciplinary matters will probably need to give less weight to business origination and more to billable hours and supervisory and management responsibilities. A firm dependent on small transactional matters will need to have a broad base of business getters and will therefore tend to rate origination credits higher. A diverse, multisite firm will have a greater need for management skill and will tend to reward this more highly than a relatively homogeneous, single-site firm would.

Compensation system experts note that any compensation scheme, if it is to stand up over time, must pass two tests: that of internal equity and that of external equity. Internal equity requires that, whatever the rules are, they be applied in a consistent manner. Even when internal consistency has been achieved, there remains the test of external equity: Do the compensation rewards in the firm reflect the economic realities of the open market? In the past, law firms have not had to confront this issue because, until recently, there has been no appreciable market in law firm partners. It is clear from the results of this survey, however, that, as this market develops, many firms will be forced to make significant shifts in the relative rewards they allocate to different types of partners.