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Do We Need to Slice the Pie Differently?

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Recent client engagements have had a heavy emphasis on partner compensation. What makes this newsworthy is that many of these firms have historically been committed to equal profit share, but perceived differentials in performance are giving rise to tensions that some in the partnership feel can only be remedied through differential compensation.

Being part of a profession which is by nature cautious, firms which have changed their compensation system have done so only after thorough analysis of the current system and its shortcomings, careful review and modelling of the alternatives followed by an internal pitch to get everyone (or a majority) on board.

The choice of profit sharing system (and evaluation criteria) depends very much on the specific firm's history, culture, jurisdiction, size and maturity. Whilst it is rare for all partners in a firm to be totally satisfied with the compensation system, for any system to be successful there has to be alignment between the methodology for admitting partners, partner performance criteria and the profit sharing system. The profit sharing system is really the last piece in the puzzle.

In order for a new compensation system to be accepted (or, ideally, successful) it should have the following characteristics:

- It is fair
- It rewards outstanding performance and contribution overall, not just financial performance
- It does not create internal competition
- It does not discourage partners from doing the activities that build the brand of the firm
- It does not discourage partners from doing work the firm has traditionally done and wants to continue to do that is not as remunerative as some other types of work

I would also add to the above list that for any change to be adopted, it is introduced with a two-year sunset clause where there will be a thorough review before anything permanent is introduced.

Every system requires active and robust management to ensure that partners do not creep their way up to progression beyond their competence and contribution. Any movement away from equal profit share will necessarily involve a degree of subjective assessment. It is therefore necessary to revisit the current partner performance criteria to ensure it encourages partner behaviour that is consistent with the strategic direction of the firm. You will have to flesh out the following:

- Baseline performance criteria – minimum level of performance for an equity partner in the firm
- Individual performance criteria – tailoring performance criteria for partners based on their practice group, client base and their specific requirements in terms of the firm's strategic plan
- Methodology for assessing partner performance
- Mechanisms for dealing with outstanding contribution
- The role of management – this will range from the reports provided to partners, through to who will be responsible for sheep-dogging partners to hit their targets, through to the determination of profit shares.

Any changes to the compensation system will necessarily give rise to winners and losers. Assuming the compensation system has been designed with the characteristics of my first set of bullet points, in time all participants should be better off or at the very least more fairly compensated. Where the wheels usually fall off is if the primary design of any change means that a select group is able to win in the short term, or ensures that someone else does not win.

To conclude, in the Australian and New Zealand market I envisage the conversations around profit sharing will become more frequent as we see the transfer of equity pick up pace, and both incoming and incumbent partners consider it an appropriate time to review all aspects of firm management.