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Remuneration

Shaking Up Profit Sharing

The substantial remodelling of remuneration systems requires time and planning and the involvement of partners at every stage. **Nick Jarrett-Kerr** considers the steps for the successful implementation of new profit sharing systems

Few firms are entirely happy with their partner profit-sharing systems. For any firm considering making changes, a good starting point is to understand the extent to which the current system is failing to meet the needs of partners or the firm and the extent of the changes that might be needed. Lawyers constantly seek perfection, and yet there is no perfect way of allocating and distributing a law firm's profits among its partners. All that can be hoped for is to attain a "best practice" solution and in doing so avoid discarding worthwhile principles and processes just because some partners can – often mistakenly – blame the existing system rather than inefficient implementation of it.

Lack of inter-partner trust linked with widespread feelings of unfairness can help to make any system untenable. The first big question to decide is whether the firm needs to fundamentally overhaul the system or to persevere, despite the apparent shortcomings of the current system.

It should be made clear to partners (if they are not already aware of it) that there is no perfect compensation system and firms should resist the temptation to discard a system just for the sake of change. Additionally, many firms have found that fundamental changes to the way partners are rewarded and compensated are little short of impossible to achieve in the real world. Not only can internal politics get in the way, but the management time and effort involved in the introduction of a new system is hugely time-consuming and disruptive. Nevertheless, whilst there is no such thing as a perfect system it seems that many partner remuneration and compensation schemes are flawed and in need of either a complete overhaul or some substantial remodelling.

Changing times

As a firm grows in size, the need for formal structures increases so that partners can understand the way things are done. In many

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small-to-medium sized firms, changes to profit-sharing mechanisms can be made somewhat informally, with all partners involved in the discussions. Once a firm gets above a certain size (around 20 to 30 partners), changes need to be made in a more structured way. Whatever the size of the firm any effort to change its profit sharing or compensation system, and the allied performance management system, can give rise to a number of points:

- For any initiative to succeed there must be a widespread and deep-rooted sense of *dissatisfaction with the status quo*, or at the very least a strong feeling in the firm that change is needed.
- The system should be rooted in and linked to the firm's *strategy and objectives*. Leadership should have a clear vision for what the desired conclusion might be, and should be careful to ensure that partners share this vision.
- Such initiatives must neither become one man's crusade, nor be left to one person to have sole responsibility for design and implementation. Whilst there may be partners who will oppose, reject or even subvert any attempt to change the system, success will depend not just on the acquiescence and sympathy of the majority of partners, but on there being *a group of partners who are prepared to put in time and energy to support and share the objectives*.
- Unless the current system is fatally flawed, it is often easier to move to a system that is seen to be *sequential and a natural flow from the previous system*. To move, for instance, from an extreme "eat-what-you-kill" system straight to a pure lockstep system would be extremely difficult to achieve.
- It is difficult to introduce a new system piecemeal, but some degree of *incremental change* can be conducted as part of a staged process. The establishment of new partnership criteria and expected partner behaviours can often precede the introduction of a new compensation setting system.
- Whatever profit-sharing or compensation system the firm has in mind, initiatives need to be in place to encourage *a sharing team-based culture*, that emphasises the gains and benefits to be had from diversifying opportunities and spreading risk among a group of partners, and refuses to value aggressive internal competition or anything which promotes individual selfishness.
- The system for developing partner skills and competencies – and ultimately for rewarding the development of such skills – should settle only for *the pursuit of excellence*, recognising that to be content only with the pursuit of competence will lead to inevitable decline.
- *Communication, before, during and after the project is critical.* The project should ensure that partners understand the whole performance management process. Those managing the project should manage expectations, avoiding, if they can, any system that requires over-frequent and repetitive subjective assessments with all the anxiety, loss of time and raised temperatures which are inevitably involved.
- Once introduced, the design of the system should be amended as infrequently as possible, and as much effort as possible put into *fair and consistent implementation* and in ensuring that the new system becomes an essential part of the fabric of the firm.

Incremental change

It is clear that there are a great many spokes to the compensation and profit sharing wheel. Few firms will want to embark on an ambitious project to transform all parts of it. Most are looking for a system that will reward and compensate partners based on their overall contribution to the firm's strategic goals rooted in factors and criteria that will be essentially subjective or qualitative. In addition to the choice of the compensation model, firms will need to consider some or all of the following:

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- Clarify and decide their vision of the desired conclusion.
- Define what is expected of partners in terms of the roles, responsibilities and behaviours to drive performance.
- Criteria for the critical areas of performance or the balanced scorecard.
- A clear system for managing partner performance.
- A methodology for partner development and promotion, including tiers of partnership.
- A system for judging, scoring and assessing partners particularly in subjective areas of performance.
- A framework for 360-degree feedback.

Business school

Remuneration

- A series of constitutional documents and papers to deal with all the issues including a new suite of appraisal documents and changes to the partnership deed or members' agreement.

Projects can be dealt with iteratively and incrementally, provided that they are part of an overall plan. Many firms work hard on the above elements quite separately from any project to change the compensation structure itself. The danger lies in attempting to make a shift towards a subjectively assessed system without having first introduced a balanced scorecard or agreed on the firm's critical areas of performance and bedded those changes in. Where the firm has already decided on its critical areas of performance, those areas will often need to be revisited to make the criteria as clear and measurable as possible.

It is suggested that the profit sharing system itself is the final change to be made as it needs to be built on the firm foundations of all the other areas listed above. It should also be clear that the new system cannot be introduced incrementally, in that you can have some partners on the old system and some on the new. It is possible to consider a shadow scheme where the old system is used and the new system is piloted in parallel to see how partners might have been affected by the new regime. Some firms – particularly those that are moving from a predominantly lockstep model to a modified lockstep – have chosen to introduce a relatively small amount of performance-related elements – say 5% or 10% of the whole compensation package, so that the effect of the change can be monitored and scaled up over time. One worry is that some firms have found that a small amount of performance-related compensation can lead to relatively small differences between partners which can lead to both resentment and envy.

First steps

Before starting the project, there are some key questions which the firm's leaders need to address:

- Decide whether the partners agree, or are likely to agree, that the overall issue of compensation – or indeed any of the issues raised above – forms a major concern that needs to be resolved. It is important to see that partners fully and deeply understand all the implications of what the firm is trying to achieve.
- Identify possible obstacles and what other side-issues might arise that could derail the project.

Five phases of implementation

Phase one

Managers seek agreement from partners to launch an initiative. It should be clear that any change to a rewards or compensation system will require partners to change their behaviour in some way and therefore partners must agree in principle that there is a need for some change. As discussed, there is no point in proposing a major change if partners do not perceive it to be a major issue. Equally, the partners' reactions to proposals in due course may well be neutral or unsupportive if they do not have a reasonable level of understanding about the issues and their implications.

Phase two

The leaders then crystallise their thinking in a green paper that spells out the issues and challenges and clarifies what they mean in terms of future partner performance and behaviours. Establish a timetable and some desired objectives and then identify clearly the various options available for the firm. At this stage, sufficient detail should be provided to engage the attention of partners and to move them from a superficial understanding of the issues to a deeper and more cognitive level.

The leaders should then meet the partners as a whole or in small groups and discuss the proposals. These meetings should be fairly informal and should provide an opportunity for dialogue. There should however be something of an agenda with particular focus on:

- The performance required from the partners for the firm to attain its strategy.
- The project's objective.
- The options for change and what each means in terms of partner performance and behaviour.
- Whether the firm needs to build or improve its "balanced scorecard" or critical areas of performance and how the leaders envisage how this will be achieved.
- How, in broad terms, partner performance will be managed and assessed.
- The transition from the current system to the new or revamped model.

Phase three

The leaders get approval to appoint a project group to take the project forward and to come up with detailed recommendations in the form of a white paper. The white paper should aim to spell out:

- The options that have been considered and the reasons behind the rejection of some proposals.
- The details of what will be required of partners under the new regime, including, if appropriate, details of any new or revised performance management system.
- What this means in behaviour terms.
- What this means in terms of competence and skills – the detailed drafting of a balanced scorecard is an important element here.
- What the various processes and systems will be like when it is complete.
- How the proposals address the flaws in the old.
- In any form of seniority system, what a partner can do to move up on the new system.
- A sheet showing the position of each partner on the old and new model (with assumptions).

Phase four

Following this, the white paper can be converted into a suite of documents and voted on or ratified. At the same time, changes can be effected if necessary to the partnership deed or members agreement.

Phase five

There then comes the tricky phase of implementation. Unlike some projects, the introduction of a new system to allocate compensation or remuneration cannot be phased – you cannot have some on the new system and some not.

However, some issues can be phased – the introduction of a balanced scorecard and a partner performance management system, for example.

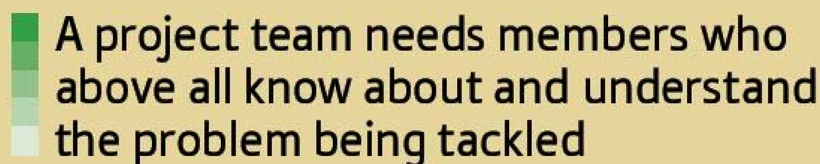
It is also advisable to get any new performance assessment processes in place and agreed ahead of anything else – a pilot scheme can help here.

- Establish supporters and likely opposition. Every firm has a group of opinion formers and if the firm leaders cannot convince them to support and identify with your objectives, your chances of victory will be substantially diminished.
- The firm needs to decide from the start whether it is likely to have the time, resources and energy to see the project through.

Project teams and partner workshops

The introduction of systems and processes needed to change a compensation system forms a large, time-consuming project. The management of the project, plus its implementation, is crucial. A project team can be useful in this. Many project teams in law firms have a curious habit of emerging without any particular selection process but – however chosen – they need clear accountabilities and commitment. Team members can be selected to provide a balance.

A project team needs members who above all know about and understand the problem being tackled, and who both care enough and will make sufficient time to do something about it. It helps to have one or two sceptics in the team to keep the group honest and to act as the grit in the oyster. The project must be clearly scoped and have a timetable and a budget. The choice of a project team leader for any initiative is critical. This person needs to know that they have the power to enforce. They must be well respected in the partnership and have demonstrable leadership skills. They must also have credibility in the firm and the clear support of the leadership group. The project leader needs to be able to grasp the necessary sensitivities and emotions that can be raised among partners during the process, and the wisdom to understand the checks and balances which need to be incorporated into any changed mechanisms.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It seems obvious to suggest that the leader must have the capacity to devote the necessary time and the authority to obtain the necessary resources, but it is quite surprising how many internal projects in law firms run out of steam because the project leader keeps getting sucked into unavoidable client work. It also helps greatly if the project leader gets on well with the managing partner and the leadership group and has an open line to them and to departments and their heads for team members. Finally, it is vital that the leader has good organisational capabilities (or, at the least, the active support of a capable administrator) together with sufficient operational experience to know how to get things done. The true test of a project leader is the extent to which they are able to easily manage and organise an internal project and to sell the results internally.

Workshops or face-to-face?

Partners do not always say what they think and agreement in a partners' meeting does not always imply commitment. Face-to-face interviews with partners by someone wholly objective and detached can help to reveal some of the deeper-seated issues and fears that partners may have, as well as being able to identify areas of consensus. In addition, partner workshops can help both with partner engagement and commitment as well as with feedback on some of the thought processes. The process of developing a balanced scorecard or critical areas of performance is one of the core elements of the whole approach to changing compensation or profit sharing mechanisms towards one which has assessable or subjective elements.

Most partners should be involved to some extent in this work and the workshops are a good place to involve them. While the degree of participation may vary, there are major benefits in including as many partners as possible in the discussion about the skills and competences to be defined in the creation of the balanced scorecard. Some of this can take place by a facilitator or members of the project team interviewing relevant partners and other stakeholders. Other discussions can develop in a workshop situation. It is vital to ensure that any partner workshops are tightly managed and directed – drafting proposals by committee is not recommended and there is a fine line between the obtaining of valuable feedback on the one hand, and the undesirable watering down of proposals on the other.

Small firms may be able to conduct workshops as part of a partners meeting or to split into two or three workshops – it is vital to try to have the groups not too small or too big.

Part of the agenda for such workshops is to discuss, describe and define the skills and competencies needed by partners for the firm to succeed in reaching its strategic objectives.

The discussion can then move on to the sort of behaviours to be expected of partners. The first step is to create a compact set of definitions of the current set of competencies that the firm currently deploys, as well as any new competencies or skills that must be worked on. However, this step does not go nearly far enough. A descriptive competence can be bland, meaningless and immeasurable, unless accompanied by "behavioural indicators" which show in greater detail what the competence looks like in practice, and what partners have to demonstrate to show evidence that they have mastered the skill.

Conclusion

The issues touched on here – partner accountability and performance, the wider role of a law firm owner, partner development and progression, and how firms reward, compensate and reward their partners – go to the very heart of the partnership ethos. In many larger firms, partners have become disillusioned and cynical about the nature of their relationships with their firms. Many partners complain about no longer being "true partners" but merely paid employees on fixed-term contracts. Partners can also come from a tradition of independence evidenced by membership of a loose franchise of soloist, autonomous individuals. Such partners also find it hard to adjust to the need for a more cohesive organisation. Partners in firms with a history of pure lockstep are finding it equally hard to accept the increased scrutiny of their performance which merit-based remuneration systems require. The truth is that radical change to a firm's partner remuneration system requires time and planning and will involve the firm in considering a whole range of other issues.

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