

# GOVERNANCE

## *in the Growing Partnership*

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NO GOVERNANCE STRUCTURE CAN ENTIRELY PREVENT PROBLEMS CAUSED BY WEAK AND INEFFECTUAL MANAGEMENT, OR THE GENERAL MUDDLE WHICH ACCOMPANIES MANAGEMENT VACUUMS, OR LONG TERM DISASTERS CAUSED BY PETTY TYRANTS.

However, a coherent and balanced management structure clearly helps. This is particularly true of a governance structure which is aligned to the strategic and business needs of the firm and which contains the appropriate provisions for mature and sensible accountability. There is of course no shrink-wrapped governance solution which will suit every firm at every stage in its development. It is, however, important to understand both the reasons for governance difficulties and also the principles which can assist firms to discover sensible recipes to

suit their particular circumstances. This article provides a framework for firms to consider when thinking about their governance. It explains the transition points at or around which firms may need to consider changing their structural model, and looks at some of the typical problem areas encountered as firms grow. The article also outlines a typical structure for professional partnerships with fifty to seventy five partners or more and in excess of two hundred professionals – what might be described as medium sized firms.



*by Nick Jarrett-Kerr*

### UNDERSTANDING STRUCTURAL FAULT LINES

The problem is typically historical. In many cases the management arrangements which may have suited the partnership in the past, have just ceased to work as the firm has moved on. As firms grow, it is no longer practicable to involve every partner in every

## ARTICLE SUMMARY

- **Governance structures in law firms are often outdated and ill-suited for further growth.**
- **Transition points are critical as properly constructed governance and management can support the overall objectives of the firm.**
- **Good governance structures strike a balance with the firm's strategy; corporate models offer some ideas for alternatives to the classic 'partnership systems'.**
- **While every structural solution is unique, all partners need to adapt to the new structures and back the required changes.**

decision. Equally, it becomes difficult for the managing partner in a fast growing firm to consult with all partners or even connect with them in a meaningful way. At the same time, the firm has usually not yet developed a sensible hierarchy of accountability. Combined with an absence of role definition at the level of department or divisional head, this can lead general partners to feel disenfranchised and uninvolved in major decision-making, and – even worse – to become disengaged from the strategic planning and business direction of the firm. One example is the annual budget. Tablets of stone delivered from a mountain top do not seem to work well in partnerships. A budget which is prepared and delivered top down to uninvolved partners does little to engage and motivate partners to stretch for an uncomfortable target. What then happens usually is that subversion and inertia take over. Partners simply ignore the loftily delivered edicts and the firm's financial performance meanders or deteriorates.

The problem then is that firms, unless well advised, can often tend to lurch from a previously extreme consensus model of governance to an equally extreme autocratic model, spurred on by calls for 'strong management'. In the extreme version of the autocratic model, consultation and partner involvement disappear out of the window and partners find themselves bullied into meeting performance targets. Consensus freaks get replaced by control freaks.

There is also no greater example of management muddle than the tangle in which many firms find themselves over management elections. Typical examples of weird election provisions include:

- **Partners in a department or practice area having the entrenched right to vote for their practice area head who then automatically has a seat on the management board or executive committee;**
- **The partnership as a whole voting for board members who then divide up the jobs of managing partner and departmental heads between them;**
- **In one firm, it is reported that the managing partner is elected by a board of advisors. The board of advisors is appointed by the managing partner;**
- **In another law firm, the partners in each practice group elect the practice group leaders. If a partner is in more than one practice group, they get half a vote for each group they are in (a partner in three groups gets 1 1/2 votes whereas a partner in one group gets one vote). The chairman of the corporate department is by definition chairman of the firm and the chairman of the Litigation department is by definition the managing partner. If the chairman or managing partner retires or resigns, an election is called and all practice group chairs stand for election.**

Such bizarre practices may be designed to act as a check and balance on management, but tend to produce governance systems which are inflexible and slow to change and in which partners gain election success through politics rather than management competence. The structure should support methods of selection which give the best chance of appointing the best managers rather than those who are most senior, the most popular or the most politically savvy.

### RECOGNISING THE TRANSITION POINTS

It is critical to recognise, as early as possible, the growing need for a change in governance structure, and to anticipate the transition points at which the previous arrangements for managing and governing the affairs of the firm can become ineffective. We have noticed some typical transition points in the growth of many partnerships. Just as milk can go sour seemingly within minutes, the transition point from effectiveness to ineffectiveness can happen within a very short time.

One such transition point occurs when a firm reaches about twenty partners. Until that point a large measure of informality can be seen in many partnership arrangements including partnership reward systems. Often, of course, such smaller firms are heavily influenced or led by a strong or idiosyncratic founder – or set of founding partners – and can falter quite markedly in the classic founders' trap if the firm fails to appreciate the need for change as it develops. At

around the twenty partner point, however, informality of management tends to stop working and needs to be replaced with something a bit more formal. Partners usually have a growing appreciation that not every decision can be made in partners' meetings and become ready to embrace a structure in which decision-making is filtered and refined provided that they continue to be consulted by someone they know and trust and that consensus is somehow achieved on most decisions. In this phase, a simple management structure is usually enough. Accordingly, many firms will simply have a management committee presided over by the managing partner and reporting to the partnership on a regular basis.

The next stage of development is trickier. There is a governance transition point when the small to medium size firm becomes too large for management by consensus. Although this point is reached by firms at varying sizes, this transition point often (but not always) occurs when the firm reaches between fifty and seventy five partners and more than two hundred professionals. But there are two problems. First, change in size of itself may not always bring about the need for change and is not the only transition trigger. The need for revisions to the governance structure can also be brought about by mergers, significant change in the leadership group, sudden change in profitability, the onset of a crisis of some sort, and even an increase in the number of offices or jurisdictions.

### TYPICAL TRANSITION TRIGGERS

- SIZE
- MERGERS
- SIGNIFICANT CHANGES IN LEADERSHIP GROUP
- SUDDEN CHANGE IN PROFITABILITY
- ONSET OF CRISIS
- INCREASE IN NUMBER OF OFFICES



The second problem is that some firms continue with their existing management structures long after changes ought to have been made. After all, the development of appropriate governance arrangements (particularly in medium sized professional service firms) tends to lag way behind the development of the firm's strategy and growth, and varies somewhat according to how democratic or autocratic the firm has previously been. Many firms partners, accustomed to consultation and even control in the context of a small firm, are reluctant to cede their authority as the firm changes. This means that many firms carry on growing far beyond the normal transition point without any change in structure; the growing pains become more acute as they struggle to continue to accommodate extreme consensus (or indeed extreme autocracy). Accordingly, the trick is for the leadership team to look ahead for anticipated transition points

and to be aware of what triggers those transition points. The team can then take steps to work out what governance structure is needed and work on the partnership to educate the partners and begin to soften them up for the unpleasant reality that the firm needs to make changes which are likely to lead to the twin displeasures of decreased autonomy on the one hand and increased accountability on the other.

### THE PURPOSE OF GOVERNANCE

Whether you are a partner, a client, a lender (or even an investor), there are certain things which all parties want to see in a vibrant and progressive professional services firm. They want to see a well-coordinated firm rather than just a loose group of individuals. Clients in particular want to see partners working as a team with consistently applied and agreed methodologies and approaches. Indeed, how the firm delivers its



## THE PURPOSE OF GOVERNANCE – TEN PROPOSITIONS

1. STRATEGY CREATION FOR COMMITTED, COMPETITIVE AND PROFITABLE BUSINESSES
2. ALIGNMENT OF INTERNAL OPERATIONS WITH EXTERNAL SERVICE
3. COHESIVENESS AND COORDINATION
4. PROGRESSIVE AND CONSISTENT WORKING PRACTICES
5. FLEXIBLE AND EFFICIENT DECISION-MAKING
6. ARCHITECTURE OF BUSINESS UNITS
7. FORMULATION OF PLANS FOR BUSINESS UNITS TO MATCH OVERALL FIRM STRATEGY
8. CLARITY OF RULES AND ACCOUNTABILITIES
9. PROVISION OF RESOURCES
10. RISK MANAGEMENT AND SUCCESSION

IT IS CLEAR THAT GETTING THE STRATEGIC CHOICES CORRECT FOR ANY FIRM IS NOT AN IVORY TOWER EXERCISE DURING WHICH THE MANAGING PARTNER AND A FEW OTHERS CLOSET THEMSELVES IN GREAT SECRECY BEFORE UNVEILING A NEW STRATEGY TO THEIR ADMIRING PARTNERS. RATHER IT IS OFTEN AN EMERGING AND EVOLVING EXERCISE WHICH REQUIRES INPUT AT ALL LEVELS.

services is of as much importance to clients as what the firm delivers. Above all, external parties of all types want to see a 'one-firm' approach accompanied by well designed systems and processes.

The governance structure can assist with all of these desirable features. The ten propositions highlight the areas where a properly constructed governance and management structure can help support the overall objectives of the firm. One such aim of any governance structure is to achieve alignment with the formulation and implementation of strategy. This balance between strategy and structure takes two main forms. First, it is critically important to ensure that the way the firm operates and managed itself internally matches the way the firm operates externally both currently and in the future. If the firm's objectives include growth, for instance, the firm needs to be sure that the governance structure will be fit for purpose as the firm grows. It is not always possible to get this adjustment right. The point however remains that partners meetings can fairly quickly become too large for sensible decision-making, and management committees can also become too big or too unrepresentative. The same is true of the issues which are often described as 'Reserved Matters'. These comprise areas of decision making which have to be put to the vote of the general partnership rather than being delegated to the managing partner or some board or committee with executive authority. These Reserved Matters usually shrink to a few

important issues over time and it is vital that they should be kept as minimal as possible. We have, for example, seen in some partnership agreements, provisions that prohibit the spending of more than a fairly small amount of money without the partnership's approval - and usually that outdated financial limit has not changed for many years. At the end of the day, there are only a few key decisions over which partners as shareholders should retain a vote. These are all in the area of major changes - changes to the firm's constitution or entity status, mergers and acquisitions, major changes in policy or strategic direction and major changes in capital or debt structure. In practice, whilst many partnerships reserve the right to vote on new partners, the admission of new partners can quickly becomes a nominal ratification process.

The second balancing act between strategy and structure concerns the creation of the firm's ongoing strategy. It is clear that getting the strategic choices correct for any firm is not an ivory tower exercise during which the managing partner and a few others closet themselves in great secrecy before unveiling a new strategy to their admiring partners. Rather it is often an emerging and evolving exercise which requires input at all levels. Nevertheless, there is a top level need for a selective group of partners to filter ideas, analyse situations and issues, and generally oversee the whole process of strategy formulation. The task here is to bench test the emerging plan for clarity

and reality and to ensure communication. In the smaller firms, partners can be highly involved in this process, but as the firm grows, the business needs to find the right formula and structure to enable this overseer task to be done effectively.

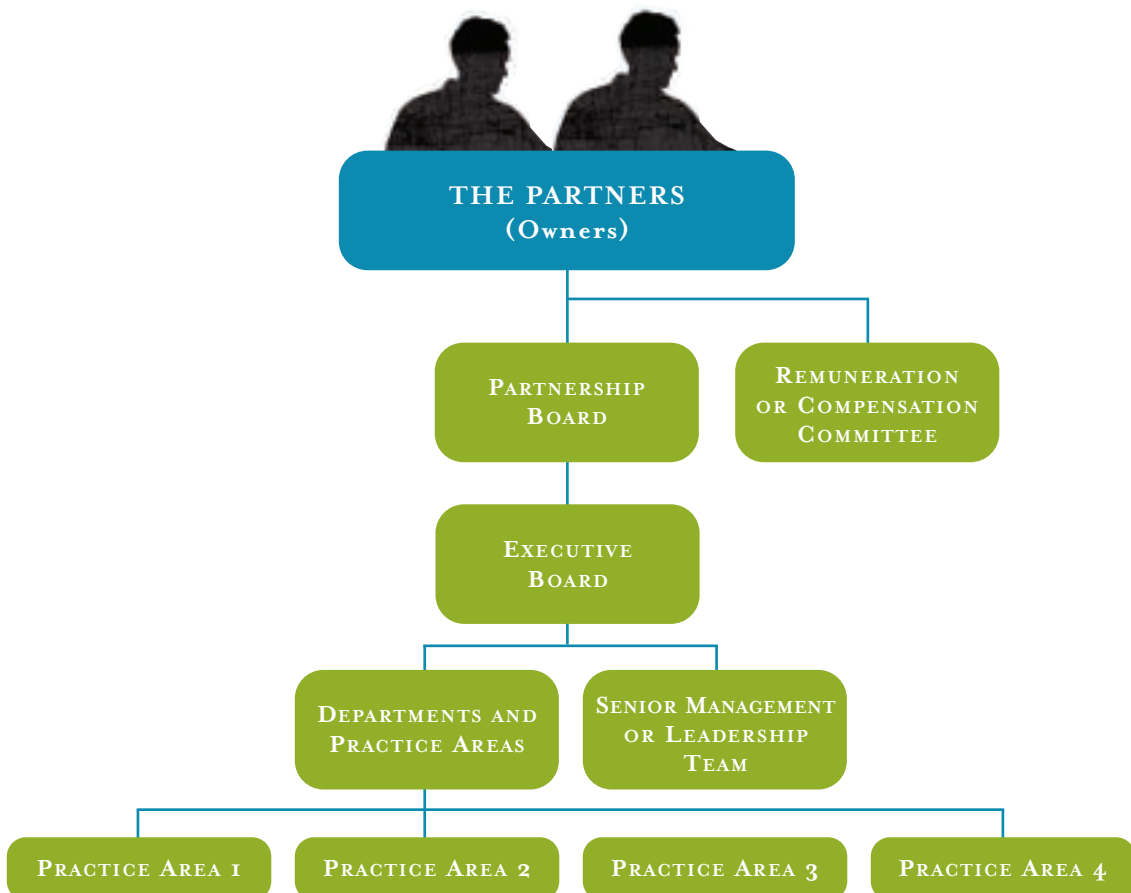
Another main aim of any governance structure is to ensure overall coordination and firm cohesiveness. The brutal truth is that many firms completely fail to achieve any sense of assimilation. A multitude of firms remain loose associations of solo practitioners even as they grow. Some firms achieve cohesiveness at office or practice area level but do not transfer that cohesiveness to the whole firm – and a silo culture is spawned. Other firms seem to enter a phase where the top level management becomes remote and aloof – uninvolved and disconnected from the areas of fee generation. One managing

partner was fairly recently described to me as ‘never seen round the offices, managing by dictat and email’. In another firm, the management committee was made up of the managing partner and senior professional managers in charge of the support function – with no representation at practice group level.

### THE TREND TOWARDS CORPORATE STRUCTURES

In the face of these problems the increasing trend towards a more corporate style of governance seems inevitable. Indeed, the trend will speed up as the markets for professional services continue to consolidate. The imperatives for this trend are becoming clear. Firms need to drive business performance and the overriding priorities of the management structures of the firm must be

FIGURE I  
POSSIBLE GOVERNANCE MODEL FOR MEDIUM SIZED FIRMS (ORGANIGRAM)



directed towards this imperative as well as strategy implementation. At the same time, the role of the managing partner or CEO is becoming much more 'executive' – with greater authority and less consensus-driven. The authority of the management boards and bodies is also increasing. The interests of partners as shareholders from the management and operational decisions of the organisation are steadily separating. In some progressive firms, we are seeing the introduction of external non-executive directors at board level, whilst line management is being strengthened with beefed up roles – and accountabilities – for group and divisional heads.

### ONE POSSIBLE STRUCTURE FOR MEDIUM SIZE FIRMS

Clearly, there is no one-size-fits-all governance structure for any firm. However, medium size firms (of the sort of scale previously discussed) should consider making a clear distinction between the interests of partners as proprietors on the one hand and those of the firm as a business on the other. There are many ways of achieving this; one is by changing the structure to a three layered model. The three layers in this model would be the Partnership Board (mainly oriented towards the partners as owners), the Executive Board (mainly oriented towards the firm as a business) and the Divisions, Practice Areas or Groups (mainly oriented towards the delivery of client services).

#### 1. *The Partnership Board or Council*

This elected body would in effect act as the guardian or trustee for the partners. It would consist of the Senior Partner or Chairman, the Managing Partner or CEO and a number of directly elected members which might include representation from fixed share or salaried partners. Among its duties would be an overseer role for the firm's over-arching strategy, and in most cases, strategy formulation would start in this forum. It could, absent a separate

## RELATED RESOURCES

(all available on [www.KermaPartners.com](http://www.KermaPartners.com))

- THE ROLE OF THE MANAGING PARTNER; by Nick Jarrett-Kerr
- THE BIG PARTNERSHIP TENT; by Ed Wesemann
- FACING THE FUTURE; by Nick Jarrett-Kerr
- MANAGING THE CONSENSUS-BASED LAW FIRM; by Ed Wesemann

Compensation or Remuneration Committee, be responsible for partner remuneration and discipline. The Partnership Board or Council should also be responsible for the principles behind all the big decisions which are likely to affect the partners in their capacity of owners. Its responsibilities should include recommendations to the partners on all reserved matters – matters such as the opening and closing of offices, mergers, and partner promotions. One concern of any partnership is that there should be some checks and balances, hence some of the bizarre election processes referred to earlier. It would therefore be a primary purpose of the Board or Council to act as the firm's moderating and monitoring control on the operations of the Executive Board and the Leadership Team.

#### 2. *The Executive Board*

This Board would typically comprise the Managing Partner or CEO, and the senior management team (comprising the COO – if there is one – and the heads of professional functions such as Finance, HR, and Marketing); for many medium-sized firms these make up the leadership team. Additionally, a small selection of partners (who would usually be the group or

IN ORDER TO ACHIEVE THE OBJECTIVES OF ANY NEW GOVERNANCE STRUCTURE, PARTNERS NEED TO RECOGNISE THAT THE CHANGES WILL NOT JUST BE THEORETICAL BUT THAT THE WHOLE MODE OF OPERATION WILL ALTER. WHILST THERE WILL OF COURSE BE CONSULTATION, THERE WILL NO LONGER BE CONSENSUS ON MANY AREAS OF DECISION-MAKING.

divisional heads) should be members of the board. The Executive Board's responsibilities would include the formulation and implementation of annual budgets and business plans. This Board would have a big role in the context of the development of strategy and the detailed analysis which accompanies strategic planning. This work would be done in conjunction with the Partnership Council or under its overseeing eye. Strategy formulation and strategic positioning for some firms may be straightforward in concept terms but strategy implementation is never easy – the Executive Board has important executive duties here. Other responsibilities would include:

- **Driving and monitoring economic and business performance including the performance, both financial and operational, of each practice group and team, and the improvement of profitability, and**
- **The development and implementation of policies for the improvement of the firm's Intellectual Capital including risk management, quality, client care, human resources, IT and marketing.**

It may be controversial for some firms, but I believe that the partners with principal executive responsibility – those who will have a seat on the Executive Board – should be selected by the Managing Partner who needs to be free to choose and balance his or her management team. In many firms, there is a trend for the Managing Partner to be selected by a selection committee rather than by a direct election.

### *3. The Divisions, Practice Areas, and Departments*

There are many operations within a professional services firm that can only be done at a practitioner level. These are familiar to most firms and will not change much as the governance structure develops. The main responsibilities at this level include the apportionment of work between partners and teams and the setting of team/individual targets within the context of the overall budget and business plan. Consistent services must be delivered and knowledge management, workflows and precedents have to be developed. The division or practice area also needs to be accountable to the Managing Partner, and ultimately the partnership, for its performance, its quality of work and the development of expertise.

Although such responsibilities may be familiar, what is often missing on a day to day basis is appropriate implementation. Governance structures can only supply a framework in which accountability can happen, follow up occur, and the principles of active management can be adhered to.

### **HOW DO PARTNERS ADAPT AS THE GOVERNANCE STRUCTURE DEVELOPS?**

In order to achieve the objectives of any new governance structure, partners need to recognise that the changes will not just be theoretical but that the whole mode of operation will alter. Whilst there will of course be consultation, there will no longer be consensus on many areas of decision-making. The leadership team must be

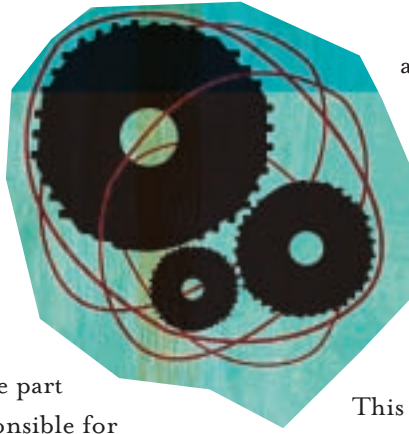


allowed to get on with its job and make decisions which would then be reported to the partnership. Additionally, those board members who are partners will not just be representing their office or division but need to understand that their role will be executive and decisive. They will be part of a leadership team which is responsible for driving the firm forward.

We come across many firms where the partners who are members of either of the main boards continue to regard attendance as both optional and secondary to their client work. For any vibrant business, meetings just have to take precedence over client work and should be run on a tighter corporate type model with properly prepared papers and focused discussion, and a minimum of 'house-keeping' and circular discussion.

Partners do not always respond well to such changes in management structures. At times, they will protest vocally, but often their protests are seen silently in undermining, back-sliding, and even subversion. Often partners will simply ignore edicts which they dislike and, if they get away with it once, will try the same trick again. At one firm, many major decisions of the board, until quite recently, were invariably reversed as a result of partner protests. Other decisions were frequently made by the board as a result of political pressure rather than business need.

Before making any changes, the firm leaders need to achieve three things. First, they must communicate a compelling view of the horizon which they visualise for the firm, and the structure which needs to be in place to enable the firm to move successfully towards that vision. Second, they need to anticipate the likely obstacles to sensible and disciplined governance



at an emotional level within the partnership, bearing in mind the loss of influence which many partners will feel that a new structure will entail. Third, they must work to build up trust and confidence amongst partners.

This is why it is important for partners to discuss structural issues openly and maturely, recognising that if the firm is to progress, the implementation of strong but sensible management needs to be accompanied by responsible and accountable partner behaviour.

### CONCLUSION

It is often correctly said that structure should follow strategy, but in our view it should not lag far behind. As firms consolidate and grow, there is a constant need to keep a watchful eye on the management and decision-making processes in any firm, and the likely transition points when changes need to be made. The design of the changed structure is critical – it needs to be fit for current and future purposes – but how those modifications are proposed and steered through the partnership requires a deft touch.

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