

“Fortune calls” – compensation and legal service delivery



By Patrick Dransfield

When shopping in the beautiful Indonesian handicrafts store, Alun Alun, I wondered why none of the sales staff would help me beyond three feet of their glass table. They all wore the same uniform and everything appeared under the brand Alun Alun. I realised of course, they were paid and received commission from smaller individual franchisees. The commission structure directly affected their service to me. How much like the ‘eat what you kill’ model of a law firm partnership

structure? The over-arching branding appears the same but how incentivised is the partner to help me beyond his own office or practice group?

It is my premise that partner compensation lies at the heart of the partnership-structured law firm, and how a partner is compensated dictates how he behaves towards his colleagues, and as a consequence, what level of service he and his firm delivers to their clients. Therefore, it is my belief that, to borrow ‘Freakonomics’ Steven D Levitt’s¹ phrase “the hidden side

of everything”, it is important to ask what system of compensation for partners a law firm employs when considering the law firm as a panel firm or a regular service provider.

The purpose of this article is not to judge any particular system but to alert in-house counsel to the relationship between compensation and partner behaviour, and hence to be able to evaluate the likely service level of a particular firm with ‘eyes wide open’. I have put together a table (below) of the most common compensation

Eat What You Kill

Solely rewards partners’ individual efforts

Pros: Every partner has total responsibility for his income and clients

Cons: Total lack of responsibility for managing the firm. No collegiality

Modified Hale & Dorr

First incentive based compensation system dividing partner activity into Finders: Minders: and Grinders

Pros: Much better than any other system at rewarding individual partners as based solely on billable hour

Cons: does not reward partners for management, training etc.

Simple Unit

Mixed criteria for compensation, based on firm’s strategic goals

Pros: Simple, and therefore seemingly ‘fair’

Cons: Encourages Client hoarding and hence potentially not client-friendly

Lockstep

Each partner is rewarded an ever-increasing share of the firm’s profits, based solely on seniority

Pros: Firm’s management is stable and partners enjoy security

Cons: Potential for disaffection of younger partners: firm may stagnate

Potentially Less Client-Friendly

systems currently employed by law firm partnerships and also indicated which are most likely to bring collegiality and reward partners who ‘play nicely’. At best this is very rough and – as firms move away from the billable hour – likely to prove out of date pretty quickly. However, as a rule of thumb, I hope it proves a useful guide when general counsel ask potential panel law firms what compensation system they employ and how this compensation system is woven into the core values and strategic goals of the partnership.

Good incentive

Debevoise & Plimpton, for example, has adopted the lockstep system of compensation, a system that it shares with certain of its peer firms in New York (examples include Cravath, Swaine & Moore, Davis Polk & Wardwell and Simpson Thacher & Bartlett, among others). Christopher K. Tahbaz, Partner and Co-Chair of

Asian Litigation at Debevoise shared with me the following insights into the firm’s compensation structure:

“Debevoise is a lockstep partnership with only one partnership tier, and we all are equity partners. With the lockstep model, we are able to service clients around the world with a team that is best suited for that client’s needs. Lockstep partnership allows us to service clients across all disciplines as well, leading to the lawyer with the most relevant experience joining the team. For example, if there is an intellectual property lawyer in New York

needed for a client I am working with in Asia, I would not hesitate in involving that lawyer. This structure keeps the focus on providing the best client service, and removes internal conflict from the compensation equation”.

To quote Levitt “experts are humans and humans respond to incentives. How any given expert treats you, therefore, will depend on how that expert’s incentives are set up. This is no idle matter but based on empirical evidence.”

A compensation system should relate to the law firm’s strategic goals

“A lockstep partnership allows us to service clients across all disciplines leading to the lawyer with the most relevant experience joining the team”



Christopher K. Tahbaz

Equal Partnership	50/50 Subjective – Objective	Team Building
Typically used by smaller firms. Assumption all partners contribute equally albeit in different ways	40 percent based on billings 10 percent client generation 50 percent Subjective criteria, including Client satisfaction, Training of associates etc.	Compensation determined by firm/ practice group profitability
Pros: Focused on firm profitability and client service	Pros: Flexibility in what is rewarded (eg client relations, training of juniors). Builds collegiality	Pros: Encourages true sharing of Client Matters
Cons: No financial reason for extra individual effort by partner	Cons: Too ‘touchy-feely’ – not objective and not individual profit-orientated. Open to manipulation	Cons: Doesn’t reward ‘star performers’ who therefore may not stay

Potentially More Client-Friendly

– and a global law firm needs to get the basic building block of compensation right. To mangle for our purposes a phrase from Joseph Schumpeter (1883–1950), “the condition of the monetary being of a firm is a symptom of all its conditions. Everything a firm wants,

does, suffers, and is, is reflected in its monetary system.”

Thus, if a firm with global ambitions claims to be ‘client first’ but employs an ‘eat what you kill’ compensation system, then there will almost certainly be a mismatch between its

stated mission (potentially pure marketing spiel) and the actual behaviour of its individual partners and offices within the network. Important if you are putting together a multi-jurisdictional deal!

Footnote

- 1) “*Freakonomics: A Rogue Economist Explores the Hidden Side of Everything*” by Steven Levitt and Stephen Dubner, Joanna Cotler Books, 2005

End note

I am grateful to Caroline Lim, Leader of Legal Risk, Compliance & Government Affairs, Asia Pacific, and her team at Heidrick & Struggles for providing both inspiration and research for the above.

Patrick Dransfield is the Publishing Director of Pacific Business Press and Co-Director of In-House Community™. He has fifteen years experience working alongside the legal industry, including eight years of working directly for international firms (Shearman & Sterling and White & Case, respectively) as Marketing Director, Asia-Pacific.

Blane R Prescott, is the Chief Executive Officer of law firm Brown, Stein, Hyatt, Faber Schrek where he manages the overall business and strategy of the firm. Brown, Stein, Hyatt, Faber Schrek is also the fourth largest lobbying firm in the US. Prescott most recently served as a Senior Vice President and Managing Director for Hildebrandt Baker Robbins where he helped professional service firms around the world develop strategy and tackle leadership and management issues. Here he shares with Patrick Dransfield his experience on compensation, strategy and law firm management.

AMC: ‘Lockstep’ or ‘eat what you kill’, a ‘hybrid’ – or ‘something new’? What is the best system to link client service performance with compensation?

It has been observed, both anecdotally and through more rigorous psychological studies, that both lawyers and law firms tend to avoid difficult internal issues. And this seems to be especially true when those issues involve personal performance and compensation. This is one of many reasons that

lockstep and pure formula ‘eat what you kill’ compensation systems were so popular for so long. But as the profession became more competitive, the lockstep method of blindly paying everyone as if they were ultimately presumed to make the same contribution began to show its obvious flaws. And likewise with formula approaches to compensation, it has been repeatedly shown that simplistic measures often produce simplistic behaviors that aren’t always consistent with teamwork, client interests, or profitability. Despite the overwhelming evidence that complex behaviors involving cognitive skills are not easily motivated by simplistic financial incentives, law firms continue to search for magic solutions to compensation that require a minimum of effort.

So what does work? It is amazing that law firms are slow to pick up on the research and experience that shows an individually tailored compensation approach that is customised around the strengths of the individual tends to outperform almost every other form of compensation. There are highly successful, well developed systems in widespread use that rely heavily on

leaders spending time to both understand and guide the performance of individual partners in ways that first and foremost benefit the firm, and second by making it explicitly clear to each partner how their unique skills and contributions can maximise their own compensation. The challenge is that ‘maximise their own compensation’ is different than the highest compensation in the firm.

AMC: What are the two most important concepts you have learned over time about compensation?

First, you actually have to talk with people and spend the time both understanding them and helping them, and second, you actually have to be honest with them (about their own compensation potential, their strengths and their weaknesses, etc.). The second concept is made immeasurably easier if you have that rare ability to have difficult conversations with people without allowing it to become personal, primarily through your ability to truly convince them that you are trying to help them (which isn’t always easy with highly skeptical people).

AMC: *Is there an optimum limit to the number of partners in a firm to deliver true value to their clients?*

No. There isn't so much an absolute size limit, but rather, success and value are most likely dependent on whether the firm has enough great, natural leaders to guide the performance and behavior of the partners. If you believe the studies which say less than five percent of the population has great leadership skills, and consider the fact that in most law firms most partners presume they are all in that five percent, you run into an obvious problem. There isn't so much a size limit, as there is a shortage of leaders and a basic lack of willing followers.

AMC: *As clients move away from being billed by the hour, what effect does this have on the way that lawyers will get compensated in the future?*

As we have seen in recent years, there is a significant shift to profitability

“The problem with this shift to profitability testing is that many law firms take simplistic approaches, not realising that their methods may actually discourage teamwork, or discourage what is in the best interests of their clients”



Blane R Prescott

testing. For a long time, law firms only focused on some of the vague indicators of profitability – hours, realisation, and occasionally leverage. But that focus on such indicators was sufficient when the legal profession was largely a sellers' market. As the market has evolved and profits have become harder to come by, law firms have learned that those indicators no longer guarantee profits. So logically, law firms are now rapidly shifting to looking at the actual profits being generated at a 'matter' or 'client' level

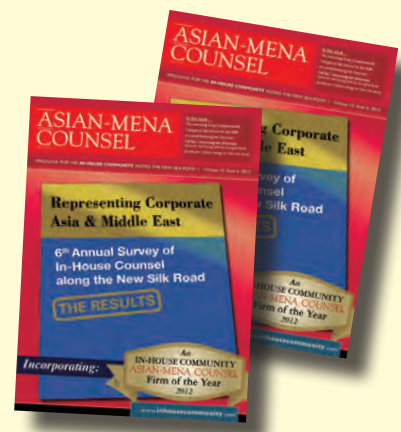
as one of the key indicators of performance. The problem with this shift to profitability testing is that many law firms take simplistic approaches, not realising that their methods may actually discourage teamwork, or discourage what is in the best interests of their clients (keep in mind, your being profitable is not necessarily bad for your clients). Focusing on profitability of matters and clients tends to be a far more useful and successful approach than the testing of individual lawyer profitability.

In next month's issue...

The upcoming issue of ASIAN-MENA COUNSEL features the findings of our landmark annual **Representing Corporate Asia & Middle East survey of the In-House Community**. Now in its sixth year, and with a record number of senior in-house counsel contributing, the report provides the most representative, and widely read assessment of the mindset of, and the challenges facing the In-House Community across the Asia-MENA region. Derived entirely from the votes and testimonials of in-house practitioners, the report also includes a full run-down of ASIAN-MENA COUNSEL's **In-House Community Firms of the Year, 2012**. Find out which law firms were able to distinguish themselves in each jurisdiction, and read about the qualities that gave our winners a leading edge.



Magazine for the In-House Community
www.inhousecommunity.com



For information on how to contribute
email: editorial@inhousecommunity.com