

PETER SCOTT CONSULTING

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All – equity LLPs / partnerships: A future model for some firms?

If your firm has equity and non-equity categories of membership / partnership, when did you last look at that structure and ask the question –

*Why do we have equity members / partners **and** fixed share / salaried members / partners?*

Even if you may be able to identify the reasons why your firm initially established or has continued with that structure, it may still be helpful to question whether having a non-equity category is helping or hindering your firm to achieve its goals. Re-visiting an old decision is never a bad thing, particularly in a fast-changing environment such as today's legal markets because the original rationale may have ceased to be valid. The recent HMRC proposals setting out new rules for salaried members of LLPs have brought into sharp focus the position of fixed share members, and this is now requiring firms with such members to urgently rethink their structures. However in this Briefing Note I will also discuss partnerships which, although not caught by the new rules, can still have issues brought about by having different categories of partnership.

It may be instructive to look at some of the reasons given for why firms have developed and retain salaried / fixed share partnerships (some of which I myself used when I was managing a firm) –

- There was a time when the names of partners were listed on the notepaper, and being seen to have a large number of partners mattered to some. That as a reason for appointing salaried partners would appear to have largely disappeared, although I have recently heard of small firms appointing salaried partners just to make up the numbers because their insurers require a minimum number.
- Other firms have appointed senior associates as salaried or fixed share partners because otherwise they fear they will lose those people. Retaining high quality people is vital if firms are to maintain their competitiveness, and elevation to salaried or fixed share partnership has often been seen as necessary to keep the best talent (at least for a while). However, how much thought is ever given to whether a particular senior associate whose services a firm is keen to retain, is ready or suited to becoming a salaried or fixed share partner or will ever become an equity partner? Alternatively, is it ever considered that such a person should become an equity partner immediately, or is some form of non-equity partnership regarded by some firms as a necessary 'rite of passage'? I suspect that too often the non-equity model

is so embedded in a firm's culture that little thought is given to whether there might be an alternative.

- On the other hand, some forward thinking firms have developed well – thought through and transparent career paths for their people which include progression to salaried and fixed share partnership as a clearly defined stepping stone to equity, and clear indications are given as to what will need to be achieved to successfully navigate the gateways to equity, with support provided by the firm. However, even some of these firms are now looking at whether their partnership structures, which may have served them quite well in the past, are now fit for purpose.

However, having a non-equity category of partnership can also create its own problems as illustrated by the following comments made by some fixed share partners in answer to an internal questionnaire –

What do you like / dislike most about the Firm?

Dislike – the Them (equity partners) and Us (fixed share partners) – not peculiar to this firm.

How motivated do you feel?

At the moment not very. As a fixed share partner I would be very wary about changing business practices etc just to boost equity partners' profits.

It has been difficult to maintain motivation in so far as my partner role is concerned.

What hurdles are there to change?

Partnership structure – we have many more fixed share partners than the firm had historically.

To establish a culture within the Partnership which allows for open and constructive discussion.

A 'them and us' environment can easily occur, particularly if the non-equity partners are conspicuously excluded from any involvement in the running of the firm. How many firms have two parts to their partners' meetings – one for all partners at the end of which the non-equities are asked to leave? That can easily sow the seeds of discontent.

Holding out someone as a partner or as a member of an LLP who is unsuited to or unprepared for the role is unlikely to enhance a firm's reputation, either externally or

internally. However, there has been an assumption that most lawyers / professionals want to become partners.

But is this the case? Are firms asking their people what they want from their careers?

Not everyone wishes or is suited to becoming a partner, and instead of shoe-horning unsuitable or unprepared people into non-equity partner roles, firms need to be able to persuade those who cannot or do not wish to make the jump to partnership that there is still a very worthwhile and well-paid career within the firm.

If as a result of the HMRC salaried member rules, LLPs choose (as it seems many are proposing to do) to go down the capital contribution route, then they may also need to consider afresh how they reward and involve their fixed share members who may now have issues with **the balance of their risk and reward** having contributed a large amount of capital to the firm. I would suggest that any firm considering going down this road should stand back from the immediate issue (the new rules) and carefully consider the overall picture with a view to arriving at a well – thought out structure capable of serving the needs of the firm for the longer term.

If firms do decide to move to an all-equity model this will require them to structure and manage their partnership / LLP arrangements differently in a number of respects. For example -

Partner preparation

The gateways to equity partnership will be more demanding, using objective criteria for partner admittance and it is likely that less people will come through to partnership, which will become a prize worth working for. Potential partners should not just be selected but will need to be supported and developed for their future roles. Putting in place effective processes to do this will be necessary if -

- New partners are to be ready to make an immediate business contribution
- An unnecessary churn is to be avoided of potential partners who leave because of uncertainty of prospects or disillusionment
- Bringing in partners who are not ready, with all the problems that can cause, is to be avoided
- Aspiring partners are to be introduced to the behaviour and attitudes required of them
- The career expectations of those who want partnership but who are not ready, are to be managed
- Those who decide they do not want partnership or who are just not cut out for it, are to be motivated

Some firms already have in place fast track coaching programmes for those identified as having the drive and potential to make equity partner. Through performance planning they have one to one coaching which can directly support those participating to achieve high performance and to make them ready for partnership.

Such programmes can –

- Show that a firm is investing in its people, so helping to attract and retain good talent
- Bring through a stream of suitable partners
- Improve performance through enhanced skills in crucial areas such as client development, financial management, leadership and entrepreneurship.
- Manage career expectations and avoid unnecessary disillusionment.

Partner reward structures

If firms move to an all-equity model then partner reward structures, particularly if a group of former fixed share or salaried partners are taken into equity, will need to be reviewed to see whether the existing profit sharing system –

- will help to achieve the firm's objectives; and
- will fairly reward each partner's contribution to the firm.

Firms should never underestimate the damage that can be caused if partners perceive that their contribution is not being valued and fairly rewarded. *Relative reward* between partners can be a driver of unhappiness if one partner thinks he or she is worth more than another partner but this not being reflected in terms of their relative rewards.

On the other hand, absolute reward is also important to many partners and in every legal market there is a threshold level of average partner profitability which will need to be achieved or exceeded if the best partners are to be recruited and retained by a firm. A firm which is below that level risks losing its best people to more profitable firms and will be unable to offer competitive financial rewards to recruit the best in the market.

A firm that wants to be successful in today's competitive markets must ensure that it has access to highly trained, skilled and motivated people who are high achievers. Increasingly, firms are moving to performance-based remuneration systems as performance management has for long been recognised as a key component to gain competitive advantage. Two of the most common purposes for which performance is measured are **reward and progression** within a firm and these can be used to attract and retain key partners who are outstanding performers and who will be instrumental in building a firm's future success.

And a firm's people will need to know in which key areas their performance will be measured, their performance goals and how their performance rates against these goals. Actively managing performance in this way will be a critical objective if a firm is to outperform its rivals.

If a firm is considering a move to a performance - based reward structure or is thinking of changing its current performance - based reward structure, then the objectives of doing so will need to be carefully thought through. Ideally such changes should -

- Have a strong emphasis on areas of performance which are consistent with and advance the strategic goals of the firm
- Help to maintain the firm's competitive positioning in the partner recruitment market
- Determine the relative contribution of each partner with respect to other partners, by differentiating rewards for high performers from those of average performers. If problems exist with underperformers, then that problem should be addressed outside the reward structure.
- Establish individual partner goals and aim to move partners towards their strengths and away from their weaknesses
- Reward sustained performance

Performance criteria are fundamental to developing a reward strategy and a firm should consider what its people should be doing differently / better / more of / less of, to drive innovation and client satisfaction and to advance a firm's competitive goals, by helping to develop higher levels of achievement in relation to, for example -

- Client service
- Skills and expertise
- A culture of sharing
- Enhanced financial performance (not just individual billings)
- Enhancement of a firm's reputation and profile
- Market share

Performance criteria should ideally cover both activities that are an investment in longer term competitiveness and short term profitability, and can relate to individual performance as well as group performance, depending upon a firm's objectives.

Linking performance management to a reward structure requires that the process is (and is seen by partners to be) fair and equitable and rewards those that contribute most to a firm's success. The performance review process therefore becomes critical if a performance related reward structure is to be successful and achieve its objectives.

Crucial to this process is the requirement for **trust and confidence** between those who assess performance and determine rewards and the rest of the partner. This is particularly important where, instead of using a formulaic performance measurement system

in which data is entered and reward is automatically calculated, a more subjective approach is used, as where a remuneration committee determines the compensation due to a partner based on their knowledge and judgment of that partner's contribution to the firm.

I am not suggesting in this Briefing Note that the all-equity model is right for all firms, but it may become an appropriate structure for some if it can be seen to help a firm better achieve its goals. However, one of the greatest challenges for such businesses will be how to attract and retain good talent in the absence of equity partnership prospects. This is a challenge also now being experienced by externally-owned ABSs as they try to find ways to show aspiring lawyers that they can still have worthwhile and rewarding careers in those businesses even though partnership / ownership is not on offer.

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