

Remuneration systems for partners of law firms

19/10/2016

Practice Management analysis: Following news that Linklaters partners are due to vote on changes to their lockstep remuneration structure, Peter Scott, principal of Peter Scott Consulting and former managing partner of Eversheds' London and European offices, examines the potential alternative methods of law firm remuneration.

Can you outline the most usual forms of remuneration for equity partners?

While it is probably true to say that there are as many forms of partner remuneration as there are law firms, in the sense that every firm is different and has different needs and objectives, two basic types of reward models have evolved (and are still evolving):

Lockstep

This is where remuneration is based solely on seniority and where a partner climbs a 'lockstep' over a period of years, starting from a low base (perhaps 50% of a full share) until the partner becomes 'whole' with an equal full share. The partner then remains on that plateau until retirement. This is often known as 'traditional' lockstep and many firms still cling to this form of 'dividing up the spoils', despite both internal and external pressures for change.

Modified lockstep arrangements

These involve, to varying degrees, using various elements of partner performance as criteria for both a partner's advancement up a lockstep and allocation of reward. There is no 'one size fits all', many remuneration structures employ elements from traditional lockstep linked to the application of performance management disciplines.

Eat what you kill

I do not regard 'eat what you kill' as a true remuneration model or as something desirable for a law firm. It is often used in situations which are not partnerships but merely cost sharing arrangements—the participants share certain overheads but otherwise keep everything they generate as individuals. It is suited to barristers' chambers and other professions such as dentists' practices.

What are the pressures on firms that may cause them to review their forms of remuneration? In particular, several large firms are reported recently to be altering their lockstep arrangements. If so, what is the reasoning behind it?

All law firms exist in markets where performance by their people is all-important. As competition between firms becomes more intense as firms strive to gain a competitive advantage over rivals, the competition between firms for 'top talent' likewise increases. Reward is driven by market considerations—firms unable to offer competitive rewards in their markets risk not only losing their outstanding people but also being unable to recruit the best.

This intense competition for law firm talent is currently well illustrated by a number of the best known City firms having to rethink their traditional lockstep models or revise their existing modified locksteps. This is an attempt to make themselves less vulnerable to losing some of their best talent to poaching by (in particular) US law firms in London. These firms are likely to have well-developed and heavily performance-based reward structures which will give star performers the chance to be paid what they consider they are 'worth'. The notion of 'relative worth', whereby a partner considers he or she is 'worth' more than fellow partners because of the greater contribution he or she makes, can be a powerful driver to feeling 'under-valued' and a strong incentive to considering offers of better-remunerated partnership elsewhere based upon merit.

For these reasons, performance-based remuneration models which can effectively measure 'relative worth' and more fairly match remuneration to a partner's contribution are now becoming attractive to many partners, whether they are in large City-based firms or in smaller firms elsewhere.

How have pressures such as those you have described changed how firms in the UK have rewarded partners in recent years? You mention US law firms—is there much difference between firms here and in the US?

While many firms, particularly smaller ones, continue to retain traditional lockstep, on the other hand (for the reasons mentioned above associated with competitive advantage), there has been a growing trend for a number of years of firms moving away from traditional seniority-driven lockstep to some form of performance-related modified lockstep.

The reason why the traditional lockstep model is less widespread now is because for many firms, in current market conditions, it no longer appears 'fit for purpose'. This is because it:

- o is unlikely to 'fairly' match reward to contribution
- o may not measure 'relative worth' between partners
- o may be inflexible and not capable of responding to the strategic needs of a firm, and
- o may demotivate and disincorporate the best performers

Reward systems which incorporate performance elements which form, to varying degrees, a basis for advancement up a lockstep and as a basis for reward have for many years been gaining in popularity and use. This process is likely to continue at an accelerating pace.

Compared with a traditional lockstep, a well thought out performance-related reward system which has a strong emphasis on merit and performance across a broad range of criteria is likely to be more attractive to a firm because it should:

- o help to build a firm's competitive position in the talent market
- o help to advance achievement of a firm's strategic goals
- o encourage the development of new skills, experience, capabilities and motivation within a firm
- o help to create a culture of high performance and sharing to gain a competitive advantage over rivals, and
- o determine the relative contribution of each partner with respect to other partners by differentiating between high and average performers ('underperformers' should be dealt with separately outside of a reward structure)

Clearly, developing a range of performance criteria designed to enhance a firm's competitive edge is fundamental to implementing an effective performance-related reward system. Criteria will differ from firm to firm and will need to be amended to meet market challenges from time to time. They are likely to be broadly-based and include, for example:

- o developing and maintaining profitable client relationships
- o enhancing profitability and managing cash flow (but not just personal billings)
- o managing people and projects, and
- o internal sharing and co-selling

UK law firms have tended to lag behind some US law firms in evolving modified lockstep remuneration based around performance. This could possibly be because of differences in business cultures—are US law firms in general perhaps more meritocratic than some of their UK counterparts? Whatever the reasons, many US law firms have over time developed effective ways to measure the 'worth' of their partners and to allocate reward based on that relative worth in a way which, as recent events in the London market have illustrated, can serve to enhance a firm's competitive edge in the 'war on talent'.

Are there any forms of remuneration systems that firms could consider that are used elsewhere or in other professions or industries?

Increasingly some law firms are beginning to implement partner reward systems, based not only around the individual's contribution to the business, but also on how the group, of which the individual is a part, has performed. The group might be an individual office, or a sector-based or discipline-based group within an office or across a firm. Group-based reward can be particularly beneficial for a firm in so far as it can encourage team working for the good of all, instead of individuals competing against each other.

On the other hand, taking 'ready-made' systems from other firms, professions or industries can be dangerous because each law firm will have its own 'culture' and what may have worked well in one firm, profession or industry may well be a disaster when implemented in a particular firm. In a partnership in particular, it is important to build consensus and 'take partners with you' rather than attempting to foist a remuneration system on them. A quote from one of David Maister's books is very much to the point:

'Those who contribute the most to the overall success of the office are the most highly rewarded. Notice that this does not suggest what the pay scheme should be. *The determining factor is just whether the people think it rewards the right people* (emphasis added).'

Whatever the form of the remuneration system and in whatever industry or profession, the challenge is always to ensure that if it is performance-based, then that performance can be accurately and objectively measured. However, I would not recommend an arithmetical approach (as tends to happen with systems designed by accountants) resulting in some form of point's score, as no performance measurement using a number of broad criteria of the type I have mentioned above can be that accurate. It is for this reason that just a few broad performance categories are usually recommended, particularly where a firm is looking at rewarding exceptional performance as against average performance. Likewise, in a partnership the process of allocating reward should be carried out in a transparent manner which builds trust and confidence in the system.

How do you think the structure of partner remuneration may change in the future?

Whichever system a firm currently uses to reward its partners, as the competition between firms becomes ever more intense, if it wants to be successful in the future it will need to consider whether its current remuneration system is working well for the firm or is actually holding it back.

From my observations of what is happening in the profession and within law firms because of the pressures mentioned earlier, I am seeing increasing moves towards more performance-based reward within both large and smaller firms.

Interviewed by Diana Bentley.

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