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MEANINGFUL COMPENSATION FOR PRACTICE AND INDUSTRY TEAM LEADERS (AND TEAMS) – HOW IMPORTANT IS IT?

by

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This monograph addresses the increasingly important topic of rewards and compensation for practice and industry team performance. Included are a summary of the monograph to set the stage, an update of the legal marketplace, summarized responsibilities of practice/industry teams, some brief thoughts on partner compensation systems, and, finally, our suggested approach.

Summary

First, the answer to the critical question posed in the above title is simple – **it is very, very important!** If the successful future of a law firm of any reasonable size is dependent on successful growth and development, then – from within – that growth and development must be achieved through direct management and performance at the team/group level. And, achieving that performance and growth at the team level requires specific compensation and recognition.

The problem is that too few firms – either at all or meaningfully – compensate team leaders and members for team performance. The perfect answer (and remember, that perfect is the enemy of the good) is to completely revise compensation systems to include team performance. While that is the perfect answer, it is not done in most firms very often (and, it certainly will not be just because a consulting firm says it should). Rather, we recommend the process of *"grafting"* rewards and recognition for team performance onto and within existing partner compensation systems – something virtually any firm can do.

In the remainder of this monograph, we make the case for and spell out our specific recommendation.

The Legal Marketplace

As I look at law firm management effectiveness in the context of the 33 years I have consulted to law firm managements and the 47 years that I have been a strategic management consultant, I see a slow, but steady evolution from the mid-1980s to today (with some increased acceleration in the last few years).

- In many ways, this evolution resembles the effect that Tiger Woods had on the professional golf tour. The men's PGA tour in the 1980s and into the 90s was essentially a fraternity of very good golfers who competed hard, but were not hardened and chiseled athletes (like they are now). Their evenings were not spent in the workout trailer, unless socially lifting 12 ounce weights is considered exercise.

- Tiger changed all that. He was in tremendous physical shape, he stayed that way, he definitely knew how to win, and he worked out at night (okay, not every night). In order to compete, the other golfers had to get in shape (in fact, to a very high level) and figure out how to win. Look at the top PGA tour golfers today – many of them are in as good or better shape than Tiger was at the apex of his career and there are no longer afraid of Tiger Woods – or anyone else for that matter.

Going back to that earlier time period, law firm management was often a part-time thing, it really did not impact firm results (unless managements were truly horrible – and some were), and the partners in most firms voiced the incorrect and illogical opinion that they were *"a profession, not a business."* No, law firms then and now were in the business of providing professional services which requires effective management to be successful in both the short and longer term.

It was recognized that practicing law – for many lawyers and their firms – was very, very lucrative. Smart young women and men recognized that by going to law school they could find a position that took advantage of their inherent smarts and their work ethic and, if lucky, they would make a heckuva lot of money.

But, a number of things happened on the way to income increases as far as the eye could see. The legal market became considerably more competitive for clients and talent, competition from outside the legal profession began to worm its way in (although that has generally subsided), and clients began looking for real talent in the areas they needed help and/or experience in the industry (or industries) of their businesses, thus forcing law firms to organize by practice and industry specialization.

Although there had been historical downturns, they were minor in nature and most savvy law firm managers could say that the practice of law was reasonably risk free. Then came the Great Recession (2008 to 2010), which accelerated the level of competition, led in some cases to significant attorney layoffs, and made it clear that change was necessary. Improved firm and practice management, effective use of management data, and new creative methods to manage the practice of law became necessary to grow and to remain successful.

The Strategic Growth Imperative

Smock Law Firm Consultants has always preached that growth is as essential for law firm strategic success as it is for any business. In the long-term, if you do not grow, you do not survive.

There are three common primary growth strategies for law firms to consider:

- **Recruiting talented laterals** primarily at the partner level (but also associates), preferably bringing with them books of profitable business

- Emphasizing client service and focus through **practice and industry teams** that provide services and counsel that meet the needs of legal service areas or industries and grow a firm's reputation (or brand)

- **Combining with another law firm or other law firms** in such a way that the resulting firm is in a stronger competitive position to serve its clients and to grow.

We believe that the appropriate way for a well led and managed law firm to grow is to embrace all three of these generic strategies and apply them to the specifics of a given firm and its markets.

The first of these three strategies presents the least probability of achieving any substantive growth – as unfortunately, adding laterals is usually accompanied by continuing natural and unnatural attrition. In many ways, recruiting laterals has become the default strategic growth approach, because law firms do not run their practice and industry teams as well as they should and there is an inherent internal resistance to merging. SLFC conducts an end of the year survey, as we will this year, and we expect that this first inherent growth strategy (i.e. - growth by laterals) will still be at the top of the list.

However, we are finally seeing a continually improving capability and capacity to lead and manage effective practice and industry teams. Simply put, whether a firm wants to combine/merge or not, it has to manage what it has and get better and better at doing it, because that is the competitive market imperative. Well-run, focused practice and industry teams offer the best opportunity for consistent and continuing growth in the near term.

We have written extensively and spent a good bit of our actual client time working on potential mergers and combinations. If a firm wants to grow in the long-term, there is no better strategy than finding a like firm or firms that also want to grow and have complementary practices, clients, management principles, and marketing approaches. This creates a "*new firm*" to achieve important synergies, serve clients better, upgrade their competitive position, and make more money. But, doing so is a lot easier said then done.

While we do support and encourage all three of these generic growth strategies, the rest of this monograph is focused on the second – improving the management of practice and industry teams by improving the reward and motivation processes for those teams and the individuals in those teams (primarily its leaders, but also its members).

<u>The Leadership, Management, and Development of Practice and/or Industry Teams</u>

The idea of providing compensation and/or rewards to your practice and industry team leaders presupposes that this compensation and these rewards are based on solid performance. A caveat is called for here. One of my favorite comedians, for years, has been Steve Martin and while there are a lot of comedy bits that he did/does well, I believe there is a real message in one. Remember when he said he was going to tell you *"how to make a million dollars and not pay any taxes."* The first step, of course, was to *"**make a million dollars**."* In the same context, meaningful compensation and/or rewards to practice team leaders (or members) presupposes effective practice and industry team organization, management, and performance. Rewards have to follow true accomplishments or they are not rewards.

For the purposes of this monograph, we are assuming practice and industry teams to be essentially the same thing – a cohesive group of attorneys focused on the same area of practice or the same industry and responsible for four key functions – marketing and client acquisition, client service delivery and satisfaction, financial and operational performance, and people development. You can click through here to see our most recent monograph (summer of 2016) on practice and industry team effectiveness.

Following are the characteristics that need to be included in effective practice team management:

- A clear, well understood firmwide practice team organization and a clear articulation of the responsibilities of teams, their leaders, and their members (each has to have a role)
- Assigned leadership – with very few exceptions, practice teams require a single leader
- ***"It's the team, not the leader"*** – firms need to focus attention on the involvement of the full team, expect all team members to fully participate in their specific roles, and have their performance, as members of the team, rewarded and/or sanctioned
- Reflect reality – the needs of the clients and/or industries that those teams serve and the services those teams provide, dictate what the team looks like and how it is structured
- Broad delegation within the team – partners (and associates, paralegals, and staff) within the team each need some team related responsibility/task for which they are accountable to the full team and, ultimately, to the firm
- Planning and budgeting – teams should be held accountable for achieving a budgeted and agreed upon **contribution to profit**
- Sufficient support and resources.

If practice/industry teams perform in excess of their plans (or above the expectations placed on them), then it is natural for them to expect to be rewarded – this is capitalism, is it not?

<u>Some Thoughts on Partner Compensation Systems</u>

But, partner compensation and partner compensation systems in law firms tend to be very different than executive compensation systems in companies/corporations. Usually executives are rewarded for overall company performance and, specifically, for performance against the plan/budget of the unit for which they are responsible.

Partner compensation in a law firm is an individual focused relationship between the firm and the individual partner. Even when all partners' compensation is considered, the statistic most often used is PPEP (Profits per Equity Partner) – still a focus on the individual.

Virtually every firm has a different partner compensation system – many have evolved over a long period of time and represent years of tinkering and compromises. Most are both reasonably effective and supported by the partners in a firm.

Most firms' systems compensate or reward results that a partner is individually responsible for (either origination, billing responsibility, or matter/case responsibility).

- The systems are either *"objective"* (based on a formula for rewarding the above specific responsibilities) or *"subjective"* (a relative decision in comparison to other partners, based on performance against the above responsibilities and other factors, like firm citizenship). Most systems though are a combination of both objective and subjective – although we have seen pure objective systems work well and fully subjective systems work well.

- Also, partner compensation systems can be either *"open"* (where all of the partners know what all of the other partners make) or *"closed"* (where individual partner compensation is confidential and only a few people know who makes what). Over the years, there has been a definitive trend toward more *"open"* systems. But, there still are a number of firms that have closed systems and we have seen both open and closed systems work very well.

- These are simple and straightforward concepts – but the way they come together in a specific firm is usually quite different from other firms. Virtually all law firm partner compensation systems differ from each other to some degree and, thus, that is why they are such a significant obstacle in effecting meaningful mergers/ combinations.

If you do simple secondary research on law firm partner compensation systems, you will pull up a number of articles by consultants dogmatically arguing for one form of compensation over another, mostly open. We have found that what works depends on the firm, how it operates, and its culture. Usually, you can assume that Firm A's system works well for Firm A and Firm B's works well for Firm B. And, we always disagree with dogma, be it relative to partner compensation or any other element of law firm management.

However, what virtually no system does well is reward, accurately and comprehensively, team activities and team leadership – primarily because the whole concept of teams is new and partners' concern with compensation systems (and, really, relative compensation) has been an important emotional issue for the 30+ years I have served law firms. Most present law firm partner compensation systems reward what was important then, not necessarily what is important now.

<u>SLFC's Suggestion for an Easy to Develop System to Reward Practice/Industry Team Leadership</u>

First, recognize that most practice/industry team leaders are not now rewarded directly for either the responsibilities they perform as team leader or the performance of the team. But actually, they usually are through some jimmying of the existing individual compensation system to ensure that they get some compensation that recognizes team leader responsibility.

- That might be, and often is, a stipend (say, $25,000 or more extra per year to be a team leader). Also and in virtually all cases, team members (remember, it is the team, not the leaders, that is the true secret to success) receive no compensation adjustments for team performance (or lack thereof).

- Thus, in most firms, neither the team leaders nor team members are directly rewarded for performance. A number of firms will say that *"we take that (team leadership and/or membership) into account in considering partner compensation,"* but there is little evidence that they really do that.

In a perfect world, the best way to ensure the recognition and reward of team leader and team performance is to redo the present compensation (yes, a system overhaul) to reflect the reality of and importance of team leader/member performance. We could easily end this monograph with that recommendation – but, virtually no one will ever implement it. So, we are suggesting a different approach for doing this that should fit most, if not all, firms and, importantly, be easy to implement and, importantly, can easily be accomplished sooner rather than later.

The reason we included the brief information before on the key things practice/industry teams should do was the premise and our belief that (as in Steve Martin), you first have to manage your practice teams effectively and achieve measurable and desired results in order to be able to accurately and fairly distribute rewards to leaders and members.

The key management tool used in achieving practice/industry team success is the development and implementation of a rational, effective, quantified, and well implemented planning system. In our suggested approach, the annual team plans (that is right, every single one of them) become the basis for not only managing the firm and the teams, but for rewarding the leaders and team members.

The comprehensive practice or industry team's plan should include four key elements:

- A **strategic direction** that very simply states the overall role that a team plays in the firm and the few strategies the team will undertake to carry out that role

- A **financial plan** that spells out what the intended performance will be for the coming year, not only including the team's bottom line (that is, **contribution to profit**), but also how busy the people on the team will be, how much revenue will be brought in, what growth is achieved, and other important measures

- A **marketing plan** that spells out what the practice/industry team is going to do to build its business and integrate, from a business development sense, with the other practice and industry teams in the firm

- Finally, an **operational/action plan** that spells out the specific action steps the team in this leadership will take over the next year to carry out the strategic plan, achieve the financial objectives, and grow the practice.

These plans should be short and to the point and all four elements make up a practice/industry team's plan for the year. The plans should be shared with all partners (not just in the team, but also across the firm) and collectively serve as the basis for what the overall firm intends to do.

Compensation decisions are usually made upon completion of the year and when actual vis-à-vis planned results are evident. Our recommendation is to essentially graft the practice/industry leader and team compensation to the compensation system that already exists in a firm (using the same concept as an addition to a house – attach it to that house). Specific steps, relative to partner level team leaders and members, follow.

- As part of the firm planning process, the compensation of all partners needs to be budgeted – to meet the needs of the present system and to allow for designated compensation for team leaders and members.

- While different firms do lots of different things in terms of paying out compensation during the year – such as common draws for all partners, a percentage of budgeted compensation, etc. – we recommend that team leader and member compensation (for team management and performance) be an end of the year decision (for those individuals).

- The team budgets for the year should allow for normal compensation for team leaders and members, given achievement of the overall team plan, (both quantitative and qualitative objective achievement of team plan specifics).

- The financial statistic used to measure team performance is that of **contribution to profit**, not net profit or net income. Contribution to profit is simply the revenue produced by team members (with the revenue following the person not the team) minus the direct costs of the team (salaries, benefits, training costs, marketing costs, and other directly attributed costs). Overall firm overhead for full firm related costs is not borne by or calculated for the teams – we should note that when it is, it is a counterproductive source of friction.

- During the year, there should be effective reports produced, on a monthly basis, that enable team leaders and members to know how they are doing against their specific firm plans. We also suggest that you measure work done for each group by other groups and vice versa.

- At the end of the year, after results have been finalized, the firm's regular compensation processes should be executed. However, that process works, team leaders must have a visible and substantive role in setting compensation for everyone on the team, even if they are not receiving a bonus for team performance.

- Specific bonus amounts, as well as regular compensation attributed to team efforts, should be delineated in the specific announcement of compensation changes to partners and, depending on the openness of the system, the information that should be provided to all partners. Simply put, if you have an open system, then all the partners need to know how much team leaders and team members are compensated for team performance.

- And importantly, the team leaders and the team members need to know why the decisions were made for this supplemental compensation. Performance should be identified and spelled out – and opportunities for improvement (for those who did not perform well) should be delineated.

This **"addition to a house"** compensation concept is a positive way to get to what most firms recognize must be done – quickly and effectively. It can be utilized/implemented regardless of the specifics of the partner compensation system and can be tacked on to virtually any compensation system. We do recommend, however, that the full system be internally reviewed on a regular basis (probably every three to five years) to ensure that, stem to stern, the reward system is doing what is expected to do – encouraging performance that benefits clients and, ultimately, the firm and its owners.

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John Smock is one of the founding partners of Smock Law Firm Consultants with hundreds of law firm management consulting assignments over the years. While his focus is strategic direction, he also helps his clients solve vexing external and internal management issues (such as practice group management and partner rewards and compensation). In addition to his greater than 30 years working with law firms, John has led and managed multiple practice teams and offices as a partner at Arthur Young.

Smock Law Firm Consultants is a smaller, but well regarded and highly experienced law firm management consultancy that focuses on seven distinct areas – **overall firm and individual practice strategic planning and direction; strategic plan implementation; law firm mergers and combinations; practice/industry team management; law firm economics; operational excellence; and strategic management issue resolution** (which includes broad experience in partner compensation systems). John Smock and his two partners – **Peter Giuliani and Gary Fiebert** – each have over 40 years experience in professional service firm management and bring unique skills and backgrounds to help law firm clients address their management issues.

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