Respect=Compensation=Respect

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R-E-S-P-E-C-T! Otis Redding pinned the song in 1965 and Aretha Franklin made it famous in 1967.

Every generation still sings about respect. Attorneys pay particular attention to this word especially when it comes to their compensation.

Respect = Compensation = Respect

Compensation systems play a significant role in influencing a law firm's culture. The benchmarks that a firm uses to determine compensation not only nod to the differences in the financial rewards that partners receive. They also signal to a partner their value to the firm.

According to a study by the University of Georgetown Law Center, *Money and Meaning: The Moral Economy of Law Firm Compensation*, "law firms face the challenge in their compensation systems of eliciting the ongoing commitment of their partners by affording them respect on the basis of what may be very different criteria. How a firm responds to this challenge will have the effect of forging a particular conception of professionalism for that organization and its lawyers." The study further states, "Time and again, we hear that a firm's compensation system plays a crucial role in shaping its culture, and that partner satisfaction with compensation is critical in eliciting attachment to the firm." One of the partners in the study describes the significance of compensation this way:

"At the end of the day, after all of these things, the barometer is compensation, okay? Compensation sends incentives, it sends signals, it conveys culture. This is the language we speak, it's the way we know how we're valued. {W}e know everything by how we are compensated, by whatever the metrics are for compensation"

COMPENSATION SYSTEMS

Partner compensation is probably one of the most sensitive aspects of a law firm's practice management. Whether you are adopting a new system or modifying the current one, there must be an extraordinary amount of thought, care, and study.

Systems are either non-performance-based systems or performance-based systems. Here are the typical systems:

Non-Performance-Based Systems:

- **Ownership percentage:** Income is allocated on relative ownership percentage.
- **Pay equal:** All partners are paid equally, or nearly so.
- **Seniority or lock-step:** Partners are paid based on years as a partner. This method is all but obsolete, however, some firms still have a baseline built into their systems for more senior partners.

Performance-Based Systems:

- **One person decides:** Typically the managing partner or other designated key partner (often referred to as the designated pie slicer).
- **Compensation committee:** Instead of one person allocating income alone, a highly credible, small number of partners is elected and/or appointed to allocate income.
- **Paper and Pencil:** The partners complete a ballot in which they allocate income to all partners. Each partner's ballot is averaged and the result is the income allocation.
- **Pure formula:** An algebraic formula devised, based on business origination, book of business, billable hours, realization, and other factors.
- **Shared overhead:** Also referred to as profit center accounting. Each partner is allocated a share of the firm expenses, individual expenses are allocated to the partner directly.

Whatever method the firm decides to use, the most popular systems have a base compensation and a year-end bonus. The base compensation/draws can be set at the beginning of the year based on prior year performance or the base can be determined by current year productivity.When a firm utilizes the latter, a partner will take draws against the projected compensation with a semi-annual or year-end true-up.

Other Considerations

The process of revising or developing a partner compensation system is an arduous process and the person(s) leading the study, should be prepared for many obstacles. There are other items to consider in addition to the type of compensation system decided. For example:

- How do you compensate managing partners or other practice group leaders?
- How do you compensate business origination? Do you grant credit in perpetuity, for a limited time period or perhaps your firm will not grant any credit for originating clients. When deciding this policy, keep succession planning in mind. If you grant credit in perpetuity, it may be more difficult to get a senior partner to retire.
- Don't forget about special circumstances like part-time attorneys, lateral partners, nonequity partners and so on.
- What should the capital buy-in be? How should it be handled? Will there be a capital balance maintained or will you distribute profit based on ownership percentages?

A well developed compensation structure will provide the firm with long-term benefits in retaining attorneys and recruiting new ones. There are many factors to consider as a change may impact some partners adversely. It is acceptable to phase in a new compensation system over a couple of years.

For more information and further reading on Strategy, visit our online library.

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Brenda is a recognized leader in law firm management and consulting. She consults with clients on attorney compensation plans, succession planning, budgeting & cash flow forecasting and profitability analysis. To find out more about her services, please visit www.brenda-barnes.com. Her new book on compensation is also available on the website.