2020 Equity Partner Contribution & Compensation Survey

Highlights Report

Performance Leader™

MHPR Advisors

Most professional firms will be under severe strain in 2020. How well you manage partner reward to foster co-entrepreneurship will be a key enabler of partnership cohesion this year and next.

Five survey highlights around partnership cohesion and co-entrepreneurship:

First, a staggering three-quarters of contribution measures impacting partner reward relate to production. Unsurprisingly, business development measures rank second. We provide some ideas about how emphasising measures around co-entrepreneurship could feature more to help carry your firm through the crisis to come.

Second, a top to bottom spread of 3:1 to 5:1 has become the norm, and the trend favours increasing spreads. We explain how to systemically mitigate the risk of high spreads on partnership cohesion.

Third, only 59% of respondents perceive that their firm's review process addresses poor partner performance. We suggest a systemic approach for addressing an age-old partnership problem.

Fourth, while 74% of our respondents say their partner compensation system is effective, only 52% deem their compensation management processes efficient. We share initial steps to increase efficiency in the digital age.

Fifth, partner compensation systems accommodate partners in both client-facing and firm-management roles in only 31% of cases. This undervalues leadership and risks undermining partnership cohesion. We show how to make the implicit explicit.

THE IMPORTANCE OF GETTING PARTNER COMPENSATION RIGHT IN TIMES OF COVID-19

Even before Covid-19, professional firms were facing clients demanding reduced costs and price certainty, disruption through technology and diversifying sources of competition.

Covid-19 has exacerbated these challenges. Remote working has been normalised, causing changes in firms' property and IT cost structures. While litigation, regulatory, tax and investment services thrive in times of uncertainty, clients are delaying spend on transactional services and discretionary advisory budgets. Anticipated revenue streams will change for all firms; how well they will cope depends not only on the agility of their business model but also on partnership cohesion and reserves available for investment.

As we learned during the Global Financial Crisis, strong and cohesive professional partnerships are resilient in times of economic turmoil. Protecting revenue is among partners' most important tasks in the short-term, and many have risen to this challenge. Yet managing and compensating partners for their contribution – the focus of our survey – is key to maintaining strong and cohesive partnerships that remain profitable in the medium-term.

THIS SURVEY

Our 2020 Equity Partner Contribution & Compensation Survey examines current practices in relation to partner contribution and compensation management in professional firms.

Over 160 respondents were comprised mainly from those who manage the contribution and compensation process in firms: managing partners, chief executives, chief operating officers, heads of finance and human resources and board members.

Our data collection took place prior to Covid-19 being declared a global pandemic. Many professional firms have shored up their income statement and balance sheet; these measures have included reducing distribution amounts and repositioning partners within the partnership. Yet our insights into partner compensation practices remain valid, and we have placed these insights in a post-Covid-19 context.

This 2020 survey is produced in conjunction with our collaboration partners: NatWest, Managing Partners' Forum, Chilli IQ Marketing and Edge International. The survey follows earlier iterations we conducted in 2014 and 2017.

INSIGHT #1

Use this moment to decide once and for all: are your equity partners production machines or co-entrepreneurs?

One of the most striking insights from this year's survey is the extent to which production still dominates partner contribution measurement and – by extension – partner reward. This is despite industry-wide posturing about prioritising innovation, collaboration and the client experience.

We asked our respondents to name their five measures to assess partner contribution in order of importance. These are our findings:

- A staggering three-quarters of the most 25 important measures are production-related.
- Unsurprisingly, business development featured as the most or second-most important measure in most firms.
- Leadership and its variations begin to feature only in fourth or fifth priority.
- Innovation of services do not feature in comparison to business development, production and leadership.

It appears that innovation, collaboration and the client experience hardly matter when rewarding equity partners in our respondent firms. This begs a foundation question for every partnership during times of an economic downturn: is it sustainable for equity partners to be just production machines or does this senior cohort finally need to mature – to be, feel, act and be measured as co-entrepreneurs?

Our view is clear: partnerships and equity partners must evolve to become even more entrepreneurial, and this co-entrepreneurship needs to be reflected in how partners are evaluated and how profits are shared. This is because in the short-term, it is only entrepreneurial capability, effectively deployed, that will protect the firm's revenue.

In the medium-term, we anticipate accelerated change in the professions. Equity partners must collaborate more effectively than they do now and innovate for new, comprehensive, cross-disciplinary solutions to client problems. This means developing new, digital approaches to the client experience. This in turn requires technological and data acumen which currently remains nascent in most professional firms. Consequently, performance measures must evolve beyond production metrics to ensure that profit shares can support the kinds of contribution by its co-entrepreneurs needed by the firm to thrive in future.

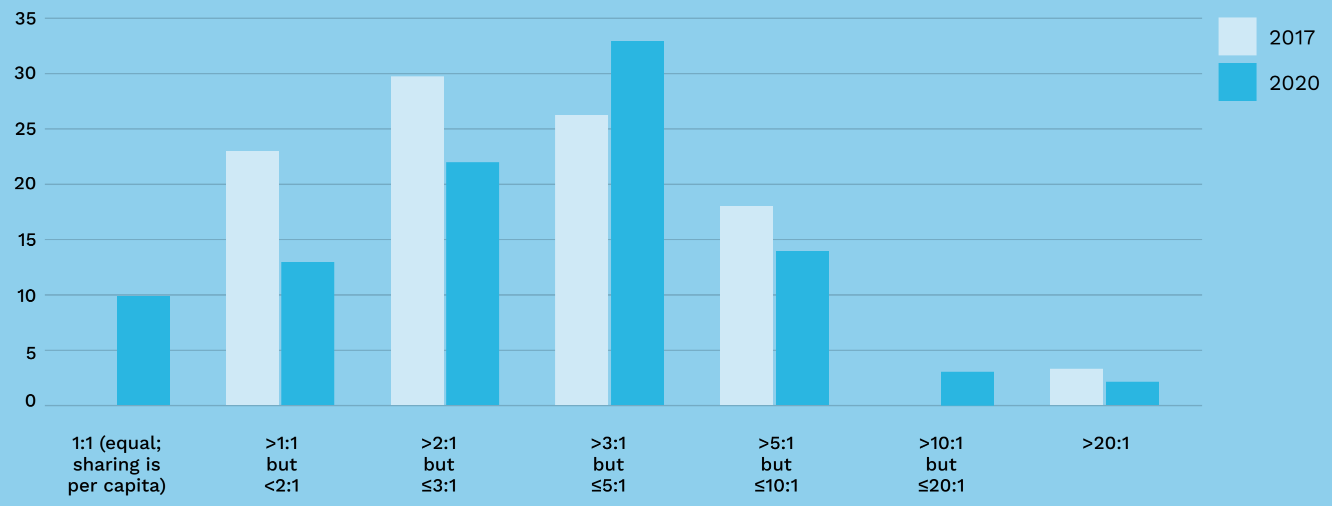
In the long-term, this implies that equity partnerships comprised mainly of co-entrepreneurs will also have fewer equity partners. This will be a result of both inevitable de-equitisation that will occur in 2020 and reshaping of many firms' business and talent resourcing models.

INSIGHT #2

Top-to-bottom reward spread is creeping up to reward high performers.

QUESTION

What is the top-to-bottom spread of compensation among your equity partners?



Our 2020 survey shows an increased spread between highest and lowest-paid equity partners when compared to our 2017 survey results.

Consistent with the observations from our consulting work, there are two explanations for the trend towards increasing spreads: first, in recent years there's been relentless pressure to increase profit shares in favor of "high performers". Second, there's been a trend to bring fixed-share or salaried partners into the equity, in part for tax reasons (in particular in the UK), to shore up the firm's capital base and – let's be candid – to avoid difficult conversations with specialists whose rainmaking potential is limited.

We have three observations about this trend. First, even a 5:1 spread allows for a cohesive professional partnership – but only if the underlying fundamentals (strategy, organisational design, governance, culture) are sound.

Second, stretch the spread too far to retain key partners and risk losing the cohesion required for collaboration and work sharing, and the rainmakers you are trying to protect.

Third, don't confuse "rainmaking" with "co-entrepreneurship." A sustainable equity partnership structure can still accommodate a technical specialist whose expertise is business critical and who espouses other qualities of entrepreneurship.

How to mitigate the risk of cohesion and key partner retention? Start with a multi-factor, meritocratic "co-entrepreneurship" test for those seeking to become equity partners and structure your profit sharing around the same factors.

It simply isn't enough to be a stellar expert or to have a big book of clients to join the equity ranks. More is needed in terms of collaborative mindset, complementary capabilities, personality, adaptability, behavior and a history or potential of achieving results for the firm. Showing partners the many ways in which they can contribute strengthens the partnership and helps explain why some partners' profit shares are substantially higher than others.

INSIGHT #3

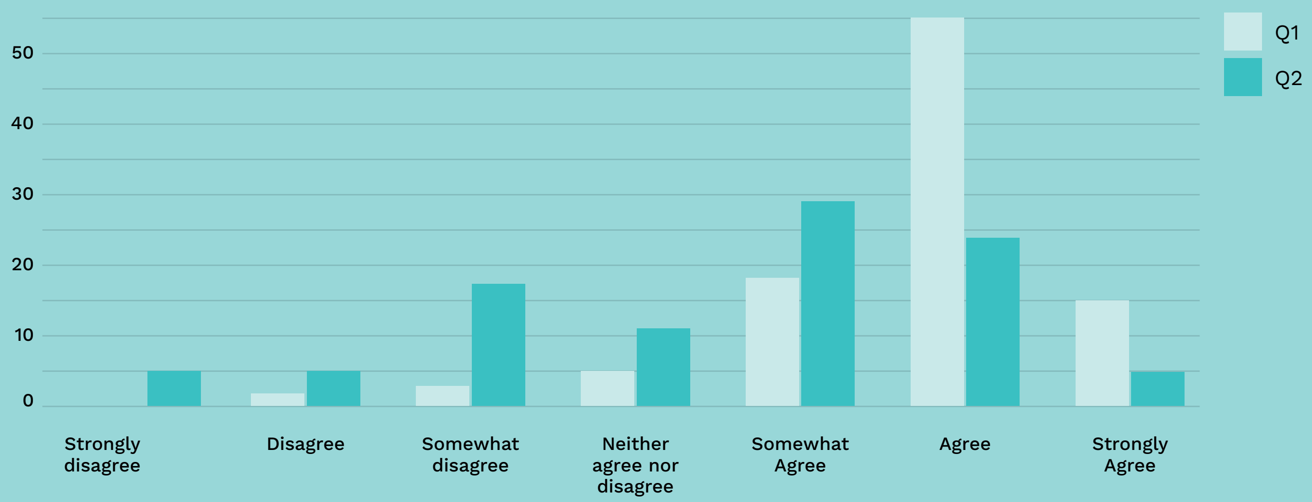
Firms recognise good performance, yet still don't address poor performance well.

QUESTION 1

To what extent to you agree that your firm's appraisal / review process recognises a partner's strong performance?

QUESTION 2

To what extent to you agree that your firm's appraisal / review process articulates clear improvement plans for poor performance?



Putting to one side criticism that evaluations place too much weight on production: it's good news that 88% of our respondents agree their firm's review process recognises strong performance well. Yet when it comes to addressing poor performance things aren't as positive: only 59% of respondents agree that poor performance is addressed with a clear improvement plan.

The ability to have honest and constructive dialogue is even more important during difficult economic times. There will be a tremendous pressure to maintain revenues in the short-term. What to do with partners with advisory practices or client portfolios that are skewed towards industries most affected by the downturn? Are they deemed "underperformers" overnight? Or does the partnership take a long-term view? If so, how many years is "long-term"?

The time is now to redefine what "contribution" really means for all partners and to then discuss with all partners what overperforming and underperforming against expectations means. In a remote work environment, this means having the right tools to have these conversations, and doing so more often than you would have when everyone is together in one office or at a few sites.

This is important, because failing to deal with poor performance can very quickly undermine partnership harmony and cohesion, especially in down years. A perceived lack of fairness can cause resentment, particularly if the compensation model assumes a roughly equal contribution. A brooding sense of unfairness, coupled with a lack of transparency about firm economics and what really counts, is a major risk to partner cohesion.

Our advice is to develop a systemic approach to addressing poor performance:

1. Give leaders the permission and skills to have regular, honest conversations with peers. Allow leaders the time to invest in relationships, so negative feedback can be contextualised as care.
2. Have clear expectations and regular touchpoints so performance improvement plans can be agreed well in advance of reward decisions.
3. Make contribution discussions easier by deploying supporting technology – for example, to ensure commitments made aren't forgotten and to facilitate a constructive dialogue even if you can't meet partners face-to-face.

INSIGHT #4

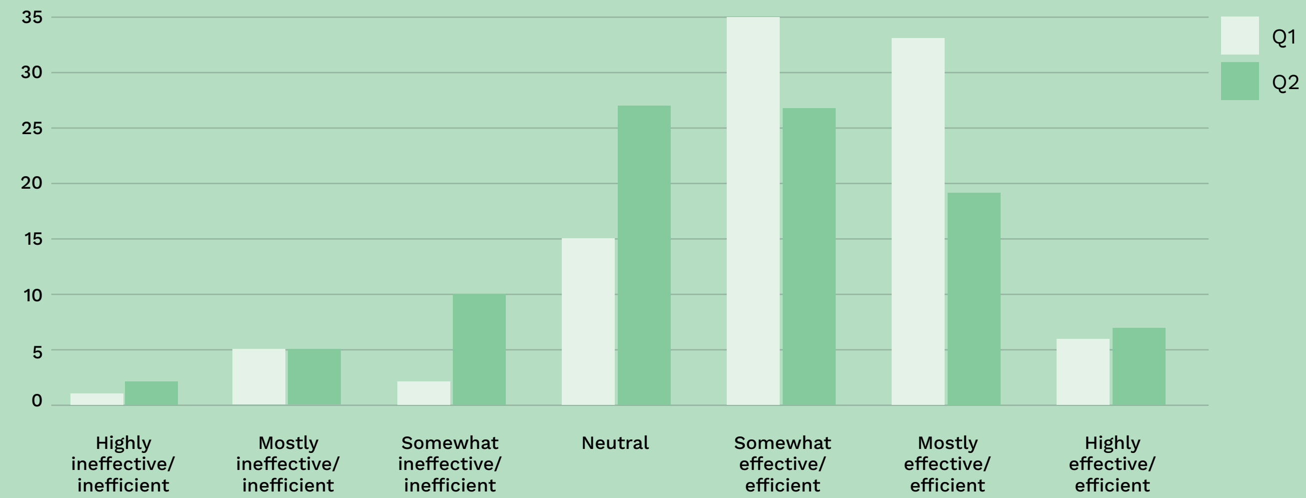
Partner compensation systems are effective at providing fair outcomes but the process could be more efficient.

QUESTION 1

Overall, how effective is your firm's partner compensation system in providing fair compensation outcomes for the substantial majority of all equity partners?

QUESTION 2

Overall, how efficient are your firm's partner compensation processes? By 'efficient' we mean providing the current outcome with an appropriate amount of resources (partner time, management time, financial resources etc)



74% of our survey's respondents deem their compensation system effective at providing fair compensation outcomes.

That's a good result, with two reservations. First, half of the 74% said their system was only "somewhat effective" – not a ringing endorsement. Second, this result could be positively skewed by our survey's respondent profile: the vast majority of our respondents are managing partners or others directly responsible for managing the process.

Perhaps reflecting their personal exertion, the same respondents were not as positive about efficiency: 52% considered the process efficient, meaning that an appropriate amount of resources are allocated to the process.

Finding better ways to manage partner compensation is important because of the opportunity costs of inefficient practices. The review and reward season is exhausting for many leaders. Their energy for transitioning to proactive contribution management for the new financial year is often sapped, meaning that problems reoccur. Also sapped is their willingness to conduct a detailed after action review on what worked, what didn't and what should be done next time.

To develop a more efficient approach we advise:

1. Design contribution and compensation processes that are simple for equity partners as well as those managing the system to understand and to apply. Much of our consulting work involves simplification.
2. Implement a profit sharing decision-making governance appropriate for the size and maturity of the firm. We often see reward governance frameworks that are either outdated or in the wrong shape – or contain too many political checks and balances that hamper sound and prompt reward decisions.
3. Implement time-saving technology that helps both year-round partner contribution management and streamlines profit sharing decision-making processes.
4. Conduct a detailed after action review after each contribution and compensation review. Make efficiency a distinct discussion point.

INSIGHT #5

Partner compensation systems tend to undervalue leadership and management roles.

QUESTION

How does your firm's partner reward structure reflect the performance of partners who are in formal management roles (e.g. managing partner, department heads, etc.)

While a majority of firms make some accommodation in their reward system for partners in management roles, only a minority (31%) explicitly accommodate these roles.

From the firm's perspective, a lack of clarity and transparency around expectations, contribution and reward for partners who "double-hat" as both client facing partners and firm leaders can risk cohesion, seeding suspicion by other partners and exacerbating reward determination inefficiencies.

From the individual partner-leader perspective, the lack of transparency risks creating reward uncertainties ("what if my numbers go down if I take this role?"); sometimes, the leadership role boosts client-facing numbers, and sometimes partners put their hand up for a management role to hide an anticipation of poor client-facing results.

All of these problems can be avoided by making the implicit explicit. The more mature the partnership is in terms of size, generation and overall age, the more important it is to agree principles around how partners performing important internal roles are rewarded.

The negotiations around making management roles explicit are often very politically complicated: it is hard to separate the best long-term structure for the firm from the individuals who are currently or potentially performing these roles.

Discussions about the relative importance of management, client leadership, production and expertise can address the scepticism of some partners: "What value do managing partners and department heads add, anyway?"

These discussions engage partners directly in the management agenda. In times of crisis, partners in management roles play a critical role: ensuring short-term survival, scanning the horizon for client and acquisition opportunities, planning across time-scales, ensuring short-term execution of the important, and maintaining partnership cohesion.

Aside from the present situation, partners in management roles have been navigating a substantial shift in how professionals advise their clients. As firms respond to client demands for greater value (more for less), technological disruption and diversified competition, reimaging the service delivery models is no small task. Having a shared understanding of management's contribution will always help strategy and execution given the semi-autonomous nature of professionals operating in partnerships.

Our advice is for firms to explicitly recognise and reward partners in management roles:

1. Articulate clear expectations for specific management roles. Applying the firm's client-facing partner contribution framework isn't enough. Those in management roles have different responsibilities: strategic planning and execution; managing peers; people leadership; collaborating C-Suite peers; financial management, technological acumen, and diversity and inclusion. By making expectations explicit, future leaders can be identified and developed, current leaders can be assessed and rewarded and succession can be managed.
2. Ensure a rational governance approach to managing the objectives of firm leaders. Depending on the size of firm, it should be the partnership board that agrees, maintains and evaluates the objectives for managing partners and perhaps some department heads. In many firms, these control mechanisms don't exist or don't work effectively.
3. In large and small firms, properly agree how much time partners are to spend on their management roles. Having clarity on this at the outset will help alleviate problems come reward time, such as a partner going overboard on his management role having lost sight of his client-facing contribution obligations.
4. Make explicit how profit sharing recognises a management role and how much is allocated to the client-facing role – and how to put the two together for partners who perform both roles.

These times need partner-leaders who can coalesce and motivate partners as co-entrepreneurs and who have the foresight and execution capability to maintain partnership cohesion. It is time to take the contributions of partner-leaders from obscurity and make them explicit.

Conclusion

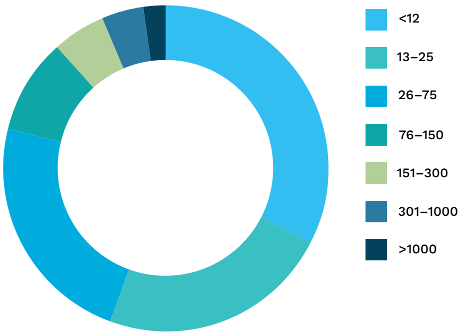
Solidarity in the Covid-19 crisis not only means supporting clients and businesses that are struggling with the measures that have been imposed. Solidarity also means working together as partners – as co-entrepreneurs – to maintain and reinvent the firm so it can be successful in the short, medium and long-term. A healthy partner compensation system will be the glue that will help your partners through the times to come.

About this survey

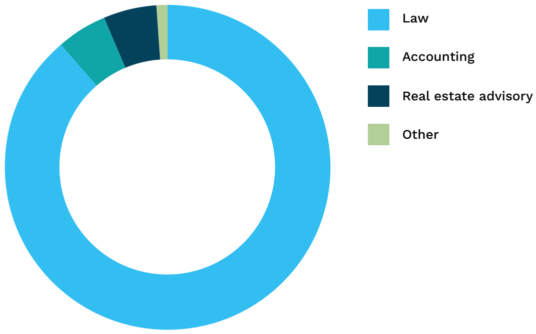
Our survey was conducted online from December 2019 to February 2020. It adopts a mixed-methods research approach, combining quantitative and qualitative analysis.

There were 162 respondents drawn from the following demographic segments:

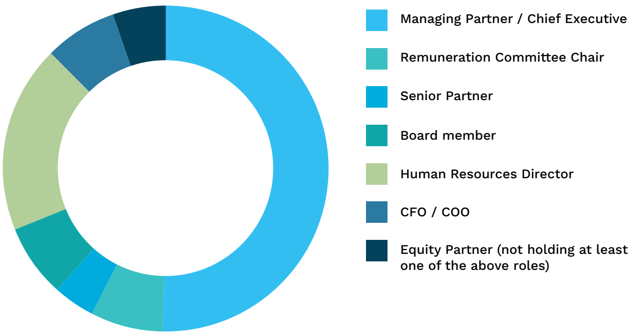
NUMBER OF PARTNERS



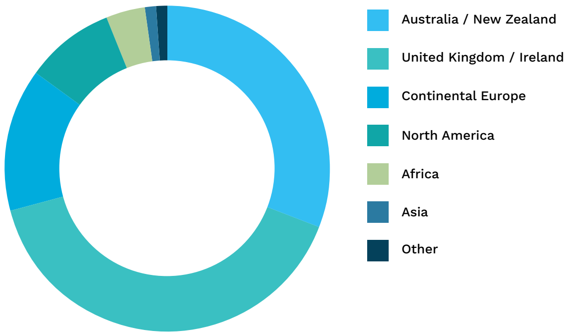
TYPE OF FIRM



ROLE IN FIRM



REGION

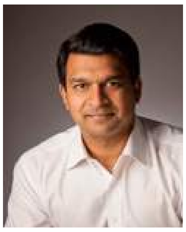


Collaboration partners

NatWest   Managing Partners' Forum   Chilli iQ   EDGE INTERNATIONAL

About the authors

Michael Roch is Head of Consulting for Performance Leader. For over 20 years Michael has advised senior management teams of professional partnerships and global PSF networks on partner remuneration, profit sharing, partnership governance, capitalization, succession, alliances and other strategic issues. Michael has consulted to market leaders in law, accounting, consulting, wealth management and real estate advisory firms in over 40 countries. He has co-founded and led a global boutique consultancy with offices in 9 counties and most recently was Co-CEO Europe of Australia-based Internal Consulting Group, a 4,500 member consulting network. Michael is author of Partner Remuneration in Law Firms (2015) and is currently co-authoring The Partner Remuneration Handbook: A State-of-the-Art Guide to Compensation Strategy and Design in Law and other Professional Services Firms (Globe Publishing, expected 2021) together with Ray D'Cruz.



Ray D'Cruz is the CEO of Performance Leader, a firm that designs and implements contribution management software for PSFs. The technology supports objective management and collaboration, project reviews and performance reviews. Ray advises clients on partner and employee contribution frameworks, contribution management practices and the design and implementation of technology. He has worked with over 100 PSFs internationally. Ray is a former lawyer and senior HR practitioner. Ray is co-authoring The Partner Remuneration Handbook: A State-of-the-Art Guide to Compensation Strategy and Design in Law and other Professional Services Firms (Globe Publishing, expected 2021) together with Michael Roch.

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