LAW360 Pulse

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How Closely Should Law Firm Leader Pay Be Tied To Profits?

By **Aebra Coe**

Law360 (November 2, 2022, 1:39 PM EDT) -- As the legal industry faces a potential decline in profits this year for the first time in recent memory, questions about how top leaders are evaluated and compensated have begun to bubble up — primarily, how important should profitability be to top leaders' pay?

A law firm managing partner, CEO or chair will make a series of decisions that ultimately have an impact on the long-term performance of the firm, and while year-to-year blips are not completely under their control, there should ideally still be a level of accountability when it comes to compensation, according to William Lee, former co-managing partner of WilmerHale.

"In major law firms and in midsize firms and successful smaller firms, the managing partner or the chair or both are responsible for the economic performance, the professional performance and the day-to-day culture of the firm. And they are responsible equally for all those things," Lee said.

While any given law firm may depart from the average, a midyear report from Wells Fargo Private Bank found that while revenue grew 5.8% on average among large and midsize law firms in the U.S. during the first six months of the year, expenses were up significantly, creating an average **decline in profits among the group** of 9.3%.

For many large law firms, economic performance is a top driver of managing partner pay, usually in the form of bonuses on top of a stipend. But in recent years, the focus has begun to shift from mostly emphasizing revenue to also include profitability as an important factor, according to Joseph Altonji, a founding principal of law firm management consultancy LawVision.

"Are we growing profit, versus only top-line revenue? That's a much more complex discussion," Altonji said.

For example, two practices could both bring in $5 million in revenue, but one may do that at a $3 million profit, while the other has a $1 million profit.

"If you look at any large law firm, there are a range of practices with a range of profit drivers. The metrics are increasingly important, and that performance can translate to the whole firm," Altonji said.

As law firms become more aware of the importance of profitability, there's only one problem when it comes to holding top leadership accountable to those metrics.

A survey in 2021 by The Remsen Group found that among 213 managing partners of law firms with 10 to 200 lawyers, objective criteria for managing partner performance and compensation appeared to be fairly uncommon.

Of the respondents, just 20% said they had a formal job description and followed it, and more than 80% of managing partners were compensated based on factors that had nothing to do with firm performance. There was a big disconnect between what the leaders hoped to achieve and how they ended up spending their time.

The picture is one of an industry, at least among more midsize firms, where law firm leader evaluations and compensation are not clearly defined, and are certainly not aimed squarely at encouraging specific action or behaviors.

"Fifty-six percent don't have a formal job description," Remsen Group founder John Remsen Jr. said. "You're the CEO of a multimillion-dollar enterprise and yet you have no job description."

It's absolutely vital that the people in law firms in charge of top leader compensation — usually a management committee offshoot — create a series of objective measures upon which leaders are evaluated, and combine those with subjective measures of performance, according to Peter Johnson, founder of management consultancy Law Practice Consultants.

"People do what's measured and rewarded, and for the most part you can't change behavior unless you can affect compensation," Johnson said.

But should those metrics only include financial performance indicators like profits? Absolutely not, the experts said. Profitability is one objective factor that is helpful to consider alongside numerous other metrics.

A few other major factors include ensuring high levels of professional integrity and quality of client service, the execution of strategic goals, and ensuring the law firm's culture aligns with the values of the partnership, according to Silvia Coulter, co-founding principal of LawVision.

It's extremely common in law firms for top leaders to get caught up in day-to-day "nonsense," Coulter explained: for instance, partners' complaints about how many windows are in their office. But it's up to those top leaders to delegate many of the more operational and menial tasks and maintain an intense focus on the firm's strategy and its future, she said.

That often means having the courage to say goodbye to partners who no longer fit within the law firm's strategic goals, whether that has to do with profitability, client service or culture, Coulter said.

According to WilmerHale's Lee, law firms looking to improve how they evaluate and compensate top leaders would likely be best served looking outside the profession for fresh ideas on how to evaluate top management.

"The most important thing is to not just look at other law firms, but to look beyond at how the best institutions in any field are doing these things," Lee said.

He reflected on an exercise his law firm underwent when the merger between Hale and Dorr LLP and Wilmer Cutler Pickering LLP created WilmerHale in 2004. The firm brought dozens of its leaders together and had two Harvard Business School professors come in and use business school case studies to teach them principles that can be useful in any institution.

A few years later, when Lee was serving alongside Bill Perlstein as co-managing partner of the combined firm, an outside expert came in again, this time to do an independent evaluation of the co-managing partners' performance, which involved confidential surveys of partners, associates and staff across the firm.

It's key that the committees responsible for evaluating the performance of top leaders don't rely solely on their own observations and instead tap into the honest opinions of the numerous people who make up the law firm, Lee said.

"In the best-performing firms and institutions, the responsibilities or the goals of the leader are clearly agreed upon and articulated," he said. "And then I think that the best-performing firms have mechanisms for evaluating the performance of the managing partner or the chair on an honest and candid basis."

--Editing by Nicole Bleier.

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