

MAKING THE GRADE: WHAT SHOULD LAW FIRM OWNERSHIP REALLY MEAN?

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Much is written about what partners are entitled to—compensation, retirement and withdrawal rights, a voice in the running of the firm and the like. Less is written about what characteristics partners should exhibit to become and remain a partner, as well as the obligations to their firm, colleagues, employees and community. This article sets forth the necessary characteristics and obligations of partners and sets forth five partner styles to help evaluate your partnership program.

Partnership in a law firm confers certain responsibilities. Partners must generate business, manage the enterprise, promote the practice, train employees and invest in the future of the firm. The business risk or success of the firm rests primarily with the partners. Partners are stewards of the enterprise with an implied responsibility to pass it on to future generations in as good, if not better, competitive position.

Large law firms (and partners) often lose sight of the important partnership responsibilities as they grow and this diminishes competitive advantage. Partner responsibilities and admission criteria actually increase with firm growth. If they do not increase, the firm will inevitably languish. Responsibilities of existing partners likewise increase over time. Partners who do not continually increase their contribution cannot be retained if the firm is to thrive.

Fully Contributing Partners

If partnership is to be meaningful, owner incomes must be sufficient to satisfy the owners, to urge associates to strive to become partners and to entice lateral hires to join the firm. In other words, owner incomes must be sufficient to attract and retain lawyers of the quality necessary to grow and improve the firm. To that end, partners must add value to the firm, be personally economically viable, build an independently sustainable practice, delegate work downward and supervise it, cross-sell work laterally to other partners and manage both the business and practice functions of the firm, as called upon to do so.

The following criteria can be used to measure the characteristics of successful partners: experience, quality work, marketing contribution, professional resource development, personal attributes, management abilities, economic contribution and business development potential. These criteria should serve as benchmarks against which all partners are continually evaluated. Making partner is not a culminating event; it is the

beginning of a greater set of obligations and a partner must continually earn the right to remain a partner.

Experience

In most large law firms, the requisite level of experience to become a partner is eight to ten years from the date first admitted to practice. In addition, it is common to require up to three years as an associate with a firm or one to two years as a “special counsel” if a lateral hire is a partner level lawyer.

The purpose of this time frame is to provide sufficient time for an associate to develop his/her ability to counsel clients, to learn the craft of lawyering, and to learn the nature of the firm’s clientele and practice. This period also affords the firm an opportunity to carefully evaluate the associate as a person, a lawyer and a potential business partner.

Quality Work

Partners are expected to have the experience and knowledge base to handle most matters independently with minimal supervision, if any. This does not mean that there is no accountability or quality control of work product. In considering an associate for partnership, each partner should ask the following questions regarding the associate’s quality of work:

- Would I be comfortable with this person’s independent handling of a complex legal matter?
- Would I hire this person to represent me in a complex legal matter?
- Would I trust this person to independently service our most valued clients?
- Does the legal and business community think highly of this person’s advice and counsel?

Marketing Contribution

Marketing, in this context, is not the targeted, client-specific activities that lead to business generation. Rather we are talking about the writing, speaking, teaching and professional and community service that increase the firm’s (and partner’s) prominence by raising its profile, image and brand awareness in the broad communities in which it operates:

- Is this person active in developing a network of contacts (building the Rolodex) and establishing relationships in the legal and business community?
- Does he/she project an understanding of business and legal subject matter that demonstrates experience and expertise through writing and speaking opportunities?

Development of Professional Resources

In a competitive, fast paced environment, partners must lead in developing skills, knowledge and experience for themselves and others. Teaching, mentoring and personal development are obligations one has to his/her own career and those of colleagues:

- Is this person a good teacher?
- Does this person readily share knowledge and work product with others?
- Does this person assist others to succeed?
- What do other associates, paralegals and staff say about this person?
- Does this person continue to develop technology and management skills?
- Does this person seek substantive continuing legal education beyond minimum requirements?

Personal Attributes

A firm should also judge associates on the type of people they are. A new partner should enhance the reputation and stature of the firm.

To seek individuals whose loyalty, maturity of judgment, honesty, industry, trustworthiness, cooperativeness and team orientation toward the firm are clearly demonstrated is not just a “Mom and apple pie” goal. These attributes speak of fundamental personal and organizational values. If the individual and the organization differ in this area, it is the organization that will suffer. Having the right people is possibly the most important decision one will make for their firm. At the ownership level it is even more critical. The following excerpts from Jim Collins’ book *Good to Great*¹ illustrate this concept well.

“First who—then what—get the right people on the bus first, and the wrong people off the bus, then get the right people in the right seats, and then figure out what direction to drive the company.”

“The right people will do the right things and deliver the best results regardless of the incentive system.”

“The data showed no pattern linking executive compensation to the process of going from good to great. It proves that it is not how you compensate your executives, it’s which executives you compensate in the first place.”

There is significant enthusiasm now for team orientation in a law firm. It is quite common to hear or read about the need to use the plural when talking about the firm. Phrases like “This is our firm” and “These are our clients” are touted to build a sense of community, mutual reliance and commonality.

However, let's consider the value in the deep commitment of the small business owner. Such an individual talks about "my business," "my customers." The business and the person are often inseparable. The pride one has as a business owner transcends simple economics. This should hold true in multiple-owner businesses as well. Some consideration might be given to such depth of personal commitment to the firm given the highly mobile nature of the legal profession today.

Key questions to ask are:

- Do I respect and trust this person?
- Would I be proud to introduce this person as my "partner?"
- Will this person be loyal?
- Will this person be a true partner or simply an employee or free agent that happens to have partnership status as long as it is personally convenient to do so?
- Is this person willing and able to take on the benefits and risks of being an equity partner?

Management Abilities

All partners must manage, even if it's only client relationships and portfolios of work. Some will be asked to manage practice areas, departments and offices. A few will be tasked with firmwide management duties including committee participation. Each will be expected to carry out those roles in an effective, efficient and profitable manner:

- Is this person perceived as fair, accessible, pragmatic?
- Is this person respected?
- Does this person learn well from prior events?
- Does this person invest time in building management and leadership skills through reading and attending educational programs?
- Would I be willing to allow this person to play a significant role in representing my interests by managing the firm's affairs?

Economic Contribution

It is economic reality that all professional service providers must contribute to the financial health of the enterprise. Generally, any associate who desires to become a partner must have established a record of sustained profitability for the firm. An associate may contribute to the firm's economic well being in more than just recording billable hours.

However, as a general guideline, an associate should be contributing at a sustained level of 2,200 to 2,500 total productive hours (client billable and other substantially meaningful time—marketing, management, training, CLE and the like) per year². Annual fee receipts generated, as a working lawyer should be in excess of

\$350,000³ for a senior associate. At this level the average senior associate is profitable, earning \$100,000⁴ for his/her law firm.

The economic criteria may seem overly demanding. However, they are achievable, provided the individual is disciplined and motivated. They are necessary when one evaluates the cost of operating the law firm. The footnotes illustrate how these numbers were developed. Using the same methodology, each firm can develop its own and its community's standards. However, no matter the firm size, city size, region or practice specialty, senior associates should be very profitable.

Partners of the firm earn most of their income. Associates create additional income opportunity by being profitable and profit margins close to 25% are appropriate. Over an associate's eight to ten year career an average margin closer to 18% is normal. This means that associates are much less profitable, maybe even unprofitable, in their early years and significantly profitable, as they become experienced practitioners.

Non-equity partners generally do not bear the risk of compensation loss or capital contribution, but they also often do not share in the upside potential like equity partners. One generally pays a non-equity partner better than a senior associate. In certain circumstances a non-equity partner may be paid a bit more than they are worth (i.e., paid at a rate in excess of the remainder from their fee receipts less overhead). This higher than pure economic pay may reflect the modest amount of business they generate, client portfolios and relationships they manage, the mentoring and training they provide younger associates and possibly to allow some additional upward opportunity in the later years of their career. How this is handled is, of course, a decision each firm must make.

Business Development

Demonstrated business development ability is one of the most significant differences between equity and non-equity status. An associate may be promoted to non-equity status absent a sufficient ability to develop and attract clientele. However, if client generation is not a strength, then the lawyer must excel in other ways. Non-equity partners must demonstrate an ability to manage and retain clientele, to supervise and train younger lawyers, or practice at a very sophisticated level to be considered for partnership.

A law firm should expect an equity partner to develop a book of business that is in excess of the economic criteria set forth above (\$350,000). Therefore, one might expect to generate a minimum of \$400,000 in good, profitable business to enter equity partner partnership.

As such, equity partners should be net exporters of work. That is, they must generate a book of business in excess of the amount they personally work. There is room for a small number of partners who do not do this, such as Self-Sufficient or Service Partners, which are defined later in this article. However, this number, if

sufficiently large relative to the total number of partners can place significant pressure on the firm. Your best business generators cannot sustain ever-increasing requirements to provide work laterally to partners. It is acceptable for a newly advanced partner to be a Service Partner for some period of time, as long as you can identify the traits requisite for them to develop into net exporters of work. If they cannot, you must critically examine if you need and if you can rationally support a partner who will consistently require work to be provided for him/her.

This model is best applied at the practice level, designing each practice group to its best configuration. It further applies to the due diligence that one considers for lateral hires. Except for special circumstances⁵, a lateral partner should have a book of business larger than the firm's current average book of business in order for the firm to improve its competitive position and not just its headcount.

The following sets of characteristics define five types of partner based on their business generation capabilities. It is possible for a firm to not have a category 1 or 5 partner. When firms struggle in a downturn, it is often a result of having too many category 3 and 4 partners relative to the number of category 1 and 2 partners and the overall population of lawyers.

A single class of ownership law firm would have room for all of these categories of partner. A two class of ownership law firm would make categories 1, 2 and 3 equity and categories 3, 4, and 5 non-equity. The middle category, number 3, can go both ways depending on various facts and circumstances and one's view of the individual's potential.

Net Exporters

1. Entrepreneurial Leader—consistently (year-to-year and in all market conditions) keeps multiple partners, associates and paralegals busy, often in many practice areas; generally the book of business is at least \$2,000,000 (many firms will not have such an individual). His/her personal market presence helps drive the firm's brand and he or she transitions relationships to others, creating deeper, broader and lasting ties to the clients.

This is the only partner category where one might justify low working lawyer fee receipts. However, the volume of business must clearly be at the mid-seven figure level for this to occur. Evaluation of this individual is based on an ability to effectively build and sustain the firm's business.

2. Business Generating Partner—capable of keeping him/her self and one to two others busy on a consistent basis with a combination of one's "own" business and by growing existing client relationships cultivated by others; generally the book of business will exceed \$650,000. His/her personal market presence is more prominent than the firm's brand for marketing and he or she understands the importance of client succession and works tirelessly at it as both a beneficiary and benefactor.

These partners need to be personally productive (i.e., performing legal work at acceptable levels) in order to justify the compensation they seek. They are evaluated based on their ability to both work and generate exportable work for their teams and hopefully some for others as well. A key factor differentiating this individual is the success achieved in transferring relationships as beneficiary and benefactor.

Neutral⁶

3. Self-Sufficient Partner—can keep the equivalent of him/her self busy, usually gets a portion of work from others and manages to export a small amount of work to others; this means a book of business of about \$400,000 to 450,000. He or she uses the firm's brand and his/her personal market presence for marketing and acknowledges at an intellectual level the need to involve others and to be a good corporate citizen in that capacity.

This is generally a young partner, who is just hitting his/her stride and is not yet positioned in the marketplace to build sufficient amounts of exportable work. Working hard personally involves doing legal work, selling business and doing those things that position the person to rise to Business Generating Partner or better in the years to come.

Net Importers⁷

4. Service Partner—usually a sophisticated lawyer/advisor and client manager who can manage a service delivery team, but can also be a young partner in firms where there is only one class of partnership. Generally does not generate a significant volume of work on his/her own; we are talking about a book of business of at least \$180,000. He or she relies significantly on the firm's brand to market and would not meet the test for self-sufficiency.

Evaluation will depend on the situation. If a young partner in a single partnership class law firm, then evaluation will resemble the Self-Sufficient Partner above. If it is the more typical experienced, older lawyer, then the evaluation is based more on ability to manage client relationships, building them where possible, but generally freeing the business generators to move on to other opportunities.

5. Technical Specialist Partner—sophisticated problem solver, particularly when the issues are complex and unique, often conceptualizes at a precedent setting level. He or she is uncomfortable with the social aspects of client interaction, often will not lead the legal team servicing a client's legal needs, but may lead the project team for a specific issue.

This individual is evaluated on personal productivity and technical expertise. Having this person provides the firm with a competitive advantage so some slippage in personal productivity is acceptable if that time further establishes that high level of

expertise (white papers, not articles; lecturing/symposiums, not simply teaching at the local law/graduate program; involvement with government policy makers, and the like).

The books of business calculations for the above positions are drawn from average position data from the 2002 Altman Weil® *Survey of Law Firm Economics*. They are summarized in the footnote below.⁸

Admission to Partnership

Bringing in a new partner should not result in an economic drain on the other partners. Once a decision is made to admit an individual to partnership the other partners must consider how to bring them in and how to compensate them. This is always a fundamentally difficult process. Partners do not want to dilute the value of their existing partnership interests and yet they want to maintain a constructive environment in which the new, expanded partnership group can go forward and prosper. This issue warrants ongoing examination. It is fair to continually ask if the actions are fair and equitable to the collective interests (existing partners, new partners and other stakeholders together).

Part of the admission process at a firm is the buy-in. All partners should contribute working capital to the law firm. The profession's standard of determining buy-ins is to value the firm on the cash basis, book value of the firm at year-end and calculate total capital requirements based on the working capital and investment needs of the firm. An associate should expect to be told about capital contributions well before consideration for partnership. Buy-in is generally not overly burdensome, but it is not immaterial either. The range of partner investment generally required depends on firm size. Average levels vary with firm size and range from \$25,000 to \$50,000 at smaller firms to \$100,000 to \$200,000 at larger firms. As an average, many firms exceed these levels, some by significant amounts. (Note that these numbers exclude work-in-progress and accounts receivable.)

The new partner should be prepared to produce the funds necessary for their buy-in. Some firms will assist with payment plans or assist with bank financing.

In Summary

One cannot overstate the importance of the people decisions in any organization. An excellent excerpt from David Maister's⁹ *Practice What You Preach* illustrates this point:

“The success of a business is a matter of choosing the right managers. A huge amount of time is spent worrying about and developing corporate strategies, missions, policies and practices. The amount of time spent thinking about screening for and appointing the best managers pales in comparison. It's time for firms to switch their attention to what really counts.”

Differentiating good employees from good partners is no easy task. Yet if the firm is to be successful, these new stewards must be identified, developed and advanced. You must communicate your expectations to associates during the interview process and reinforce the expectations with annual employee evaluations specifically measured against those required advancement attributes. If the firm is rigorous in adhering to these standards for admission to partnership, then it should thrive.

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END NOTES

¹ Jim Collins was on the faculty at the Stanford University Graduate School of Business. He now runs his own management research laboratory. He is a co-author of *Built to Last* and is the author of *Good to Great*, the source of these quotes. Both of these books are important studies for any manager/leader.

² This figure comes from studies that show that professionals work 50 to 55 hours per week towards their careers. There are approximately 45 productive workweeks in a year (52 less four vacation, two holiday and one personal).

³ The national average billable hours of a senior associate (1,848) times the national average billing rate of a senior associate (\$211) times the national average overall realization at standard rates of 90% rounded.

⁴ \$350,000 in fee receipts less the national average total compensation of \$128,000 for a senior associate less the national average per fee earner overhead of \$122,000.

⁵ Special circumstances may exist where you are filling an expertise gap or bringing on a resource-constrained portfolio that, once on board, will quickly grow to your threshold requirements.

⁶ In law firms with two tiers of partnership, this position could be equity or non-equity, depending on the facts and circumstances – even within the same firm.

⁷ In law firms with two tiers of partnership, these positions are “non-equity partners.”

⁸ Calculation of books of business, based on working lawyer figures.

EL	440	BGP	440	SSP	440	SvcP	40%	180
Equity Partner	440							
Non Equity Ptr	410							
Associate	280							
Associate	280							
½ Associate			140					
Paralegal	130							
½ Paralegal	70		70					
Total	2,050		650		440			180

<u>Status</u>	<u>Hours</u>	<u>Rate</u>	<u>Realization</u>	=	<u>Fees Produced</u>
Equity Partner	1,759	\$265	94.6%	=	\$440k rounded
Non Equity Ptr	1,744	\$247	94.6%	=	\$410k rounded
Associate	1,827	\$179	85.6%	=	\$280k rounded
Paralegal	1,393	\$114	85.6%	=	\$130k rounded

Billing Realization 93.2% Collection Realization 96.7% Overall Realization 90.1%

Partner realization is 105% of average or 94.6%

Associate and Paralegal realization is 95% of average or 85.6%

⁹ David Maister was a professor at the Harvard Business School. He is now a consultant to professional service firms and a prolific author. *Practice What You Preach* is a study of what drives profitability in professional service firms. The author of this article recommends all of his books as part of a law firm manager/leader’s reading library.