“Building a Village” Partner Compensation Plan

In my last two columns, I focused on some fundamental compensation issues found in an “Eat what you Kill” (EWYK) partner compensation model. Logically, an EWYK formula focuses on taking care of the hunter with the hunter getting credit for every kill over the life of their hunting career as well as the on-going food supplied by those kills. As I intimated in my last two columns on this topic (which you can link to and read if you want a reminder), following an EWYK partner compensation model is critical if a firm wants to create an organization that can sustain itself long-term. The problem is … this same model that makes a firm successful in the early years will likely be the culprit that either stifles or stagnates the firm’s growth or causes the firm to split-up in its more mature years.

Why? Because the basics of the model are around personal cumulative effort -- older hunters get to a point where they pretty much can live off of their past efforts. New business continues to come to them because of their large client base and referral network, so they can move from being an active order maker (someone who constantly networks to find business) to an passive order taker (someone who waits for the phone to ring). To exacerbate this situation, these same senior partners, in order to sustain their personal income stream, bring in new partners with the responsibility of helping them process and manage their existing bounty. Over time, this evolves into a firm where the senior partners maintain the lion’s share of the firm’s client relationships and the younger partners do the lion’s share of project management work. From my past columns, you know this situation will likely create a reverse employee pyramid (the reverse pyramid negatively impacts profits and puts more pressure on partners continuing as the workhorse). In addition, it puts the firm in a poor position to expect a successful succession to the next generation of owners.

The obvious question is “Why does this negatively impact the firm regarding succession?” Because the next generation of owners, due to the duties and responsibilities they have been performing, place too much emphasis and value on project management (because that is what they are comfortable doing). So, no one really values the role of managing client relationships and building/maintaining a strong network in the community the firm serves. What makes matters worse is that it is common to find that the senior partners’ referral base is constantly weakening. This network, which requires minimal management for the senior partners in their later years because the relationships have been in place for so long, is likely subject to the same generational situation. In other words, as the senior partners near retirement, their network (client owners and referral sources) is likely from the same age group. This results in the firm being in trouble. The younger partners have not built a strong enough network with the next generation of leaders taking over their clients’ businesses (because they have been the workhorse managing projects), and the senior partners contacts are becoming less influential over the decision making processes within their organizations (as the reigns of management to being transitioned to others).

So, what once was a very strong firm becomes weaker and weaker. Just for the record, this problem did not appear because the younger partners didn’t do their jobs, but because the senior partners killed any chance of the younger partners positioning themselves for the future. As many of you know from my lectures across the country, I say all of the time that “the fish stinks at the head." If an organization is in trouble, it is because the current leadership refused to focus strategically and continually defaulted to maximizing tactical objectives and short-term profits. For firms to stand a fighting chance, the existing EWYK founding or senior partners need to get it. "It" in this context means … while the EWYK model works to maximize your income today, those same ideas and philosophies will sabotage the firms chances for long-term success, stability and succession.

Here are some basics of a "Building a Village" (BAV) model that firms should seriously consider. First, it is set in a framework of accountability. In a BAV firm:

- It has to have a Strategy
- Partner and Staff goals have to be established to support that strategy
- There has to be a clear understanding of what is expected of a everyone, from partner on down
- The management has to be willing to fire anyone for non-performance or compliance, especially a partner
- The managing partner has to have a significant compensation stick to reward or punish behaviors, especially those of the partners
- Partners have to understand that in their partner or shareholder role, they are members of the Board (I am not talking about this from a legal standpoint, but from a roles and responsibilities standpoint). The Managing Partner is the Only Employee of the Board. And when partners are performing client service rather than setting strategy or policy, they work and report to the managing partner.

Under this model, the shift changes from what "you" as a partner control, to what the "firm" controls. Clients are not the property of a partner, they are the property of the firm and can therefore be moved anytime resources dictate or client service requires.

With this in mind, let's shift back to the partner compensation topic. In my experience, you can not switch from an EWYK to a BAV model of partner compensation without seriously revisiting the partner retirement formula. Generally speaking, we need to separate the big three – "Retirement, Compensation and Voting." For most firms, these three are so intertwined that change to any one of them individually is almost impossible. So, you have to take them on one at a time with the intent to redo them all. Retirement is the first step.

Why is re-visiting retirement so critical? Because one of the most important moves in shifting to the new BAV model is the destruction of the entitlement power that comes from managing a book of business. I am not saying that book of business shouldn't be a factor in the partner compensation model. However, I am saying that when a partner individually determines whether he/she will pass a client to another partner, you will quickly fall back to an EWYK form of operation. So, if you want the people with the largest books to give up control on how those clients are spread throughout the firm, you have to give them reasonable value for the asset they built under the model they have been working under (EWYK). If you don't, then why would senior partners, and just as important – why should they, move their clients to anyone else when here-to-for all of the power in the firm is rooted in the size of book you manage.

The typical benefit required to make this palatable is that younger partners need to commit to paying the older partners their retirement pay based on something other than book of business, which typically falls to ownership percentage or salary (I am not a big fan of salary as the driver and I will cover the many reasons why in a later column). Generally, for ownership percentage to become the driving model, current ownership percentages often have to be adjusted.

For those firms that have a philosophy of everyone having the same ownership level, you are now in a box within a box. Why? Because someone that was made a partner 2 years ago, who might own 1/5th of the firm (because there are 5 partners and everyone is an equal owner) likely only manages 5% or less of the firm's clients. Therefore, while ownership might be equal, the senior partners still control the firm through the revenue and profits generated by their client bases. So, while ownership might be equal, the benefits that accrue to ownership have been seriously reduced. At some time in the future, those same senior partners will circumvent the benefits outlined in the partner agreement that accrue to ownership by demanding additional benefits and concessions to the buyout formula or they won't be willing to turn over their large client base to the remaining partners. Rather than waiting to deal with this blackmailing process when a senior partner is getting ready to retire, it makes far more sense to make the fair adjustments now. On the other hand, just to be critical of both sides, for those younger partners who currently manage small books under an EWYK model of operation, are equal owners and don't want to pay the senior partners fairly for the larger books of business they have built – my response is that I would fire you right now. The greed and expectation of getting something of value and not having to pay fair value for it warrants this extreme measure, especially since this attitude will eventually become the undoing of the firm. You need to understand this basic truth. Senior partners, generally speaking, will tolerate receiving down to about 85% of what their book is worth under the EWYK formula. On the other hand, younger partners will pay a maximum of about 115% of what a book is worth from this same perspective. If a senior partner thinks he/she is going to get more than 115%, or a younger partner thinks he/she will get away with paying less than 85%, your firm doesn't have much of a future. Now, to be fair, an important ingredient of my comment above is that we are fighting over "real value," not some crazy partner's unrealistic expectation of current value just because that is what he/she paid 20 years ago.

As you can see, the BAV model gets complex quickly. We actually haven't even talked about what partner compensation looks like under this model. And in real life, you can't get there until you have covered issues like we are discussing above first. My next column will continue down this path and we will keep going until we finally get to a bottom line. Be patient … we will get there.