

The Edge International

# 2012 Global Partner Compensation System Survey



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As the practice of law becomes an increasingly global enterprise, the cultures of the law firms involved in international practice are becoming more homogeneous. Nowhere is that more apparent than in the processes that law firm partnerships use to determine partner compensation. In 2006, and again in 2008, we surveyed a significant sample of law firms throughout the world on the subject of partner compensation. Our objective was to gain an understanding of differences in firms' approaches to compensation by their size, profitability and nationality.

For 2012 we have re-administered the survey. We purposefully did not do a survey in 2010 because we speculated that the economic downturn was having a severe impact on the profitability of law firms and, accordingly, causing some firms to adopt temporary compensation systems to accommodate revenue short falls.

The result of this years survey was precisely what we anticipated. The basis and process used to compensate partners is continuing to follow the trend we saw from 2006 to 2008 in that it is becoming increasingly uniform among law firms around the world. However, there continues to be some interesting cultural differences. Among those differences:

- US and Canadian law firms lean toward much more subjective compensation systems than firms in other countries.
- The use of non-equity partners is increasing in every country and the use of these partnerships is also anticipated to increase.
- The use of "lock step" compensation systems is uniquely present in the UK and Europe, and is virtually unheard of in the other countries surveyed. However, while its use has declined in the UK, it remains a fixture in Europe and our client work in India and other parts of Asia indicate some measure of popularity in emerging economies. The use of bonuses as a means of compensation for all forms of partners is growing in all the regions surveyed.

These are the primary findings in the Edge International survey of law firm partner compensation systems around the world. The survey included 263 large law firms in the United States, the United Kingdom, Europe, Australia and Canada. In the prior surveys we had included Asia and South Africa. However, the limited number of large firms and tight competitive situations, made the gathering of reliable data difficult. Further, we concluded that, at least in Asia, the ownership structure of firms and their compensation schemes reflected cultures that were sufficiently different from the participants in other countries to be of value.

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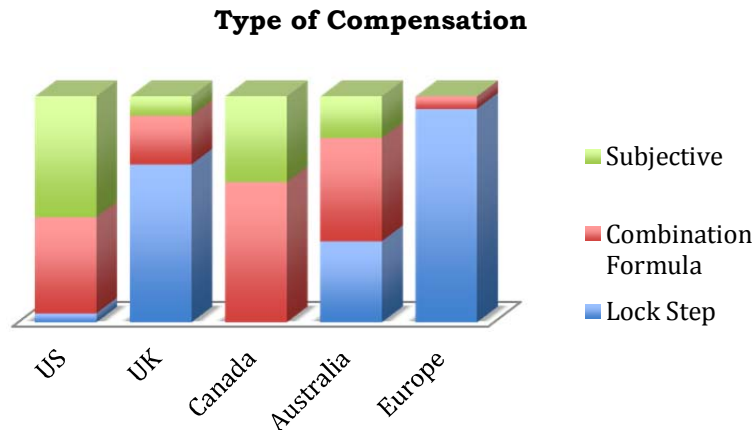


The purpose of this survey was to ascertain changes resulting from the recession. Therefore, some known consistencies from prior surveys were not resurveyed this year to shorten the survey and increase participation.

### **Basis of Compensation**

Nothing demonstrates the cultural differences among firms than the compensation system they utilize. While there are literally hundreds of variations a firm could select, most compensation systems fall into seven permutations:

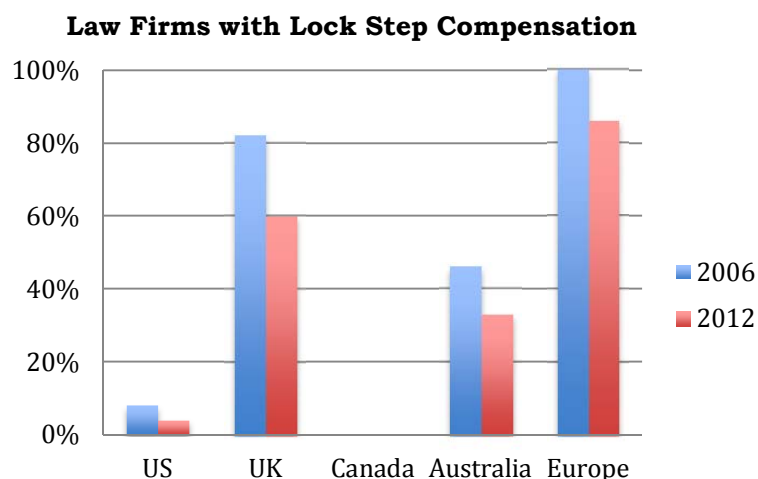
1. **Lockstep**, which sets levels of percentage participation in a firm's profits according to a predetermined set of progressively increasing steps, usually based on seniority.
2. **Equal Distribution**, which is a form of lockstep in which all partners are paid equally.
3. **Modified Lockstep**, involves a lockstep schedule which can be accelerated, decelerated or managed based upon individual performance.
4. **Formula**, where compensation is determined by a quantitative formula based on each individual partner's statistical performance.
5. **Combination**, where compensation is based on statistical performance but the application of the statistics may be subjectively modified.
6. **Subjective**, a system where compensation is determined based on the subjective decisions made by a person or committee, although inputs to the decision may include statistical information.
7. **Corporate**, which is a normal business model where partners receive a salary and bonus based on performance and then are paid dividends based on the profitability of the firm.



Because there are so many variations, we classified the responses of the participants into three categories: Lockstep, which included modified lockstep and equal distribution; Combination Formula which, as the name implies, includes the Formula and the Combination systems; and Subjective. Outside of a few responses in the UK (8% of respondents), we found virtually no law firm users of the Corporate model.

Lockstep - In the UK, 65% of responding firms utilize some means of lockstep compensation. In Europe, that figure is 86% with 41% of firms using a pure lockstep, i.e., compensation is based solely on a series of compensation steps achieved solely through seniority. In the UK only 13% of firms are pure lockstep and in Australia it is 17%. The figures for pure lockstep include a relatively small number (less than five percent) of firms that utilize equal distribution where all partners are paid equally regardless of seniority or performance. None of the responding firms in the US or Canada employ pure lockstep or equal distribution.

The use of pure lockstep appears to be on the decline. In our 2006 survey, 30% of responding firms were pure lockstep or equal distribution. In this year's survey the use of lockstep was more than cut in half to 13%.



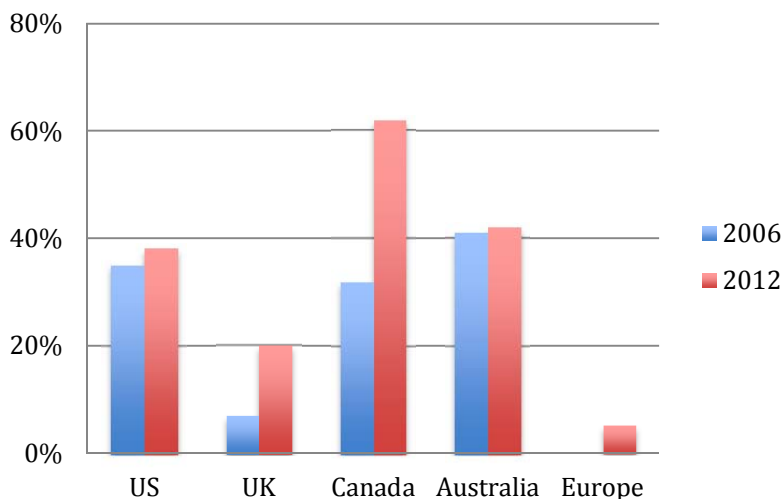
In Europe, the decline was from 67% in 2006 to 41% today. In Australia lockstep's popularity was roughly unchanged.

It has been speculated that lockstep remains as common as ever in UK and European firms. We have observed previously that it is difficult for firms to transform their compensation model completely and will prefer to modify and incrementally change their current model. Hence, it is no surprise to us to have it confirmed that firms have added some performance factors to adjust the automatic progression under lockstep. Indeed, the use of this "Modified Lockstep" has increased in Europe, from 33% to 45%, but has remained steady over the past six years in the UK at 52%. In Australia, however, the use of modified lockstep has been halved to 16 from 33% in a trend towards a Combination model. Again, even modified lockstep is virtually unknown in the US and Canada.

Formula – At one time, the concept of compensation based on a formula that took into consideration individual partner performance as a working and originating lawyer was viewed as the means of achieving a truly meritocratic compensation system. In fact, when law firms discuss merit compensation especially outside of the US they often focus on an "eat what you kill," formula system. But, with the exception of very small firms, the use of strict formulas is essentially only present in the US and represents less than five percent of law firms. Its popularity is unchanged in the past six years.

Subjective – The antithesis of a formula is a pure subjective system. In such systems, the compensation authority (usually a compensation or management committee) decides compensation on a subjective basis, often involving interviews with other partners. Typically the committee has access to statistical performance information. There is also a modified subjective compensation that utilizes a formula but the actual decisions can be heavily modified through subjective decisions. The subjective and combined systems appear to be almost uniquely Canadian, American and Australian. 54% of US law firms, 38% of Canadian firms, and 17% of Australian firms use a purely subjective

#### Law Firms with Combination (Modified Formula) Compensation



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system. Conversely, only 8% of UK firms and virtually no European firms reported that they purely use a subjective system, although subjective decisions are made in those firms where the Modified Lockstep calls for performance factors to be assessed as part of the compensation mix

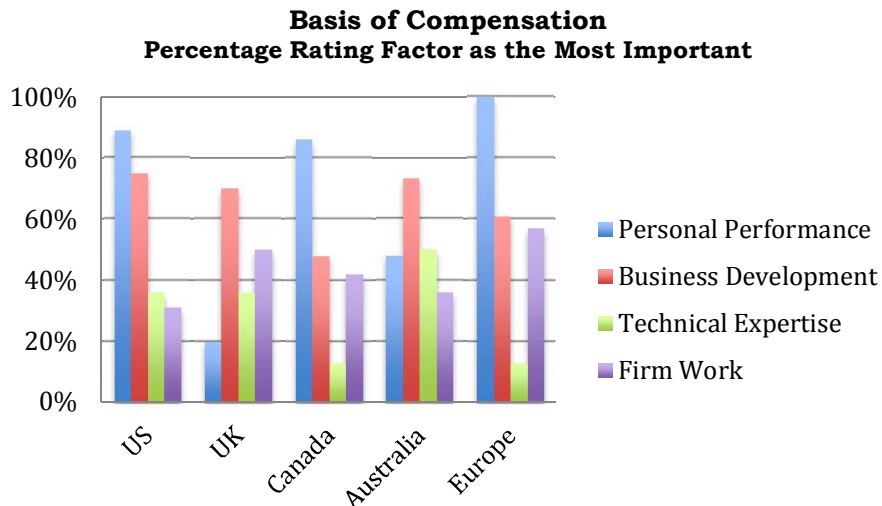
Combination - The unifying system appears to be the modified subjective or combination system. It represents the fastest growing compensation system regardless of country. In the UK the use of combination systems almost tripled going from 7% in 2006 to 20% today. In Canada the use of combination systems almost doubled to 62%. In the US it remained relatively static at 38% and in Europe it grew from zero in 2006 to 5% in 2012.

Corporate – Another growing system, reaching 8% to 9% in the UK, Europe and Australia is the corporate style compensation which pays a fixed base salary plus a bonus based on individual performance plus a dividend based on the financial success of the firm. Such systems are rarely seen in the US or Canada. We predict further growth in the corporate style system in jurisdictions such as (notably) Australia and the UK, where external investment plays a part.

The different forms of compensation systems also arguably reflect what appears to be a fundamental difference in partnership culture in which US and Canadian partners seem to be more willing to place their compensation in the judgment of others while UK, European and Australian law firm partners prefer a more predictable and pre-established set of criteria for at least part of the compensation package.

### **Compensation Factors**

There is a significant difference among countries in what law firms take into consideration in setting compensation. In the UK and Australia, business development and client management are the most highly valued



performance criteria in compensation. In those countries, approximately 75% of responding firms rated various aspects of business development as being extremely or reasonably important in the determination of partner compensation.

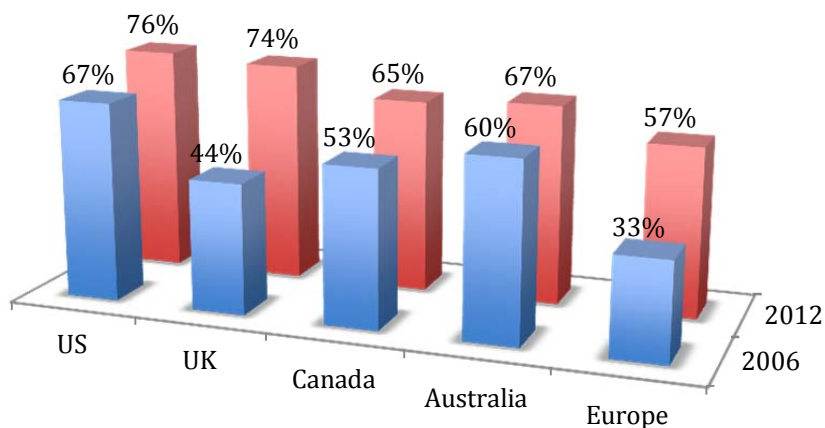
In the US and elsewhere in the world, the most commonly cited factor is the personal performance of the partner in terms of the value of the legal work he or she personally performs, followed by business development. Technical expertise and capability, or non-billable work as a firm manager or practice group leader, was not found to be a material factor for setting compensation in any country. While the graph above is based on the 2008 survey data, our studies have shown little or no changes in these factors.

Our experience shows that compensation-setting in multi-jurisdictional firms can cause issues. Sometimes, firms will use alternative partnership structures such as the Swiss Verein to separate profit pools between different jurisdictions. However, we found the overwhelming preference was for all partners to share in a single firm-wide profit pool - in the US (99%), the UK (97%) and Australia (92%). In Canada the percentage using a single profit pool dips slightly to 88% which reflects the countries historical limitations on multi-provincial law firms. The lowest was in Europe at 82%, which is most likely the result of the use of Vereins in the globalization of Continental firms.

### Bonuses

One of the most significant changes since the 2006 survey is the importance of bonuses to the typical partner compensation scheme used by larger firms.

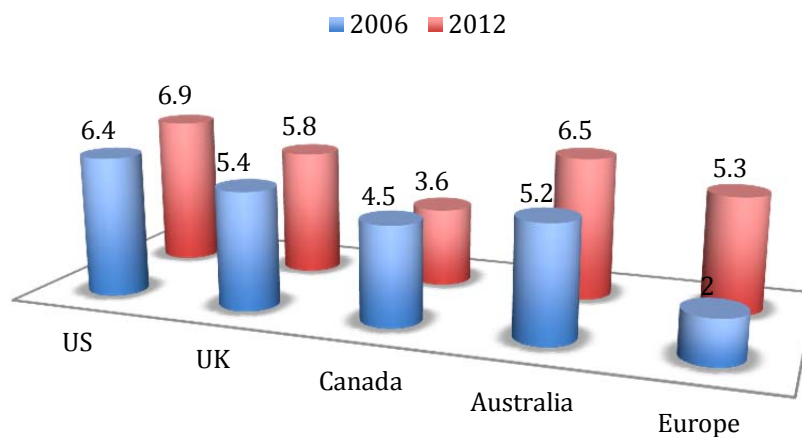
### Use of Bonuses as a Regular Part of Compensation



In every country surveyed, the use of partner bonuses has increased over the past six years. The single greatest jump is in the UK and Europe where the popularity of bonuses has increased by roughly 70%.

The amount of an average bonus has also gone up. In every country other than Canada, the percentage of the total value of bonuses, as a percentage of total distributable income, has gone up. The largest increase is in Europe where bonuses now represent 5.3% of partner compensation compared to 2% six years ago. In Canada, the average value of bonuses dropped from 4.5% to 3.6%.

### Bonuses as a Percentage of Total Partner Income





## Non-equity Partners

As anticipated in our previous surveys, the use of non-equity partnerships has continued to increase. In every country surveyed, between 80% and 90% of firms surveyed have multi-tier partnerships. In the US, 86% of firms have more than one tier of partner an increase from 77% in 2006. The vast majority of those partners are paid a fixed compensation plus a bonus. In the UK 88% of firms have non-equity partners, which is a slight decrease from 94% in 2008. Like the US, more than half of UK non-equities are paid a fixed compensation plus a bonus.

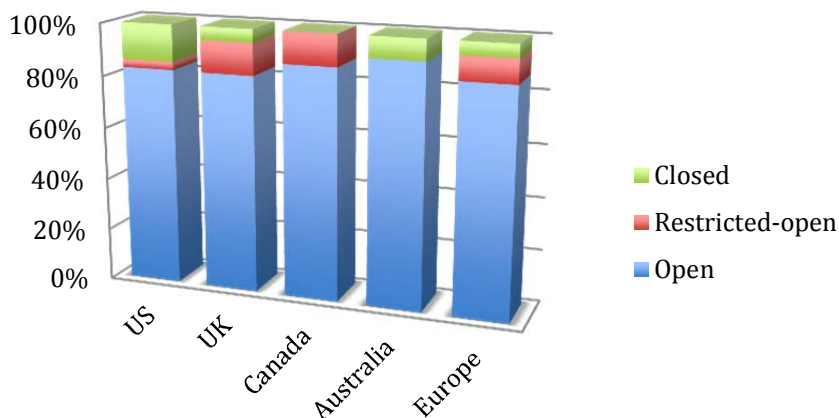
## Open and Closed Compensation Systems

A common topic of conversation among law firm leaders is the movement of firms away from open compensation system, i.e., where all partners know the compensation of all other partners. We had assumed that open systems would continue to prevail in the vast majority of firms but found that the use of open systems is rather smaller than we anticipated.

Interestingly, the US has the smallest percentage of firms reporting an open system at 73%. However, 17% of firms noted that there are some restrictions on that knowledge. We found a wide-variety of restrictions including some “need to know” provisions, i.e., practice group leaders and partners involved in assembling client service teams, and “availability upon request”. A common restriction is that partners may view the information in the managing partner’s office but may not copy or remove it from the office.

The response below labeled as Restricted-open was asked in the survey as *Partners know the tier or approximate compensation of other partners.*

### Open Compensation



The concept of a closed compensation system seems to largely be an American concept with 14% reporting a closed system. As noted above, relatively few firms in the UK, Australia and Europe have closed systems and none of the respondents in Canada have such a system.

We had expected the use of closed systems to decrease over time as consolidation in the legal industry occurs. However, the proportion of firms, at least in the US is growing slightly as some firms have used mergers to enable the closing of a traditionally open system.

### **Conclusions**

Everywhere in the world, the trend is towards greater and wider use of performance related compensation systems for at least part of the compensation package for law firm partners. Even in the UK and Europe, where the lockstep methodology is still attractive, pure lockstep is in continuing decline, whilst systems modified by performance factors, the use of bonuses (dependent on performance) and subjective-based systems are all increasing. At the same time, the trend in the US continues to move from historic highly individualistic and revenue-based formula systems towards systems where a balanced subjective view can be taken of each partner's overall contribution to the firm's success.

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## About Edge

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*The Times of London*

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The focus of our practice is law firms and corporate legal departments. We have developed an international presence working with firms and legal departments throughout Canada, the U.S., Europe, the Far East, Australia and South Africa. Law firm clients include those ranging from small boutiques to the largest in the world and our corporate legal department clients are from the Fortune 100. Edge International is honored to have served at least one of the top ten firms in over a dozen different countries.

Edge International holds the distinction of being identified in an independent survey conducted and published by Aspen Law & Business as **"one of the three most used consultants to large law firms in the U.S. and the only one among the top five that is a strategy and marketplace boutique."**

In addition, Edge International is acknowledged as the leading consultancy in providing hands-on assistance to practice leaders and the members of their practice groups to accelerate their efforts toward developing higher levels of performance.

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