

Rewarding Leadership: Firms need effective management more than ever. But compensation schemes for their chairs often fail to reflect that fact.

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Law firm compensation is more of an art than a science. Perhaps nowhere is that more clear than in compensation for firms' chairs. Recently, we surveyed 24 Am Law 200 firms about how they pay their leaders. We found that while some best practices are emerging, firms' approaches vary widely, and many of them simply don't comport with common wisdom.

Firm chairs differ from corporate chief executives in an important way: There is no market for the services of a law firm chair. John Thain moved from president of Goldman Sachs to chairman of Merrill Lynch, with a brief stop at the New York Stock Exchange along the way. Jamie Dimon jumped from Citigroup to JPMorgan Chase; and Robert Eaton moved from General Motors to Chrysler, just as Lee Iacocca went from Ford to Chrysler. Nothing remotely analogous has ever occurred in the legal profession: Chair vacancies at large law firms are always filled from within.

To anyone but a partner in an Am Law 200 law firm, this would seem implausible. But lawyers would no doubt tell you that this will likely never change—that it would be difficult for an outsider to lead a firm without being long and well schooled in its culture. Since all firms believe their cultures are uniquely collegial, strong, and good, partners in Am Law 200 firms fear cultural disruption and change. It would be risky to bring in an outsider who might shake things up and replace senior management, with the goal of improving financial performance at the expense of a contented culture. Lawyers don't like risk.

Whatever wisdom there is in looking only to within for leadership, there can be no argument that the resulting absence of a market for firm chairs depresses compensation. Chairs can only dream about what might happen if they were untethered from their firms and their pay was determined by the free market.

This is the context in which we set out to learn how lawyers set the compensation of those who lead and manage them. We found that compensation for firm chairs is determined primarily by two principal drivers:

individual performance as a lawyer (including, mainly, business development and client relationship management) or contributions to leadership and management of the firm. Just 40 percent of the firms we examined link their chair's base compensation primarily to leadership and management contributions. The other 60 percent use the same criterion (individual performance as a lawyer) for setting the chair's base pay that they use for other partners.

One might posit that all partners are compensated for leadership and management contributions, but it seems curious that a majority of firms don't view the role of chair as different enough from that of the other partners to merit different base pay criteria, especially since three-quarters of the chairs of the firms we surveyed devote only 10 percent or less of their time to legal practice. Chairs of nearly 40 percent of the firms that responded to our survey devote all their time to leading and managing their firms.

Forty percent of the firms that tie their chair's compensation primarily to contributions to leadership and management do so exclusively: All of the chair's compensation is based on these criteria. Of the remaining 60 percent, half use these criteria for setting 50-80 percent of the chair's base pay. At those firms, about half use entirely subjective criteria to judge those contributions. The other half use both objective and subjective criteria.

When we asked the chairs what they would recommend to their compensation committees as the top three criteria for compensating firm chairs, success in private practice seldom entered the picture. Three-quarters of respondents specified the overall performance of the firm, the firm's financial performance, and success in articulating a vision and achieving strategic goals as most important. This struck us as being in keeping with the meritocratic compensation systems that dominate at Am Law 200 firms.

Two-thirds of the chairs of firms we surveyed are eligible for bonuses (although only half received a bonus last year). The bonuses of roughly one-third of the chairs in this group were completely tied to the chair's performance as chair, rather than his performance as a practicing lawyer. The remaining one-third of respondent firms tie 50-80 percent to the bonus to performance as chair. In other words: Three-quarters of the responding firms expect their chair to spend 90 percent or more of his time leading and managing the firm, yet a third are willing to provide a bonus based in part on time spent doing something else.

These firms likely are led by powerful rainmakers and managers of key client relationships that they have been unable to turn over to other partners. That could be due to a weak bench of relationship managers or the belief that the chair must hold on to key client relationships that he developed prior to ascending to the chairmanship. In some firms, these relationships provide the security necessary to induce the chair to sacrifice some of the most productive years of his career for the benefit of the firm. Whatever the reason, today's highly competitive environment demands strong leadership and management. If a firm has a talented

leader, its paramount concern should be to remove any incentive for him to spend time on anything other than leading and managing the firm.

Slightly less than half the firms we surveyed address this career security issue by providing their chair with a soft landing when he steps down. Most commonly, this takes the form of a written or verbal agreement or policy, although a minority of firms write it into the firm's partnership agreement. These agreements typically assure the chair three years' pay at his highest-compensated or final year as chair, without conditions placed on his postchair performance as a partner. Chairs tell us that this last point reflects firms' confidence that they will continue to serve the firm in a valuable role, whether as rainmaker, relationship manager, practicing lawyer, good-will ambassador to important clients, or role model for young lawyers.

We believe that the emphasis by many firms on the performance of the chair as a chair—as opposed to his performance as a lawyer—is a best practice when combined with the provision of a soft landing, as well as a long-term trend shaped largely by the increasing tendency of firms to look to their most productive young partners to lead them. These superperformers command respect from their partners, act as magnets for young laterals, and possess the energy and commitment needed to chair a firm today. A quarter of the firms we surveyed limit their chairs to less than ten years in the position. At these firms, the soft-landing is needed to induce high-achieving young partners to give up all or a substantial part of their practice at the pinnacle of their careers.

At nearly all businesses, the chair or CEO is paid much better than anyone else. Not so at law firms. Chairs were the highest-paid at just 30 percent of the firms we studied. And among the third whose chairs were the most highly compensated, the difference between the chair's compensation and the next most highly compensated partner was material at only two firms. At firms whose chair was not the most highly compensated, the chair was, on average, the seventh most highly compensated partner, with an average of 8 percent of the partnership more highly compensated than the chair.

The 70 percent of the chairs who were not the most highly compensated believe that there is a method to their firms' madness. They believe that leaving money on the table and being near, but not at, the top provides them with moral authority when they ask other partners to make sacrifices for the good of the firm. They also say it shows rank-and-file partners that rainmaking and client service—attributes of the higher-paid partners—are what is most highly rewarded.

In our view, firms that compensate their chair more highly than other partners send an important message about the value of leadership and management. We see a small but growing number of firms taking a page out of the investment banking compensation model by using large bonus pools to reward high-performing partners for exceptional performance in any given year. Chairs should certainly be eligible for these bonuses and status as the top earner when they achieve extraordinary accomplishments.

We believe our study is the first time that compensation practices for firm chairs have been benchmarked. It is clear from our conversations with chairs and other firm leaders that the model for chair compensation is evolving. For firms vying for global preeminence in a dynamic and consolidating marketplace, there is a great need for clarity about the role of the chair. Over time, what a firm needs from its chair changes and evolves. What is important is to find a leader and manager who is right for the firm's needs over time, and to tailor his focus to the firm's needs by setting specific short- and long-term performance goals. We believe that tying a chair's base pay to the achievement of specific goals and paying bonuses for extraordinary strategic accomplishments are important best practices in chair compensation.