

Non-Equity Partnership

An Altman Weil Commentary

By James D. Cotterman

 **Altman Weil, Inc.**
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What Should Law Firms Do About Non-Equity Partnership?

An Altman Weil Commentary on results from the 2013 Law Firms in Transition Survey

Law Firms in Transition

The 2013 Altman Weil *Law Firms in Transition Survey* found that law firm leaders are acutely aware of the changes that the legal profession is facing. The survey also showed the evolution of thinking among firm leaders over the last five years, including some dramatic shifts in opinion since the first time the survey was conducted in 2009. *However, there was a lot less evidence of tangible changes in how law firms operate.*

What Should Law Firms Do?

Rethinking the law firm business model presents law firm leaders with many complex challenges, made more complex by the need to address them among partners with a variety of perspectives and with clients who have a range of differing needs. Law firm leaders often ask us, 'Where should we begin?'

This new series of *Altman Weil Commentaries* is designed to answer that question by providing practical first steps for law firms in a variety of key areas. The following report looks at non-equity partnership tiers.

About the Author of this Commentary

James D. Cotterman is a principal with Altman Weil, Inc. He advises law firms on compensation, capital structure and other economic issues, management and governance. Mr. Cotterman is the author of *Cotterman on Compensation*, a blog on lawyer compensation and law firm finance. He is the lead author of the ABA book *Compensation Plans for Law Firms*, and is a member of the Board of Editors of *Accounting and Financial Planning for Law Firms*.

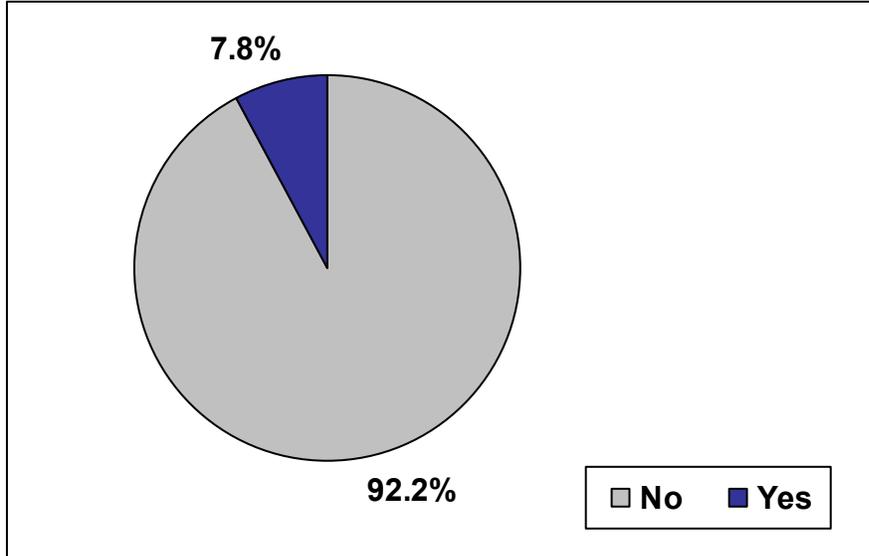
About the Survey

Conducted in March and April 2013, the *Law Firms in Transition Survey* polled Managing Partners and Chairs at 791 US law firms with 50 or more lawyers. Completed surveys were received from 238 firms (30%), including 37% of the 250 largest US law firms. The survey has been conducted annually since 2009.

The full survey is available online to download at: www.altmanweil.com/LFit2013.

Non-Equity Partnership

Do you have an 'up or out' policy for non-equity partners? (responses from two-tier firms)



Existence of an 'up or out' policy for non-equity partners - by firm size:

Up or out policy for non-equity partners	YES
50-99	2.9%
100-249	7.9%
250-499	14.7%
500-999	10.0%
1,000+	16.7%

What should law firms do about non-equity partnership?

THE SURVEY SAID

Only 7.8% of two-tier firms have an 'up or out' policy for non-equity partners.

WHAT SHOULD LAW FIRMS DO?

In most two-tier law firms, the non-equity tier has multiple entry points, few, if any, exit points, is undermanaged, and is growing in an environment where efficiency of service delivery suggests the need for fewer – not more – service partners. Non-equity partners are needed in some situations, but almost certainly not in the numbers seen in most firms. Law firms need to manage this group with much more attention and discipline – including standards for entry and exit from the tier.

Non-equity partners on average work fewer hours than either associates or equity partners. Their lower hours combined with higher base pay can create a drag on firm profitability. Non-equity partner performance should be analyzed in this light and compensation should reflect that analysis. In many cases a slowdown in pay increases and more variable pay based on performance may be warranted.

There is usually a mixed bag of lawyer categories within the non-equity tier. These will include associates moving up, laterals moving in and retiring partners moving down from equity. In each of those sub-groups will be those who will transition through the tier in a few years, and those who become permanent members going nowhere. Law firms should work to clarify varying non-equity categories, and define appropriate standards, expectations, and assessment factors for each.

Instead of a traditional rating system, law firms should think about using a ranking system for non-equity partners instead. Consider multiple factors in ranking including skills, experience, productivity and behavior. No matter how talented all of your lawyers are, there will always be a continuum from top ranked to bottom ranked. Some simply will be better than others. The lowest in the ranking are the most likely candidates for action if you want to manage the size of the group and elevate performance.

Each year, the firm should identify the bottom 10% of the non-equity tier and “solve” those problems – most likely by developing an exit strategy for each. A few may be candidates for some alternative development effort or role, but given the likely need to reduce staffing as efficiency improves, this should be a very limited outcome, if offered at all.

Over time, the goal is to reduce the number of non-owner partners the firm has. Do not use the non-equity tier as a 'warehouse' for lawyers who are good but not exceptional. Consciously understaff and fill any gaps with contract lawyers on an as needed basis.

If you don't have a non-equity tier, proceed with caution. Adding a second tier can represent a big change culturally for the firm and financially for the equity partners as it concentrates capital among a smaller group. It is an option, but one that deserves very careful examination.

Non-Equity Partnership Checklist

- Maintain a non-equity tier if you have one, but manage it with much more attention and discipline.
- Set standards for entry into and exit from the tier and stick to them.
- Slow pay increases to non-equity partners and make more pay variable based on performance.
- More clearly define the different types of non-owner tracks, and sub-categories within each track.
- Be clear on appropriate standards, expectations, and assessment factors for each.
- Identify lowest performers each year and resolve performance issues.
- Over time, reduce the number of non-owner partners the firm has.
- Consciously understaff and fill any gaps with contract lawyers to improve margins.

Contact Altman Weil

3748 West Chester Pike, Suite 203
Newtown Square, PA 19073
(610) 886-2000
www.altmanweil.com
info@altmanweil.com

James D. Cotterman: jdcotterman@altmanweil.com

