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INSIGHTS

Evolving Approaches to Partner Compensation

Over the last 5 years (2019 to 2023) the average profits per partner of the AmLaw 100 firms has increased 44% and the AmLaw 2nd 100 by 22%. Associate compensation has also increased during this time, driven by the recruiting and salary wars of 2021. And we have seen an increase in lateral partner movement across the legal industry, including at firms who have historically been reluctant to grow laterally or who have rarely lost partners.

The increase in lateral partner movement has put significant pressure on partner compensation across all segments of the legal industry. Lateral partners are often paid a premium to move, and attracting high performing laterals with significant books of business can require firms to stretch their compensation ladder. At the same time, firms are laser focused on keeping their top performers. And younger high performing partners are increasingly impatient with the historic “slow up/slow down” approach inherent in many partner compensation systems and expect to be paid in accordance with what they are delivering today.

Firms at all levels of profitability are responding by adapting their approach to partner compensation from both an offensive (growth) and defensive (retention) perspective. Approaches include:

Stretching the Scale. More firms are adding levels to the top end of their compensation scale to pay top performers. This is stretching the ratio of top to bottom compensation substantially, and ratios of 8:1 to 10:1 are becoming common, and higher ratios are not unusual. The challenge with stretching the scale is locking partners into high levels of compensation when their business may be more cyclical. In some cases, firms are using super points or bonus points rather than traditional levels to ensure that the top levels are less sticky and can respond to changes in a partner’s performance metrics year to year. Super points are often an order of magnitude higher than the next highest level, to make it clear that they are for partners with outsize performance.

Increasing Bonus Pools. More firms are adopting bonus pools, and those that have them are increasing both the size of the bonus pool and the size of individual bonuses. Bonus pools had been averaging 5-8% of net income but are being stretched to 10-12% or more. Some firms have bonus pools as large as 25%. One of the factors driving the increased bonus pools is to moderate the increase in point values or level value. As profitability increases, the rising tide rises all boats, or value of a compensation level. While this is certainly the intent of points based systems because it encourages a focus on firm performance, it can result in some partners being overpaid relative to their contributions. Diverting money to a larger bonus pool helps to redistribute some of the uplift to the partners who drove the firm’s strong performance.

Bonuses are used primarily to reward outsize current year performance, and ideally go to partners who clearly outperformed their compensation level. Bonuses are also used in lieu of adding levels, to reward consistently high performers without being locked into high prospective compensation levels. Bonuses should be meaningful (e.g., no less than c. 5% of income). Sprinkling small bonuses to many partners is harder to match with clear bonusable contributions and can become an expectation rather than a reward for performance.

Faster Movement Up and Down. Historically, many firms with level/unit systems have had a practice of moving younger partners up slowly as they develop their practices. Firms often keep levels very sticky even as partner performance in the middle and top of the scale flattens or declines. But with the increased mobility of partners among firms, high performing partners have options. Firms have had to recognize performance by advancing high performing partners more quickly through the levels. This requires being willing to move partners who are underperforming their tier down more quickly than in the past, which can be a difficult change for firms.

Limited Equity Partners. The number of non-equity partners in law firms continues to increase. Collectively, 48% of the partners in the AmLaw 200 were non-equity partners in 2023. Firms are drawing the line between equity and non-equity at higher levels of partner performance. Given the performance levels and compensation levels, particularly at the top of the non-equity ranks, a number of firms have adopted limited or variable equity partnerships. The idea of a limited equity partnership is that those partners have a stake in the firm, albeit small initially, and share in the risk and rewards of the firm. In some firms this group may be a small group between income partners and full equity while in others it may be the majority of the formerly income partner group.

The limited equity model can provide a path for partners who may not want to or be able to advance to full equity partnership, yet still offer valued contributions as members of the firm. The limited equity model can be a good way to engage and retain high performing partners who want a different path. *See more in our Insight Evolving Partner Structure*

Expanded Revenue Credits. Origination of work has been a key driver of partner compensation in many law firms. But origination is not the only contribution partners make to developing client relationships, particularly for large clients served by multiple practices within the firm. Increasingly firms are expanding the credits they capture to recognize the contributions that partners are making to originating and expanding client work. This includes credits such as client responsibility and matter management, as well as collaboration credit. The goal of expanding the credits measured is to encourage partners to work together to both pitch and expand client relationships. While measuring broader contributions is helpful, it is important to be clear about how the credits will be factored into compensation. While some firms successfully incorporate up to 5 different revenue credits in their evaluation of partners, others find that two to three is the maximum that makes sense.

Considering Profitability. Many firms focus on top line revenue generation in measuring partner contribution rather than the profitability of the work. However, as client pricing arrangements, leverage models, technology requirements or other support vary more widely in the past, it is increasingly important to consider the profitability of the revenue. Two $5 million books of business may result in very different bottom line results. Firms are looking at client profitability for pricing and matter management purposes, but an increasing number are starting to consider profitability in partner compensation decisions as well. For some it is a thumb on the scale, while for others it is becoming a more critical part of the performance evaluation and compensation decision.

We expect to see firms continue to adapt approaches to partner compensation not only to respond to market pressures, but also to incentivize and reward strong performance for the partners and the firm. While it is important to understand and consider trends in partner compensation, firms must also be careful to align any changes with their strategy and culture, and not swing the pendulum too far in a different direction.

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