Are You Developing A Star Culture?

by Patrick J. McKenna and Edwin B. Reeser

In the wake of Dewey & LeBoeuf's collapse last year, The American Lawyer published an article we had written about an issue that turned out be a major contributing cause of that implosion: the wide compensation spreads within the equity partnership of large law firms. With the release earlier this year of regular Am Law Daily contributor Steven J. Harper's book, *The Lawyer Bubble*, and a recent American Lawyer survey that detailed the compensation spreads at many large firms, the issue has gained even greater attention.

Let's cut to the core of what's potentially problematic about these widening spreads. Not only must a compensation system be presented and perceived as fair, a firm leader must ensure that it is as fair as can be reasonably expected, consistent with that firm's unique culture. Any system that is patently unfair, irrespective of firm culture, is one that asks, indeed demands, that those within the firm embrace it. There will be examples where that is the case, either because partners and associates sign on to that expectation, or because they have no choice. But remember, the best talent with the best business in today's market does have a choice. And it doesn't always vote with its wallet.

Individual power is related to dependence in most law firms. Depend on a partner for his or her book of business, or even particular skills, especially if that expertise is rare, and that partner's power rises. When any individual acquires influence disproportionately greater than that of other partners, he or she can become almost indispensable to the firm. In many cases the individual can demand special perks or preferential compensation, or break rules others are expected to respect. It does not mean that the firm will cease to exist if this lawyer leaves, only that such a loss would create palpable financial pain for some period of time.

This is where the concept of flexibility enters the picture, and where expedient judgments may dictate that it is in a firm's best interest to provide a special accommodation rather than risk or even initiate the departure of an influential partner. As a consequence, if, as a firm leader, you are giving certain individuals preferential treatment or looking the other way when star performers behave contrary to firm culture, you are fostering a double standard. Will resentment ferment among other partners, creating a dynamic capable of undermining the performance of the entire firm? It darn well should. Trading doing "what's right" for "what's expedient and convenient" is not a viable option for those in leadership positions, yet it seems to have become standard operating procedure at too many firms.

Your final decision as a firm leader comes down to weighing the value of developing a star culture versus the costs of doing so—and those costs are more than simply hard dollars. In an earlier American Lawyer article, *Sliced Too Thin,* we warned about how widening compensation spreads can inadvertently weaken practice groups, especially when collaboration is required; foster tension between peers alienating by near or future stars; and eventually induce mid-level partners to leave—an occurrence that can serve as a leading indicator of potential firm failure. Whether affirmatively adopting a star culture, or just allowing it to develop, there are other considerations for you to study:

• Don't obsess over the wrong metrics.

Star cultures in particular suffer from their oversimplified compensation formulas, exacerbated because "origination" as a criterion for compensation puts no particular value on one form of business versus another. Where many firms err in their star evaluation systems is by being unselective, by being obsessed with gross revenue, and by letting profits per partner become the sole criterion for success.

Success goes beyond a large book of business. There is the often-unexamined issue of growth potential. For example, one partner has a book of $7 million in revenue derived from clients that occupy industries with little growth potential. Another, meanwhile, has a book worth $3.5 million that is largely derived from serving a stable of biotechnology clients that are expected to grow exponentially over the coming decade. Which of these partners is more valuable to your firm? And when?

Similarly, you have a partner who consistently produces 2,400 billable hours a year and keeps a handful of associates very busy . . . all doing largely commodity work with a low margin/contribution to the partner profit pool. Compare that to yet another partner, who is likely to bill only 1,450 hours this year as he continues to invest heavily in building his skills and marketing his cutting-edge private-public-partnership (P3) practice. Again, which partner is more valuable to your firm?

Finally, you have your partner with a $20 million book of business billed at discounted commodity rates. The practice is notorious throughout the industry for its low rates, slow pay, and write-downs. A candid review tells you that the contribution to the profit pool being made by this partner and the two partners that support her is significantly exceeded by the compensation allocation they are receiving based on gross revenue, as well as the star premium you have committed to paying her. The hard truth is that the firm would be considerably more profitable without her. Contrast that with another partner who heads a lean team charging and collecting close to 98 percent of its recorded time, with an average accounts receivable turnover of about 40 days. This group's contribution to the profit pool is double the other groups, but it is taking out just half as much in compensation. Which do you want to keep, which can you afford to lose?

We don't know that there is one right answer to these questions. What we do know is that the only thing that seems to command power in most law firms today is the individual attorney's book of business, as defined by gross "revenue" and little else. That clearly is a wrong answer.

• Don't suppress innovative behavior.

In a meeting, with a large group of partners, we posed a number of statements for the assembled to both express their views and vote upon (a secret vote by virtue of electronic voting machines). One of the more telling inquiries we posed was:

> *"How many of you have thought of some idea, potential new practice, new practice niche or initiative, that has the potential to generate new revenues for the firm?"*

As we explored this same question in a number of subsequent meetings with various groups of partners, the usual answer was somewhere in the range of 69 to 83 percent in the affirmative. So, what happens to these ideas?

What we have learned is that innovation becomes much harder to stimulate when you are swimming upstream against the currents of a firm culture that doesn't affirmatively and openly encourage such innovation. Structures and processes do make a difference. They may not make innovation happen, but they prepare the ground so that any innovative ideas that exist will have some chance of getting a receptive hearing. But what kind of culture is best for enabling innovation?

Professors Zannie Voss and Glenn Voss, both from the Cox School of Business at the University of Texas together with professor Daniel Cable, of the Kenan-Flagler Business School at the University of North Carolina queried the managing directors of 146 professional theater companies to understand how much each embraced one of three different organizational cultures: a collaborative culture, a hierarchical one, or a so-called "star" culture in which talent is compensated according to the "perceived" economic value of its contributions.

The researchers examined three years of data about each theater company's revenues and royalty streams (the latter was used to gauge success at innovation, since theater companies earn royalties by licensing their original works to other theaters), and a seven-point scale to measure the influence of the three different types of culture on each theatre company. They concluded that increasing a company's "collaborative norms" rating by just one point could improve a firm's talent retention, revenues, or revenues coming from innovation, by as much as 10 to 15 percent. Conversely, the star culture scored lowest in positively affecting revenues coming from innovation.

• Don't impair partner morale.

In a star culture, the best people supposedly rise to the top in a Darwinian survival-of-the-fittest fashion. They rank their partners, pitting professionals against each other. More and more firms regularly eliminate, or de-equitize, the bottom performers—they "cull the herd" to boost profits. In such cultures, fear dominates. Partners worry about whether their names will appear on the de-equitization list and whether they can beat out their peers for recognition. In a culture that pits one colleague against another, would you trust any colleague enough to share your ideas, your work product, or your clients with him or her?

In a world where heroes are worshiped, superheroes idolized, and rock stars treated as gods, it somehow gets lost on us that the true power lies in high-performance *teams* and not just one person, however good that individual might be. Lawyers are part of a firm to be part of a team, not to exploit and raise their own standing to the detriment of all who are ranked below them.

Take three years to get your firm back on track. You don't have to—nor are you likely to be able to—do it overnight. Compress the wide compensation spread by letting the middle class "float" upward. Disgorge those lawyers who would sacrifice the future of your firm on this year's distributions to themselves. You may not survive in the long run if you don't.

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