

TRUE PROFITS PER PARTNER REVEALED (Aug 05)



As a direct follow-on from the article on partner remuneration systems (See HR Aug 05) it is interesting to note that PEP (profit per equity partner) had to be restated in a recent survey.

In England, where basic fiscal performance data has been routinely disclosed for years, there has been some whinging about profit comparisons when firms have different 'equity' structures. For example, some firms have been stripping 'partners' of equity with the inevitable result that PEP figures get distorted. (Yes, un-productive English partners get the 'heave-ho' just like some have here in Australasia.)

In statistical terms the comparison problem occurred around the definition of 'partner', generally understood to mean one who is entitled to share in a firm's profits. This used to be a 'black and white' issue but not any more apparently, as yet more obscure ways are being found to remunerate people, (guaranteed bonuses, fixed percentages of partner profits placed into salaried partners bonus pools, part salary/part equity drawings etc). It seems the ingenuity of HR professionals is considerable when it comes to designing new pay systems.

The results, when the PEP figures for the top 30 were restated after putting all partners on an equal footing, make for interesting reading. Three examples are set out below:

Firm	'Old' PEP figure	Revised PEP figure	'Old' Margin	Revised margin
Freshfields	£700,000	£700,000	45.4	45.4
Slaughter & May	£1,050,000	£998,000	43.8	44.7
Allen & Overy	£707,000	£619,000	36.3	40.0

The above indicates the necessity of ensuring like is being compared with like when considering data. At another level it may interest readers to note that when taking account of the operating margins in the same 30 top-performing English firms the variation is considerable; the highest is 54.4% and lowest is 24%. Interestingly, partner remuneration does not vary to the same degree.

US comparative performance data is often presented using a profitability index to iron out inconsistencies. Yet they too have significant variation in margin, even among the top 5. Cahill Gordon, a 225 lawyer firm that currently top the profitability index, show a margin at a heady 65% whilst 5th placed firm, White & Case (New York, 1900 lawyers) operate at 32%.

What this and the previous article may demonstrate is the lack of relationship between distributable profits and margin. When looking at time-series data for a single firm there are clear causal and associative links that demonstrate the link between seemingly unconnected events/behaviours and fiscal performance. For example, firms unable to demonstrate continuity of profit performance resulting in fluctuation of partner incomes are known to have higher than usual partner T/O and higher levels of variable/performance related pay. Whatever the primary cause of the income fluctuation at individual firms it is not a good look; placing the most important component in the legal services delivery supply chain into a position where they could easily feel undervalued. I am referring, of course, to the clients.