

PARTNERSHIPS: Do we need them?

In this, his second column for *Client Report*, Jomati consultant **MICHAEL HERLIHY** goes to the heart of law-firm models and asks: is partnership right for the client?



Michael Herlihy -
Voice of the client

Just because it has lasted a long time, is it truly necessary? Writing this on the day of England's opening game at the 2006 World Cup my mind drifts back to the FA Cup match over 30 years ago, in January 1972. On a mud-bath of a pitch with four minutes of normal time left the home team is losing one - nil. A large unathletic-looking player lumbers forward a few yards. When no one challenges him he comes forward a few yards more looks up and improbably hoofs the ball 30 yards into the top left hand corner of the goal. Yes - Ronnie Radford's legendary equaliser in Hereford United's famous FA cup victory against Newcastle. As someone who stood on the terraces at Edgar Street every Saturday as a schoolboy, it was a joyous moment. And yet my feelings about the goal are ambivalent. Yes it was the goal that launched Hereford's ascent into the Football League but it was also the goal that launched the career of commentator John Motson. For those unfamiliar with this man's work it is hard to do his achievements justice in a single sentence, but suffice to say that in over 30 years of commentary he has run the full gamut of analysis from the anodyne to the banal without, so far as I am aware, stumbling over a single moment of illumination. With no one else able to compete with insights like: "The world cup - it's a truly international event," he will again be leading the BBC's coverage of this year's event.

Anyway, having established that there need be no connection between longevity and utility we can turn our attention to the issue of partnership as a form of business association for lawyers.

For the majority of law firms that continue to be small and local in scope, partnership offers a logical and potentially effective form of business structure which may well remain with us for a long time yet. What though of the large international firms - how well does the partnership model serve them? On the face of it one might think that businesses with thousands of geographically dispersed staff

and turnover running into hundreds of millions of pounds might struggle to operate within the confines of a partnership. Surely anyone starting such a business from scratch today would opt for the greater flexibility and easier access to capital offered by a corporate structure? Be that as it may, the fact is that since 1967, when the rule limiting firms to 20 partners was abolished, large firms have flourished. Particularly since the "big bang" 20 years ago many of these firms have been extremely successful and certainly outperformed a lot of corporately held businesses of equivalent size. Of course, for most participants the nature of partnership has changed significantly over that period. Indeed according to a recent Grant Thornton survey many people feel that "partnership" as they used to know it has gone altogether. Nonetheless, most people who have been progressing through the equity in these firms over the past ten to 15 years are entitled to feel that they have done a pretty good job.

That said my interest is less in whether partnership is a good model for the owners of these businesses and more in whether it is the right model for their customers. For three reasons - relating to focus, motivation and development - I don't believe it is.

Businesses with tradable capital operate under relentless daily pressure to reduce costs, to innovate and to serve customers better. With few exceptions (the occasional family held concern perhaps) this applies whether their capital is publicly or privately held. In a partnership, even a well run one, all these imperatives come served with some side helping of "but will the partners live with it?" In a corporate environment the prospect of every significant decision "benefiting" from direct shareholder input would be greeted with horror. Apart from anything else, the demands of running a modern business simply do not afford the time and owners have to accept that whilst they can appoint, assess and, if necessary, change

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the management, for the most part management must be left to manage and be judged on the results. In a partnership such clarity is impossible to replicate. In any large organisation there is a tendency for people to become too inwardly focused, but in a partnership the sheer number of internal issues in which people not only take an interest, but actively expect to participate, creates an especially rich menu of potential distractions. Firms may have quite well developed management structures but however well established a senior partner, managing partner or management board may be, they remain subject to re-election by their partners – not a regime calculated to lead to an unambiguous focus on doing the right things from a customer standpoint.

Of course, the separation of management and ownership is not a panacea, and there are plenty of occasions in the corporate world when management may be thought to be having undue regard to its own interests and not worrying enough about its customers. However, in an environment which, for publicly held companies, is built around a quarterly reporting cycle policed by analysts and, for privately held companies, is driven by owners’ requirements for investment returns, any serious sense that “the management is behaving as if they own the company” is unlikely to be left unaddressed for very long. As a manager one might not always welcome this regime but as a customer it looks hard to better.

From a customer standpoint the second problem I see with these businesses operating as partnerships is the conflict that arises between the way in which a client wants their affairs managed and the motivation of individual partners. In a corporate environment different departments may have an interest in arguing that customers want different things (R&D; more innovation; sales lower pricing, for example) but overall, whatever the reason they are buying, it is clearly in everybody’s interest for the customer to buy as

much as possible from the firm. In law firms great efforts are often made to try to get partners to operate on the principle that what matters ultimately is the relationship between the client and the firm rather than any individual partner but in most cases – however strong the sense of collegiality that is engendered – the underlying reality is that client “ownership” is the ultimate source of power both within the firm and – in extremis – outside. Twenty years ago, when mergers and lateral hires were rare, things might have worked differently, but in the current environment it should hardly come as a surprise that partners aim off a little when deciding how exactly to apply their firm’s laudable “one for all and all for one” policy. As a client what you want is fairly simple. Firstly, you want access to the partner best placed to help you and secondly, if that partner is not someone you have worked with before (e.g. because they are in an overseas office); you want him or her to treat you in the same way and with the same priority as your “regular” partner. Firms that run themselves on a pure “eat what you kill” basis probably know how they plan to achieve this, though it is not immediately obvious to me. Experience, however, suggests, that lockstep in itself is no guarantee of better client management behaviour.

Transporting people into a corporate structure would, clearly, not of itself remove the underlying problem but the familiarity with balancing individual, team and business wide performance coupled with the increased array of reward mechanisms would surely generate some more imaginative approaches to incentivising people to provide clients with what they want.

Whilst the issues around focus and motivation are substantial, my major objection to the partnership model actually relates to the development environment it creates for people. Specifically I worry about the mindset that someone in their mid-30s who has “made partner” is, thereby,

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anointed as a fully developed player whose future development, including client support skills, can largely be left in their own hands. Obviously, a lot of firms do provide skills training for partners but, if you discount sales and marketing training and the management education provided for people going into specific roles, I am not sure how much would be left. Certainly few firms yet seem to have engaged with the question of how a partner's contribution should be expected to develop over, say a five, ten or 20-year time frame. Individual partners may have their own ideas on this but in firms where there is no actual appraisal system for partners, or none that looks much beyond billings, it seems to be asking quite a lot to ask them to identify their own development needs (supreme self awareness not always being the first quality clients highlight in their lawyers). In a corporate environment where everyone up to and including the chairman receives at least an annual appraisal this is an unimaginable state of affairs. Even without formal assessment structures, moreover, the fact that people well into their 50s are typically either competing for promotions or (increasingly) trying to avoid falling into the “bottom X%” subject to mandatory Jack Welch-style culling, means that few people are able to rest on their laurels.

So, having focused on the downsides, are there any actual benefits to clients of the partnership structure? At one time, of course, most partners would have opened for the defence with their unlimited personal liability and the comfort clients should take from this as a key distinguishing factor for their business. In the era of the LLP this is gone, though frankly for most clients I would not say greatly lamented.

Absent the ability to take away partners' houses and Porsches, though, why else should partnerships find favour with clients?

An argument put to me recently by one friend and senior partner uses as an example a conflict of

interest situation where it would be in the firm's interest for a client to commission more work/advice but the client might be better served by a different course of action e.g. settling a dispute. In this case my senior partner friend argues that in a partnership it is easier for him to advise the client to settle because as a partner he is taking money out of his own pocket rather than a third party owner's to whom as a manager or director of a corporate enterprise he might owe other duties. In response, I might note that this argument is not one that ultimately persuaded Sir David Clementi or the government, and also suggests that most large corporate clients would probably back themselves to make their own judgement provided they were given clear advice without the need for the slightly paternalistic guidance implicit in the example. Leaving those points aside, though, I think there is something much more interesting about my friend's argument.

Let me say straightaway that I have no doubt that the view about discouraging unnecessary work is very sincerely held and that most partners actually running their practices and working with clients would seek to discourage this. From that point of view I accept that most partners in major law firms, as providers of legal services to their clients, have very sound instincts. At the same time I find the assumption that an owner's interest would lie in encouraging irrelevant or misdirected work a fascinating one. For any owner seeking to build long-term value in a professional services business it would surely be self evident that foisting short-term sales on people of things they don't need is an unlikely path to success. (If not self evident, there is plenty of literature in which they could look up the answer.) If the profession can't see this then perhaps it should stick to providing legal services and, as the White Paper has concluded, let someone else have a go at the business of owning law firms. ■