



The Law Society

Managing your partner resource

Howard Hackney

18 September 2013



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Howard Hackney

Howard left Grant Thornton UK LLP in 2008 where he had been a partner for over 25 years to establish his own boutique practice. During his time at Grant Thornton he was head of professional practices for the North West and head of family businesses for the UK. At Grant Thornton he had a variety of roles including office Managing Partner, North West regional marketing partner and membership of the partners appointments panel. Howard specialises in advising mid market professional practices and family businesses. In 2002 he won the CBI's national award as "Best Business Adviser".

Howard's focus is providing "special projects" advice to firms with up to 20 partners. His experience extends from highly profitable sole practitioners to advising 3 of the top 100 law firms. Recent assignments have included sales of law firms, partnership disputes, fund raising, LLP and ltd company conversion, ABS conversions, sales and acquisitions.



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Introduction



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Agenda

- Attributes & how to assess them
- Tiers of partner
- Profits sharing regimes
- Capital structures
- Performance management and SMART objectives
- Questions throughout



Questions for you on

- Number of partners
- The topic of most interest to you
- The topic of second most interest to you





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Attributes & how to assess them



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Background

- Member of partner assessment panel
- Industrial psychologist
- Detailed interviews over two days
- Fundamental attributes
- Subsidiary issues
- Method of assessment





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Fundamental attributes

- Motivation
- Intellect
- People
- Organisation





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Motivation & intellect

- Motivation

- To add & contribute for the sake of it
- NOT for status & reward
- NOT for praise
- Self motivated
- “Death bed” question

- Intellect

- Flexibility
- See other points of view
- Argue “black is white”
- For lawyers unlikely to be an issue - BUT for accountants.....!!





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People & organisation

- People
 - Understanding
 - NOT liking or being liked
 - Ability to change style to get best from people
- Organisation
 - Use of in tray test
 - Ability to prioritise
 - Defer
 - Delegate
 - Say no
 - Bring in resources





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Subsidiary issues

- If have fundamentals these should follow
- Proven work getting
- Credibility
- Technical competence





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Assessment methodology

- Simulated scenarios
- Open questions
- Past experience
- By interview
- Non confrontational





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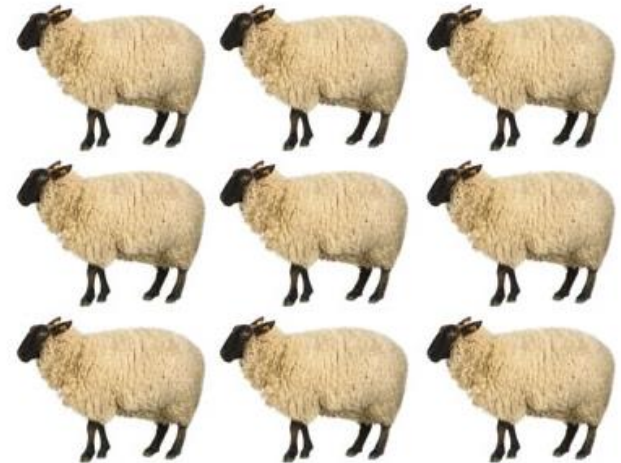
Tiers of partners

Question for you

- What type of corporate vehicle do you practice under
 - Traditional partnership
 - LLP
 - Limited company
 - Hybrid

Tiers of partner

- Salaried
- Fixed Share
- Equity (usually in a “lock-step”)
- Hybrid
- Used to manage career progression
- Tax status - Schedule D or E
- BUT HMRC consultation





Characteristics of partner types

Characteristic	Salaried	Fixed Share	Equity	Hybrid
Guaranteed salary	Yes	No	No	No
Prior salary	No	Yes	No	Yes
Variable profit	No	No	Yes	Partial
Exposure to losses	No	Probably not	Yes	Yes
Employee taxes	Yes	No	No	No
Self-employed taxes	No	Yes	Yes	Yes

HMRC consultation on taxation of partnerships

- Two issues
 - Substance of self employed status
 - Profit allocation to entities not subject to income tax regime
- Timetable
 - 2013 budget consultation announced
 - Consultation submissions by 9 August
 - Announcements Autumn statement 2013
 - Enacted 6 April 2014





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Self-employed status

- HMRC concern over disguised employment status
- Removal of presumption that an LLP member is self-employed - NI impact
- Always was going to happen
- Historically need for
 - Genuinely fluctuating profits
 - Capital at risk
 - Involvement in management
- Expected
 - Fixed share can vary by 5%
 - Capital at risk



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What now?

- Be prepared to be challenged by HMRC:
 - Tax payable earlier
 - Different NIC regime
 - Taxable benefits
- Introduce hybrid partners:
 - >5% remuneration as variable profit share
 - Capital - link to profit share & voting
 - Some voting rights
- Note that legal status unaffected - just reclassified for tax purposes

Profit allocations and income tax

- The more worrying & significant area
- Corporate members of LLP
 - Tax at 20% on profit allocated v. 45%
 - Savings often used to pay down borrowing
 - “Economic connection” between partners and corporate member
 - Apply income tax to owners of corporate member
- Is there a commercial reason for structure other than tax
- Limited company solution
 - BUT far less flexible
 - Subsequent tax changes to dividends





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Profit sharing regime

Question for you

- Do you have some form of profit sharing based meeting personal performance criteria?



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Profit sharing

- Concentrate on size of cake
- Profit sharing and capital integral to one another
- Most important issue at end of year?
 - What can the partners draw!!
 - How do I compare with my “mate” down the corridor
- Looking at true equity only, not grades of partners
- Is the theoretical structure right
- Every system has its pros and cons - team v. individual





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Theory

- Equality via lockstep
- On performance
- A mixture of the two





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Objectives

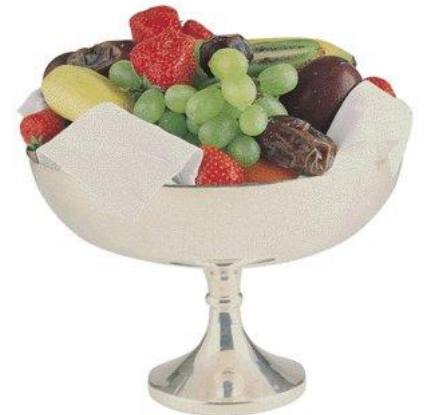
- Fairness
- Simple & understandable
- Potential to
 - Motivate
 - Grow the cake
- Flexible
 - Allows new partners
 - Super/under performers
 - No need to revisit every year





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%



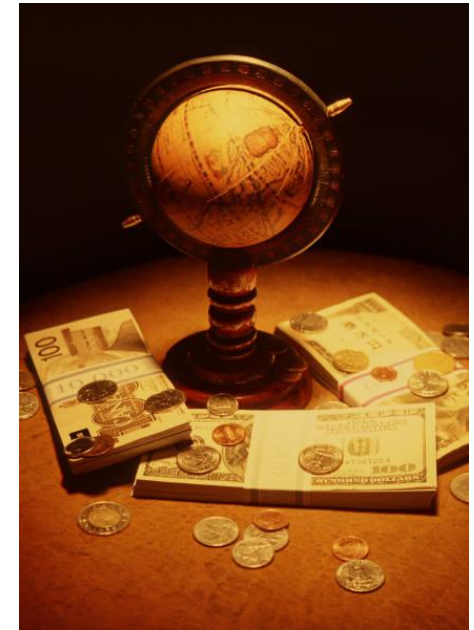
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My preference (probably)

- Interest on capital - allows borrowing & compensates for unequal current accounts
- Rate for job
- Performance pool
- Dividend
- Possibly departmental/geographic pool





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Rate for the job

- Fixed prior share
- "Rate for the job"?
- Equal or shades of difference?
- Mechanism for allocation - remuneration committee?
- Tends to be longer term
- Less volatile
- Frequency of change





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Performance pool

- % of profits - 10%?
- Sufficient to motivate but not too much to demotivate
- Appraisal & mechanism
- lack of just as divisive
- SMART objectives at start of period - able to influence
- Self appraisal
- Peer appraisal
- Remuneration committee





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Dividend

- Based on "points"
- Less divisive than % shares
- Simpler as you grow
- Need to control points in issue
- Length of time to parity
- Phasing on retirement
- Starting point 50 to 100 points? - lockstep (modified)
- More profit - longer period
- Partnership issue





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Drawings policy

- Vitally important in this climate
- Interest on capital gross monthly
- Base salary less tax monthly
- Retain tax in partnership - quasi capital BUT partner at risk
- Performance pool & dividend
 - Payable when calculated
 - Less tax
 - Probably post year end on signature of accounts
- Other amounts as an absolute exception





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Capital structures

Questions for you

- What is the average capital that each partner has in the practice?
- Have you had negotiations with your bankers in the last 18 months about the level or terms of your facilities?



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A personal view

- Agree value
- Split between "Fixed" and "Current"
- Partner current accounts to be freely withdrawable
- Fixed capital should equate to ownership and dividend
- Distinguish capital ownership from profit sharing
- Excessive balances unhealthy
- Gearing a philosophical issue
- Provision of capital a fundamental condition of partnership
- Level of partner capital relatively academic if able to borrow
- Total level in hands of “remuneration committee” ?





Points system - example

	Yr 1	Yr 2	Yr 3	Yr4	Yr5
Partner 1	100	100	100	100	100
Partner 2	60	70	80	90	100
Partner 3	100	90	80	70	60
Partner 4	0	0	50	60	70
	260	260	310	320	330



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Performance management & SMART objectives

Question for you

- Have you had an involuntary exit of a partner in the last 18 months?
- If so was it acrimonious on a scale of 1 to 5 with 1 being not at all with 5 involving the threat of or actual litigation



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Objectives

- Grow the overall size of cake
 - Reward
 - Motivate & focus
 - Support
-
- No perfect system - competing demands





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SMART objectives - for reward

Specific

Measurable

Achievable

Realistic

Time-specific



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Good & bad examples



- To improve personal effectiveness
- To increase personal billing from £200k to £225k in YE 31/3/20X5
- To improve market profile of the firm
- To issue 1 press release a month & have at least 50% published in the Daily Post in YE 31/3/20X5
- To become technically competent in xxxx new area
- To have no PII claims in YE 31/3/20X5



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Reward

- Use SMART objectives
- Set in advance of forecast period
- Allocate specific amounts to each area
- Issues
 - Finance
 - HR
 - Technical competence
 - IT/systems & procedures
 - General management
- Focus
 - Personal
 - Department/office
 - Firm





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Motivate & focus - softer issues

- Probably no money on this area
- Personal skills
- Training
- Involvement in firm wide objective setting
- Obtaining buy-in





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Support

- Role of appraisal
 - SMART objectives
 - Support
- Mentor - especially new partners
- Culture - avoid blame
- Freedom to make mistakes
- Personal development
- Confidential counselling
- Dependant on management style and skills





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Unintended consequences

- Unhealthy competition & rivalry
- Disputes over the “numbers”
- Disputes over reason for work gains
- Game playing
- No cross selling
- Management time on internal disputes
- Demotivation





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Overview re performance related reward

- Are the gains worth the “hassle”???
- If > 10 partners probably
- If < 10 partners probably not
- BUT you decide





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Questions

Links/ contacts for Law Society and other external resources that may offer further information

www.lawsociety.org.uk

If you have any ideas for future webinars please contact britha.parekh@lawsociety.org.uk



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