Industry Trends

Common Characteristics of a Successful Partner Compensation Program

By Allan D. Koltin

Q: Clearly, one of the most sensitive and controversial issues in multi-partner CPA firms is partner compensation. Is there an overriding issue that causes the conflict or is it many different things?

A: When it comes to partner compensation, I believe the overriding issue that causes much of the conflict in CPA firms is that individual partners view their own talents and performance differently from how their peers view their talents and performance. Safe to say, we all have "blind sides" and this can go a long way toward explaining the differences in perceived value and actual contribution.

Q: It seems some firms have a very structured and goal-oriented process toward determining partner compensation, while others wing it at best. Do clearly defined goals make a difference, or is the whole concept of goal-setting simply overrated?

A: Quite candidly, goal-setting might be one of the most, if not *the most*, important piece of the partner compensation journey. I find that firms that have "high harmony" when it comes to partner compensation have done an exceptional job of setting very specific, measureable, and attainable goals for the partners up front. These goals, for the most part, are the intersection of the firm's strategic goals and the partners' strengths and passions. Many firms attempt to go through the goal-setting process, but in actuality, very few do a great job of it. Partner goals need to be viewed as a "contract" between firm leadership and the individual partner, whereby the partners not only have realistic and measureable goals but, more importantly, their goals are attainable and there are no big obstacles to prevent them from achieving them.

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Q: Is it as simple as partners setting goals at the beginning of the year and then meeting at the end of the year to do a "true-up" in terms of how they did vs. their goals?

A: Nothing could be further from the truth! In the firms with successful partner compensation programs, there is typically a quarterly coaching, mentoring, and accountability structure in place whereby partners receive (1) periodic feedback on how well they are performing, in terms of their goals, and (2) assistance regarding any obstacles or challenges that may have come up during the year. How often are goals set on January 1st, and then there is smooth sailing for the subsequent 365 days of the year? More often than not, things happen or change, and partners need to realize that they also have to be accountable for the adaptability of achieving what could sometimes be viewed as a moving target.

Q: Where have you seen breakdowns in partner compensation at the end of the year, when it is time to reward partners for their performance over the past year?

A: There are two issues that can throw a wrench into the best-conceived partner compensation programs at year-end bonus time. One is what we call the "school of good harmony," in which everyone gets bonuses and the difference between the overachievers' bonuses and the underachievers' bonuses isn't that significant. All this model does is send a message to the underachievers that it is okay to cruise, and it is surely not worth the pain to stretch like the overachievers to get a little bit more money. Unfortunately, sometimes the overachievers downgrade their future performance because they conclude it is not worth it to work that much harder to get so little from the bonus pool.

The second issue deals with partners getting bonuses when they are not entirely clear why they received what they received. Leadership needs to be as specific as possible when giving bonuses so that the right performance gets reinforced going forward. I can't tell you how many times partners tell me that they got bonuses, but they are not sure if they got them simply because they're a partner, or because the bonus was specifically tagged to their achievement of certain goals.

Q: I've read a lot about balanced scorecards and their use in CPA firms. Are you a big proponent of the balanced-scorecard concept?

A: I realize I'm veering from the norm, but I think in certain situations the balanced scorecard is an ineffective way to compensate partners. For example, I find that when we try to quantify percentages for a half-dozen or so goals, we sometimes get into a mathematical mess when trying to determine the precise bonus the partner should receive. I would rather tell a partner with six goals that two of the goals are "must do," two are "should do," and two are "nice to do." The "must do" will probably determine 90 percent of your bonus allocation for the year. Having said that, the two "should do" goals should be taken pretty seriously, and the two "nice to do" goals, quite candidly, should be done just because these are basic things that good partners do. I also find that the deeper you go into the forest in terms of percentages, formulas, and structure, the more difficult it can be to have the flexibility and latitude to truly reward partners for accomplishing what matters the most.

Q: How do you get partners on board, fully understanding the potential they have (at least as viewed by their other partners), and buying into stretch goals (or at least doing different things than they are presently doing for the firm)?

A: Let's say we have a six-partner firm, and all partners believe, based on their potential, that they should be earning more than they presently are. Let's also assume that each partner could point to a couple of other partners at the table and suggest that they are underperforming partners. What I have done with firms in this situation is to put them through the following exercise:

I ask each partner to leave the room for no more than 20 minutes and write out his or her goals for the coming year. I then tell the remaining partners, "Let's pretend we can hypnotize the partner who is currently out of the room to do whatever we want for the greater good of the firm. Based on that, what should the partner's goals be, taking into account the individual's talents, passions, and potential?" Upon completion of the exercise, I ask the absent partner to return with the goals he or she created. I then hold up the two sets of goals, and it is here that we see what we refer to as the "profit gap."

Quite candidly, there is sometimes an astounding difference between what partners want to do and perceive that they are good at vs. what the other partners truly think they are capable of doing. At first, individual partners are a bit defensive when they are the focus of the exercise, but they quickly come around when they can participate and see the gap that exists for many of their other partners. I have found that this type of exercise can be a true breakthrough into getting partners to become more adaptable to change, not just for the firm but also for their individual performance and behavior.

Q: Sometimes numbers can be deceiving when it comes to looking at partner statistics that are relative to the book of business, realization, and utilization. What are one or two things we should know about statistics that the numbers, in and of themselves, won't communicate?

A: Frequently, partners' books of business won't indicate if the book is homegrown (*i.e.*, originated by that partner) or inherited (*i.e.*, passed on from a retiring partner). While there is nothing wrong with inheriting a book of business from another partner, I would not value it as highly as that of a partner who essentially originated his or her own book of business. Additionally, some partners are exceptional at bringing in new business and feeding others. At some point in time, we might look at the partner's book of business and ask why is it smaller than other partners' books? It might be necessary to remind ourselves of how many other partners this individual has fed over the years by bringing in new clients and passing them on to others in the firm.

Q: What are some things that partner compensation systems currently don't measure that firms should start measuring, or at least have a greater awareness of?

A: There's an old adage that if you can't measure it, you can't manage it, and if you can't manage it, you surely can't improve it. Some of the basic things that I think should be measured in a partner compensation system—and oftentimes are not—include the following:

- individual partner scores on client satisfaction surveys;
- new talent that the partner recruited during the year;
- results of partner upward evaluations;
- results of how well mentees of the partner are growing professionally, and how much additional responsibility they are assuming within the firm; and
- new initiatives or ventures that the partner has championed and/or that the partner has taken a leadership role in during the year.

As you can see from this list (and there are other items), these are the things that we often know some partners are doing better than others, but we simply don't measure them in the same way we measure billable hours, book of business, and new business origination.

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Q: Recently, I read that over 50 percent of the Top 200 CPA firms now have closed compensation (*i.e.*, partners only know their own compensation). It would seem on its surface that you would need a high degree of trust to have a closed compensation system. What is it about closed vs. open compensation (*i.e.*, all partners know what each other makes) that is making this trend so popular?

A: This is an easy one. My guess is that if you surveyed all the firms that have closed compensation, they would tell you it was one of the smartest things they ever did. If you surveyed the firms that didn't have it, probably half of them would tell you they're trying to move toward more of a closed compensation process. The benefit of closed compensation is that it eliminates the issue of "relative partner income," in which we are looking over our shoulders, always curious about what we earn compared to our peers. It is safe to say that if we are earning $1,000 more than our peers, we are happy, and if our compensation is $1,000 less than our peers, we are miserable. The focus of partner compensation should simply be on how Partner A continues to grow and be worth more to the firm and thus be worthy of additional compensation. In an open compensation system, not only does the issue of peer compensation exist, but there is also the embarrassing and demoralizing effect for underperforming partners who might receive small bonuses or reductions in salary and clearly don't appreciate that information being shared with the rest of the partner group. I also find in a closed compensation system that firm leadership has the ability to bring in lateral partners and cut "special" deals if necessary without the "Monday morning quarterbacking" that often occurs within the partner group.

Q: Are there any other big issues or challenges in partner compensation that you would like to share with our readers?

A: Clearly, once a firm expands from a one-office to a multiple-office firm, the age-old question will be asked, which is, "What comes first—the firm, the office, or the partner?" Combine this with a couple of unique industry teams with their own profit centers and you've got all the juicy issues that plague larger multi-office firms, ranging from the sharing (and cost allocation) of staff between offices to business origination issues regarding who is the best person to go on the sales call. I recently worked with a multi-office firm where two different offices had called on the same prospect—one because they were in the same geographic area as the prospect's business and the other because they were part of the industry team (nonprofits) that had received an invitation to propose on the prospect's business. The humor of the situation (if there was any) was that the prospect chose not to tell the two groups that they were competing against each other, and they only found it out after they had each submitted their proposals. So much for the one-firm concept!

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