Performance-based Profit Sharing versus Lock Step to Equality: Profit-sharing Systems in Australian Law Firms. A Study of Comparative Outcomes

by

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B.Ec, Grad Dip Fin Mgt

A thesis submitted in partial fulfilment of the requirements for the degree of Doctor of Business Administration (DBA)

Macquarie University
Sydney, Australia

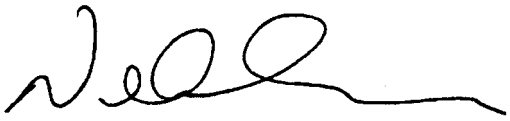
April 2012

Certification

This thesis is submitted in fulfilment of the requirements of the degree of DBA in the Graduate School of Management, Macquarie University. This represents the original work and contribution of the author, except as acknowledged by general and specific references.

I hereby certify that this has not been submitted for a higher degree to any other university or institution.

Signed:



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21 November, 2012

Abstract

Large law firms have existed in Australia for a relatively short period of time, multi-jurisdictional or ‘national firms’ for an even shorter time. Prior to the mid-1970s, partnerships were limited to seven partners or fewer; prior to the early 1990s, Australian firms practised in only one state. In recent years, large law firms have been changing. They have evolved from traditional equity partners, sharing profits equally among partners, to managed businesses, many with both equity and non-equity partnerships. Many firms now share profits differentially, according to individual performance.

The reasons for, and implications of, these changes are not fully understood. A review of the literature pertaining to both traditional law firm partnerships and contemporary partnerships, focussing on how and why firms share profits the way they do, identified gaps in the literature and practice of professional service firm management. This thesis attempts to deal with some of these gaps by increasing our understanding of the myriad consequences of chosen profit-sharing models on the internal dynamics of law firms and on the partner group in particular.

The legal profession is thought to be influenced by institutional pressures. As a result, when changes occur in leading firms they are often embraced by followers. Indeed, there is also a tendency for smaller firms to mimic large firms in embracing change. This thesis examines why some large firms are changing their partnership structure and sharing methodology – and why some are not changing – with a view to better inform those that follow and who may be tempted to embrace similar changes.

This study used phenomenological methodology to improve our understanding of a small subset of phenomena influenced by changes in the principles of the practices of profit sharing, specifically firm performance, partner performance, partner retention and gender equity. The purpose of the research is to improve our understanding of the profession’s own perceptions of the transition under investigation. Data were gathered from a significant group from within the legal profession, through in-depth interviews with the Managing Partners of 19 large law firms who have been undergoing the transition. Thus recommendations can be made to other firms contemplating and

managing similar changes. In order to triangulate the data, I analysed an existing dataset relating to firm performance, collected by me in the course of benchmarking the industry as part of a commercial venture involving FMRC. The FMRC data are considered as definitive comparative analysis information within the Australian profession.

The findings of the study increase our understanding of management practice, particularly for firms contemplating changes to their sharing methodology and seeking to understand many of the implications of so doing. This thesis also raises several opportunities for additional research to enable us to understand the investigated phenomena more fully.

Acknowledgements

I would like to thank my supervisors Dr Steven Segal and Andrew Heys for their guidance, patience and support.

I would not have been able to undertake this exercise without the support and patience of my business partner, Sam Coupland, and our staff at FMRC, thank you.

My involvement with the Australian legal profession, which made this research possible, is in large part due to my business partner and friend of many years, Sam Beasley, and his incomparable professional legacy.

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List of Abbreviations

ABS -	Australian Bureau of Statistics
CEO –	Chief Executive Officer
FMRC	The trading name of FMRC Pty Ltd, formerly the Financial Management Research Centre
GFC	Global Financial Crisis
HLS	Hybrid Lock step Schemes
LSE	Lock Step to Equality
MPB	Managed Professional Business
NSW	New South Wales
PBS	Performance Based Sharing
PSF	Professional Service Firm
UK	United Kingdom
USA	United States of America

Chapter 1 Introduction and background

Many large law firms in Australia are changing the way they manage their partnerships. They have evolved from small equal-sharing partnerships into large businesses; many are performance-based partnerships and some have two distinct classes of partner, known as ‘equity’ and ‘non-equity’ partners. Although specific research on the Australian profession is scant, in other jurisdictions such as the UK, Canada and the USA these changes have been observed to have occurred over a relatively short time and with apparent similarity among many large firms (Morris and Pinnington, 1998; Pinnington and Morris, 2002, 2003; Greenwood and Empson, 2003; Muzio and Ackroyd, 2005; Empson, 2007).

The legal profession has been shown by researchers in other jurisdictions to be affected by institutional pressures (Greenwood and Hinings, 1996; Ackroyd and Muzio, 2007). Consequently, firms tend to mimic one another in both organisation and management practice (DiMaggio and Powell, 1983). It is timely to examine whether or not change in law firm partnerships is an attempt to bring about strategic advantage or whether or not change is occurring as a manifestation of observable institutionalisation.

1.1 Purpose of the research

The purpose of this study is to understand the phenomena of change that exist around particular partnership structures and profit-sharing methodologies in large Australian law firms. Many firms have changed from a traditional partnership model to a two-tiered partnership structure, with ‘equity partners’ and ‘non-equity partners’. Firms are also changing their profit-sharing arrangements from equal-sharing to performance-based systems. The specific transitions in profit-sharing arrangements that form the focus of this thesis are law firm performance, partner performance, partner retention, changing gender demographics and gender equity in partnerships. The reasons for choosing these are given in Section 1.5 below.

The research investigates why only some firms are changing their partnership structure and profit-sharing arrangements. The research findings have consequences for industry

policy and practice and thus for the principles and practices of legal firms, as discussed in the final chapter.

1.2 The researcher as participant

The research emerges out of my professional practice and hence is appropriate for a DBA. I have been engaged as an independent analyst of and consultant to the legal profession in Australia for 25 years. During this time I have been directly involved with all of the firms represented in this study. I do not stand apart from the research or the researched, as would typically be expected in an academic study (Collis and Hussy, 2003), and I am therefore a *participant* in the research in a methodological sense.

My consulting business (FMRC Legal Pty Ltd) provides major Australian firms with annual comparative performance data via benchmarking reports across a wide variety of criteria. Comparative financial analysis for client firms includes firm performance data, individual lawyer performance data, and data pertaining to subscribing firms' expenses, prices and relative market share.

Although this experience brings with it a deep understanding of the profession and access, it may also bring researcher bias (Flick, 2007). I am acutely aware of this and have at all times endeavoured to remain as objective as possible. Issues of researcher bias are discussed in Chapter 4.

For the last 20 years, I have been concerned with measuring objective performance parameters of my clients in the legal services sector, such as financial performance and lawyer productivity. This research project shifts the focus onto a more qualitative interpretation of performance parameters, specifically the perceived impact of different profit-sharing systems and the reasons firms have changed, as experienced by those driving the changes and living through a period during which changes are occurring. The transition from one profit-sharing paradigm to another is a qualitative change and so requires a qualitative methodology.

The changing nature of law firms has drawn the attention of international researchers. In the USA, those exploring change include Gilson and Mnookin (1985), Greenwood, Hinings and Brown (1990), Greenwood and Hinings (1996), Sherer and Lee (2002), and others. In Canada, we find Cooper et al. (1996) and, in the UK, we find Morris and Pinnington (1998), Pinnington and Morris (2002, 2003), Greenwood and Empson (2003), Muzio and Ackroyd (2005), Empson (2007), and others. The contributions of these and many other researchers are addressed in Chapter 3 but at this stage it is important to note the apparent lack of research pertaining directly to management practices in the Australian legal profession.

With the exception of Gray (1998) and Pinnington and Gray (2007), there is little in the way of scholarly literature about management in the legal profession in Australia. It is the intention of this study to improve management practice through research by drawing on both the insights of international researchers and the interpretation of primary data collected from Australian law firms to inform management practice in Australian law firms

1.3 Research questions

This thesis uses hermeneutic phenomenology (Laverty, 2003) to develop an understanding of firms' likely experiences that result from selecting a profit-sharing system and, simultaneously, the experiences that become closed to them. The origins and justification for the research and the research question are presented in Chapter 3.

My advice to clients who are considering altering their profit-sharing arrangements by necessity differs from firm to firm. However, it is underpinned by untested assumptions about the utility of management axioms widely found in industry (such as performance-based pay can improve individual and work group performance) and proprietary tools, such as the balanced score card performance management approach (Kaplan and Norton, 1992).

In recent years, our firm has become acutely aware of the influence that we and other consultants have on the business practices and consequently the lives of law firm

partners who are clients. It is contended here that such advice is often anecdotal or involves unverifiable supposition and is usually rooted in a consulting firm's proprietary methods or approaches. Increasingly, I am encountering firms for whom a 'one size fits all' recommendation by a consultant has been counterproductive. For example, one firm who recently instituted performance-based profit sharing experienced a significant increase in voluntary partner attrition and a decrease in total profit in the following year.

It is not the intent of this thesis to determine the 'best' method for sharing profits among partners, but rather to add to our understanding of the lived reality that alternative models create. Any profit-sharing system contains a set of inherent assumptions, which may or may not be true and which create a set of experiences for those embracing these assumptions. This thesis seeks to explore these phenomena with the aim of adding to our understanding of the worlds that open and the worlds that close as a consequence of profit-sharing methodology. The central research question of the thesis is thus:

What are the likely experiences that open up or close down to large Australian law firms as a result of their chosen partner profit-sharing system?

To answer the central research question I examine secondary questions around the phenomena of the changing law firm partnership, specifically:

1. How are partnerships changing the way they share?
2. Why are partnerships changing the way they share?
3. What do leaders of firms perceive are the human and cultural consequences of change for the phenomena surrounding sharing?
4. What is the likely impact of change on organisational performance?

1.4 Research design

The interpretive nature of this research in understanding phenomena and their relationship to profit-sharing methodologies sits comfortably within a phenomenological paradigm, an approach that enables one "to inductively and holistically understand human experience in context specific settings" (Patton, 2002, p.37). Selection of a phenomenological paradigm enables a "complete member research

approach" (Cresswell, 1994, p.13), with the researcher as participant. It is thought that the phenomenological paradigm places a value on the researcher's experiences and perceptions as a mechanism for achieving significant and meaningful insight (Lincoln and Guba, 1985).

The phenomenological paradigm uses qualitative methods to explore and understand individual experiences in a natural environment (Lincoln and Guba, 1985). The qualitative methodology I chose to achieve these aims in this study was hermeneutic phenomenology (Laverty, 2003). Phenomenology and hermeneutic phenomenology are often referred to interchangeably (Laverty, 2003). There is, however, an important distinction between them. Where phenomenoligists use a technique they term 'bracketing' to exclude their pre-conceptions from their research (Giorgi, 1985), hermeneutic phenomenologists do not 'bracket' or set aside their biases and assumptions "but rather they are embedded and essential to interpretive process" (Laverty, 2003, p.17).

I obtained the data utilised in the study from interviews with 19 Managing Partners, CEOs or Chairmen of Partners. In an approach consistent with phenomenological research, data were not coded using any form of selective coding (Collis and Hussy, 2003). Instead, I rigorously and repeatedly analysed the data, the essence of the lived experience. To ensure validity of the findings, I discussed the conclusions at length with my consulting colleagues. These discussions were informed by the relevant literature.

At the conclusion of this process I was able to answer or, in phenomenological terms borrowed from the writings of Spinoza et al. (1997), open new possibilities posed by the research questions. In addition, the findings from the study provide guidelines for industry policy and practice. Although the study contributes to our understanding of the phenomena under investigation, the complex nature of such phenomena enables recommendations for further research.

In this respect, the form of phenomenology used in this study is not underpinned by truth as verification but as seeing things in new ways, opening up new possibilities or as expressed by Gadamer (in Warnke, 1987) in his hermeneutic philosophy, explaining the horizons in which a question, problem or puzzle emerges.

1.5 Rationale, significance and justification for the research

Several other researchers have analysed profit-sharing models among law firm partners (Gilson and Mnookin, 1985; Morris and Pinnington, 1998 on law firms specifically; Burrows and Black, 1998; Ittner and Larker, 2003 on wider professional partnerships). Since these analyses, most sharing models have evolved to incorporate performance. Furthermore, the Australian profession has widely embraced the use of two-tiered partnerships, with some partners enjoying ownership and others remaining employed. At the same time there have been increasing numbers of female practitioners coming to partnership, most remaining as non-equity partners, for all intents and purposes acting as senior employees.

This thesis examines the evolution of sharing models and organisational structures and how these management approaches impact key strategic challenges, specifically partner retention, performance and the gender balance within partnerships. It explores perceptions and opinions amongst a sample of Australian significant firm Managing Partners and CEOs, how their firms are coping with these challenges, and how significantly they regard these challenges, if they regard them at all. In short, this study is about how large legal firms see themselves coping with a changing set of principles on which their structure is based.

Management consultants who specialise in law firm management continue to play an influential role in shaping the legal practice landscape. Much of the advice offered by my organisation has been based on anecdotal experience accrued over a 30-year timeframe. This thesis aims to bring a more rigorous process to the formulation of the principles that guide advice to law firm clients.

The changing dynamics that provide the focus for this thesis – law firm performance, partner performance, partner attrition, changing gender demographics and gender equity in partnership – arise from my professional practice. It is mainly the management of these dynamics that prompts a law firm to examine the suitability of their current profit-sharing system. The findings from this research will be of significant material benefit to

all law firms and the great majority of Australian lawyers, as I make recommendations that contribute to both industry policy and individual firm practice.

1.6 Terms and definitions used in this thesis

Large law firms Firms that occupy the top and mid tiers of the Australian profession with more than 40 equity partners and annual billings greater than $25 million. In the 2007/08 ABS Legal Services Australia study, there were 55 firms with gross fees in excess of $25 million, and 11,189 smaller firms (ABS Legal Services, Australia. 8667.0, 2007–08).

Smaller firms Firms that can easily be defined as everyone else. The great majority of these firms have fewer than 20 partners, the largest subset of small firms having fewer than 10.

Top-tier firms 'Top Tier' is a self-adopted descriptor used by the largest firms in Australia. Top-tier Australian firms are all national firms with several offices in the key states of New South Wales, Victoria, Queensland and Western Australia. The composition of the 'top tier' seems somewhat subjective (different firms may see it slightly differently) however all firms described as being 'top tier', or describing themselves as such are full service commercial firms practicing nationally.

Mid-tier firms All other large firms outside the top tier. While some 'mid-tier'firms have a national practice they are not full service firms. Like 'top tier', 'mid-tier' is a self-adopted description.

Equity partner A partner who has an ownership share in the firm.

Fixed-draw partner An equity partner who is paid a fixed income.

Salaried partner An employed partner who does not have an ownership share and is usually paid a fixed salary.

Non-equity partner Partners who do not have an ownership share. Their description may vary from firm to firm but is usually either ‘salaried partner’ or ‘general partner’.

Managing partner The partner of the firm who is responsible for the overall management of the firm.

Chairman of Partners The partner responsible for chairing the firm’s management committee and the firm’s partnership meeting. The Chairman of Partners is often seen to be the leader of a firm that does not have a Managing Partner and usually has more management responsibility that any other partner.

Two tiered partnership Partnerships that have both equity and salaried partners.

Profit sharing system, methodology or arrangement The system that equity partners use to divide the profits of the firm.

Partner profit The operating profit of the firm in any given year.

Full-service law firms Large firms that provide the full range of legal services that might be required by a corporation.

Full-parity partner A partner who is on the maximum share of profit, usually sharing equally with his or her full parity colleagues.

1.7 Limitations and key assumptions

This research focuses on a segment of one discrete industry. Its generalisability to other professional service providers and other non-professional service partnerships is limited.

The research focuses on the assumptions regarding profit-sharing systems of 19 Managing Partners from large law firms. In some jurisdictions this would be considered to be a relatively small sampling frame. In Australia, however, the legal market is

relatively small. There are only 55 firms in the eligible population; this sample captures 35% of the eligible population. In this context, the sample of firms represented in this study is, in fact, a relatively large proportion of those eligible.
The research is concerned with the assumptions regarding profit-sharing systems of Managing Partners, Chairmen of Partnerships and CEOs, depending on the management structure of participating firms. As such, it studies a segment of the profession at a particular point in time. The phenomena under question are dynamic; perceptions of partnership structure, partner performance, partner attrition and greater inclusion of female partners have changed over time and continue to change. It is likely that perceptions will change with subsequent generations of firm leaders and managers.

Many industries ebb and flow with the fortunes of the wider economy in general and those of the clients or customers they serve specifically. Law firms are no different. Australia enjoyed buoyant economic conditions for many years, particularly between 1995 and 2007. When the interviews were conducted for this study, the fortunes of the Australian economy had turned and the period that became known as the Global Financial Crisis (GFC) years ensued. This change may have influenced the participants' perceptions of some of the phenomena under examination.

1.8 Thesis outline

This is a study of the lived experience of large Australian law firms. At its core is a learning process guided by hermeneutic phenomenology. This thesis is intended to be accessible to practitioners and their law firm clients, and has been written as such. The unit of analysis in this study is the Managing Partner, CEO or Chairman of Partners, depending on a particular firm's current management structure.

This thesis consists of seven chapters. Chapter 2 presents the relevant background to aid understanding of the key issues under investigation. Chapter 3 explores literature pertaining to the management of law firms and law firm partnerships. The literature review provides the theoretical framework of the thesis. The literature review examines different aspects of law firm and law firm partnership management, with particular attention to profit-sharing arrangements and the phenomena surrounding them.

Chapter 4 outlines the research methodology, and explains why this particular methodology was chosen and why it is appropriate to the research objectives and the researcher. It also deals with research rigor, the potential for bias and the limitations of the research.

Chapter 5 presents the data analysis and resulting conclusions. The data are presented in rich form, utilising the verbatim perceptions of representative participants. This has been done to avoid any bias that may occur from summarising or paraphrasing data.

Chapter 6 discusses observations from the data. Chapter 7 then draws conclusions that answer the research questions and give rise to recommendations for policy, management practice and further research.

Chapter 2 Research background

2.1 The changing profession

The practice of solicitors is regulated by the current Legal Profession Act in each of Australia's seven state jurisdictions[1]. In most Australian states, lawyers generally practise as either a solicitor or a barrister. A 'fused profession' in Tasmania and South Australia means lawyers in those states often practise as both barristers and solicitors. Barristers are most recognisable for their work as advocates, appearing on behalf of a client in court, although a significant part of their individual practice may be giving opinions on a particular point of law. Barristers practise as individual sole traders. Although they congregate in 'barristers' chambers' and may appear in groups, their business structure is regulated and they may not form partnerships or companies.

Solicitors also practise as corporate or 'in-house counsel' in many commercial organisations, not-for-profit organisations and in government. A solicitor's role is less obviously defined than that of a barrister. This thesis is concerned with private solicitors' practice. Private solicitors, as distinct from in-house counsel (corporate employees) or government solicitors, are in business with a view to making profits. Solicitors may practise as sole traders, or form partnerships or companies. They may even become publicly owned companies, listed on the Australian Stock Exchange.

This study focuses on the leaders of large Australian law firms. These firms typically act for corporations, companies and governments, providing legal advice and representing them in litigation (disputes) and commercial transactions.

The Australian legal industry is experiencing significant change. The phenomenon of the large law firm is relatively new to Australia. Prior to the 1970s amendments of the legal profession act (the exact timing of which differed slightly from state to state but clustered around the NSW amendments of 1976), partnerships were limited to 10, and

[1] The current legislation governing legal practice in the jurisdictions where large firms practise is: ACT, Legal Practice Act, 2006; NSW, Legal Practice Act, 2004; QLD, Legal Practice Act, 2007; SA, Legal Practice act, 1981; VIC, Legal Practice Act, 1996; WA, Legal Practice Act, 2008.

lawyers were limited to practising in partnerships. With few exceptions, most firms acted for corporations, small and medium-sized businesses and private clients simultaneously. Since the legislative amendments enabling larger partnerships, the industry has become segmented between large multi-location firms capable of providing the full range of commercial law services to corporations and government, and smaller providers serving SMEs, small business and personal clients. Although large and small firms could be considered to be practising as two separate industries, they are treated the same. Both small and large firms are regulated, structured and scrutinised by independent, government-appointed 'consumer watchdogs'. All partnerships, regardless of size, are governed by the Partnership Act of 1892 and their respective state-based regulatory regimes (legal profession act) for matters of practice. Large and small firms compete for the same labour resource at many levels and, more recently, for the same commercial clients, particularly among the small to medium business sector and governments.

Large firms do not form the majority of Australian legal firms, nor do they employ the majority of lawyers, but they are influential in the industry in that they are trend setters and opinion leaders. Large firm partners are regular presenters in Continuing Legal Education (CLE) offerings and have long been regarded by their colleagues in smaller firms as 'thought leaders'. The Managing Partners of large firms are highly sought-after presenters in the growing business of practice management forums, the participants at which are often small to mid-sized firms. In recent years, such forums have included the Annual Australian Managing Partners Forum, Chilli Marketing; Australian Association of Legal Practice Managers Annual Symposium, 2007–10 and the Financial Review Law Firm Managing Partners Forum, April 20, 2011. Other smaller firms are not only listening to large firms, they are seeking and paying for advice from the managers, leaders and partners of large firms. For this reason a study of large law firms' experience of profit sharing will be instructive to the wider population of solicitor practices.

Although intra-professional communication and knowledge sharing has been both collegiate and frequent, traditionally law firms have kept their operating modalities and their success very much to themselves (Gilson and Mnookin, 1985; Morris and Pinnington, 1998). Little was known about the legal industry until it started to gain the

attention of researchers in North America towards the end of the 1970s (Cantor, 1978; Nelson, 1981). Lessons from international jurisdictions reflect similar trends in Australia. .Gilson and Mnookin (1985) have observed that in the USA researchers have often struggled to gain access, firms rarely spoke to journalists, self-promotion was prohibited by professional bodies, partners seldom moved from one firm to the next, staff mobility was low and clients stayed with one firm for many years, often decades

The profession gained increasing research attention during the early 1980s, particularly in North America and the United Kingdom (Gilson and Mnookin, 1985; Maister, 1993; Greenwood and Hinings, 1996; Morris and Pinnington, 1998; Ackroyd and Muzio, 2007; Empson, 2007; Brock, 2008 and others). In Australia, research on the management of law firms remains scant. More recently, a legal media has emerged in Australia. Both of Australia's national newspapers ('Legal Affairs', *Australian Financial Review* Friday, Fairfax; 'legal affairs' *The Australian* Friday, Fairfax) have a weekly feature dedicated to legal affairs, concerning themselves in the main with Australia's largest firms.

Despite the new public face of the Australian profession, local academic research focusing on changing approaches to management and the partnership arrangements of law firms has not matched the growth of this important industry, with few exceptions (Gray, 1998; Pinnington and Gray, 2007). Research is not only scant, it is absent. North American and European researchers have led the way in developing an understanding of the legal profession in their local jurisdictions.

The neo institutional literature characterises the legal industry as an industry populated with organisations that are highly institutionalised and often slow to embrace change (DiMaggio and Powell, 1991; Greenwood and Hinings, 1996; Hirsch and Lounsbury, 1997). This thesis takes a contrary view, examining ongoing change and the likely impact of that change from the perspective of those most recently affected, the elite law firms themselves, with a view to informing the practice of follower firms.

There is little doubt that law firms are different from many other businesses. Although they are closely aligned with other professional service organisations, any similarities are superficial. Law firms manage statutory obligations and duties of care that go

beyond good, ethical business practice – for example, to the courts and their professional bodies and to their clients – that other enterprises do not have to concern themselves with.

Business decisions that in other industries or professions would ordinarily be determined by firms and markets are, in many jurisdictions, regulated and open to scrutiny through the office of the state-based Legal Services Commissioner. Regulation and reregulation have become a constant in most Australian jurisdictions. To this we can add the complexity of differing regulatory regimes in all of Australia's eight separate jurisdictions (state, territorial and federal). For instance, incorporated practice is permitted in four of the seven state or territorial jurisdictions. Other examples can be found in the CLE requirements of different states and the different admission requirements of each state.

The relatively recent phenomenon of the large, multi-jurisdictional law firm has begun to attract the attention of researchers (Sherer and Lee, 2002; Pinnington and Morris, 2003; Ackroyd and Muzio, 2007). This study contributes to this debate and builds on the work of researchers looking at evolving business structures (Morris and Pinnington, 1998; Greenwood and Empson, 2003), organisational sociologists (Greenwood and Hinings, 1993, 1996; Kirkpatrick and Ackroyd, 2003; Ackroyd and Muzio, 2007; Brock, 2008) and those examining issues such as gender equity in law firm partnerships (Hull and Nelson, 2000; Bolton and Muzio, 2007) and talent retention (Kirschembaum and Goldberg, 1976; Ing-Chung et al., 2006).

It is not the intent of this study to examine the intricate mechanics of sharing mechanisms. Other researchers, most notably Gilson and Mnookin (1984) and more recently Morris and Pinnington (1998), have explained the primary profit-sharing models and options well. This research deals with the consequences of selected models. The research is concerned with how the managers and leaders of firms see partnership mechanics (such as two-tiered partnerships) and profit-sharing systems impacting the significant challenges that confront all firms. The research aims to draw conclusions and thus guide management practice in other firms as they seek a management response to their changing context.

2.2 The significance of law firms

The large law firm, with its nature of organisation and form, emerged in the early 20th century in the USA. Full-service law firms, capable of servicing the entire legal needs of large corporations, grew to prominence in the Australasian legal sector during the late 1970s.

The Legal Services Australia report (ABS, 2007–08) stratifies law firms according to gross fee turnover. The 2007–08 report shows that large firms (with a turnover greater than A$25 million) employ approximately one-third of all practising solicitors (10,695 solicitors out of a total of 34,587) and account for one-third of the legal profession's total annual fee income (A$5.68 billion out of a total of A$14.69 billion). There were 55 large firms practising at the time of writing.

Large Australian law firms are growing with, and often in spite of, economic times. From relatively humble beginnings, the typical large Australian law firm has evolved over the last 30 years or so into a large, organised group of highly specialised lawyers, often working in specialist practice groups, across geographic borders, both national and international, involving multiple disparate jurisdictions. This development has occurred over a relatively short period of time[2] and in spite of recent research that finds nonlinear relationships between international diversification and profitability per partner (Brock et al., 2006; Hitt et al., 2007). In other words, large firms are expanding within Australia and abroad, despite research finding that international expansion has not improved profit levels in many US and UK law firms (Brock et al., 2006; Hitt et al., 2007).

2.3 The evolving nature of partnership in Australia

Any examination of the Australian legal profession must factor in the special nature of professional partnership as an organisational type. Partnerships and the legislation that governs them were inherited, in principle, from English law, on the settlement of Australia. Australian State and Territorial Partnership Acts are all jurisdictionally

[2] Prior to 1976 Partnership Act amendments, partner numbers were limited to 10 partners. Multi-jurisdictional practice was permitted in Queensland in 1996 and earlier in other states, enabling national firms to be created.

specific[3]. All of these governing acts, however, have at their core two significant principles. First, partnership is not a legal identity in its own right as is the case for corporations, regulated in Australia under one federal act. All partnership assets are owned collectively by the partners, unlike a corporation. For instance, as in the UK, they cannot partition assets (Greenwood and Empson, 2003). Partnership is recognised as a relationship between two or more people, based on mutual trust, carrying out a business in common with a view to profit (Partnership Act, 1892). Second, liability for any losses is shared by partners jointly and severally. All partners are fully liable for the actions of any and all of their fellow partners; similarly, all can be bound by the actions or undertakings of one.

Large law firms in Australia practise as partnerships by choice – they are legally entitled to incorporate or to become a public company. Although they have generally contracted through their partnership deed beyond the law of partnership[4], partners remain bound, jointly and severally, for the debts and actions of their fellow partners regardless of their relative ownership stake and, in some cases, solely because they enjoy the title of partner even though they are, in fact, not owners. Many large firm partnerships currently comprise two discrete tiers of partner: equity partners and non-equity partners.

Some large Australian law firms have commissioned historians to write their firm history (Welbourn, 2011 on Freehills). Others summarise their histories in concise form on web pages and in firm brochures. However, a comprehensive account of the history of the private legal profession in Australia has not been written. Anecdotally, it is well known, however, that two tiered partnerships emerged in Australia during the mid-1980s. As profits grew at a rate beyond that of salary growth, promotion from employee to equity partner became a significantly bigger prize. In many firms a first tier of partnership, non-equity partnership, was created, in large part to extend the progression from admission as a solicitor and promotion to ownership, effectively filling the widening gap between the incomes of employed lawyers and those of equity partners.

[3] Respective state partnership acts are: ACT, Partnership Act, 1963; NSW, Partnership Act, 1892; NT, Partnership Act 1997; QLD, Partnership Act, 1891; SA, Partnership Act, 1891; TAS, Partnership Act, 1891; VIC, Partnership Act, 1958; WA, Partnership Act, 1895.

[4] Large partnerships are usually governed by a partnership deed that sets out the obligations of individual partners, the entitlements of partners and the extent of a partner's relative share of liability. In such agreements, salaried partners are usually indemnified against losses by their fellow equity partners.

In the law firm management literature, Ackroyd and Muzio (2008, p.740) observe of the English legal profession "salaried partner status ... which was rare as recently as the late 1980s, is today increasingly frequent". They go further to observe that "[a]s the name implies this is the granting of the title 'partner' to solicitors in salaried positions. Such positions may or may not provide some sort of link between profits and earnings but these will always fall short of the benefits accruing to equity partnership".

In Australian law firms, the treatment of salaried partners reflects the English experience. Salaried partners are often restricted in decision making, access to information and reward. They remain employees, although under partnership law they are recognised as responsible and accountable owners (respective state partnership acts make no distinction between salaried and equity partners). In some firms, non-equity partnership is a requisite step to partnership; in others it is used as a tool to promote and retain candidates who aspire to the title of partner but who may not meet all of the requirements of the equity partnership. The majority of firms in this study have 'salaried partners'. The reasons these firms structure their partnerships as they do are presented and discussed in chapters 5, 6 and 7.

Large Australian firms generally refer to these partners as 'fixed draw partners'. Others use the terms 'salaried partners' or 'non-equity partners'. Regardless of the title used, the important distinction remains that these partners usually do not participate in the firm's partner profit-sharing system; rather, they are remunerated based on a negotiated compensation that may entail a salary and a performance-related bonus.

It is worth noting that the economic success of firms and partners in Australia differ greatly (FMRC Legal Large Firm Comparative Survey 1997–2007, Australian Financial Review Annual Partner Income Survey 2000–2011). In times of falling profits, non-equity partners (in less successful firms) may earn more than equity partners. This situation brings with it a set of challenges that some firms now face. The central research question of this thesis examines, in part, the perceived success of the construct of two tiered-partnerships and the likelihood of their continuation.

As Australian law firm partnerships are evolving, some traditional elements of partnership remain. Examples of traditional partnership behaviour have been observed

in the UK profession. In an analysis of the relative success of professional partnership as a form of governance, Greenwood and Empson (2003, p.926) conclude of traditional equity partnerships: “They command intense loyalty and commitment by use of a tournament system of career advancement. They provide an organisational context based upon collegial controls, within which experts satisfy their need for self-determination and reap direct financial reward from their efforts and the efforts of their peers”. The impact of two-tiered partnerships on the homogeneity, commitment to collegial processes and up-or-out career tournaments that have enabled traditional equity partnerships to endure is not fully understood.

Like any community, law firm partnerships develop a unique culture. In *Managing the Modern Law Firm (2007)* Empson (2007) writes of partnership ethos (“characteristics, beliefs and behaviours of a community”: *Oxford English Dictionary*). Partnership ethos is said to be constructed largely through the competing dynamics of individual autonomy and the pursuit of collective achievement. Having completed a large study of partnerships conducted over two years Empson (2007) observed:

> In each of the firms I have studied, however, there is a strong and dynamic tension between the interests of the individual and the interests of the collective. The management of partnerships are in effect engaged in a constant struggle to identify and resolve the tension between the individual and the collective. In this context, a commonly understood partnership ethos represents a powerful unifying force which serves to counteract the potentially self-serving impulse that drive each partner individually (p.21).

It is suggested that it is the balance of collective interest and self-interest that contributes to a dynamic or ‘culture’ within the partnership. This study examines some aspects of partnership culture, how it is perceived to influence sharing and how it is influenced by it.

Regardless of economic fortune, structure, strategy or partnership culture, one of the many management challenges faced by large and small partnerships alike is that of sharing the firm’s profits or losses among partners whose contributions may differ. This study examines the way in which the different ways for sharing profits influence the

lived experience inside Australian law firms. It is therefore appropriate to briefly examine the alternative systems used by firms.

2.4 How law firms share profits

Although they have unique features, law firms are nevertheless businesses. Law firms exist to serve their clients and in so doing make profits for the owners. The methodology used to share those profits among partners is of interest for many reasons, principally because shared methodologies have the potential to impact on firm culture, performance and ongoing success (Gilson and Mnookin, 1984). It is likely that profit-sharing systems also impact on the partnership ethos (Empson, 2007).

A chosen sharing system conveys to individual partners precisely what the wider partnership values as a collective (Gilson and Mnookin, 1985). The behaviours that the collective seeks to foster and reward provide a guide to individuals for ideal partner behaviour, as seen by the majority of partners. The relative priority placed by a partnership on individual financial performance, other non-financial performance parameters, teamwork or the pursuit of collective success articulates a clear message to those within the partnership and those aspiring to join it. It is likely that partner behaviours will, in turn, mirror any expectation created by this prioritisation.

There are many variations of the core profit-sharing models used by law firms. All of the firms that participated in this study have models that are subtly unique. Models have evolved – informed by firm history, contemporary management axioms (for example, the widespread belief in the utility of performance-based pay), consultants' advice and actual or desired partnership culture – into a blend of three primary models: lock step to equality, performance-based and hybrid lock step models (*AFR*, September 16, 2011).

Each of these models is, in fact, relatively new. During the late 1970s, partnerships valued their 'goodwill' and partnership interests were bought and sold. New partners purchased a proportionate share of the firm's assets, including goodwill. On retirement, a partner's interest was purchased by the remaining partners. Unequal ownership occurred among partners although equal ownership was considered usual. The valuation

of a partner's interest upon retirement, for example, was more often than not a matter for negotiation. In firms with equal ownership, equal profit sharing was considered normal.

As firms grew, the valuation of goodwill and its sale between partners became cumbersome. Furthermore, firms began to merge with one another to create multi-location large firms – the first of these was Freehills in 1979 (Welborn, 2011). The relative valuation each firm placed on its goodwill proved a significant barrier to the execution of a successful merger. Simultaneously, the building of brand equity required the appointment of the most talented lawyers to partnership (Gilson and Mnookin, 1985), not just those who could afford it or those who were related to the incumbents. This thinking represented a significant shift from the literature of the time. In an agency theoretic examination of partnerships, Alchian and Demsetz (1972, p.790) asserted that partnerships "will be small and more likely to occur among relatives or long standing acquaintances". History has, of course, proved this prediction wrong.

Change from valuing and selling goodwill to partner entry via 'lock step' had already emerged in the USA (Gilson and Mnookin, 1985). Although little was known of profit-sharing systems outside the USA (Nelson, 1988), Morris and Pinnington (1998) observed that the majority of large UK law firms had 'lock step' partnerships. Similarly, many Australian firms have embraced the equity structures and sharing arrangement used by their large international contemporaries.

There is no literature that explains the evolution of profit-sharing methodologies in Australia. My discussions with consultants of the time enable anecdotal observation that the first alternative to trading valuable goodwill that emerged in Australia was 'lock step'. Under this model, a partner acquires his or her interest over a period of time, usually in equal annual increments. Having acquired a full share, the partner would share equally with his or her 'full share' contemporaries, much as partners had for many decades under previous models (Morris and Pinnington, 1998).

2.4.1 Lock Step to Equality (LSE)

Lock step describes the means by which a new equity partner acquires his or her equity. Lock step firms typically admit new equity partners every year; some do so a number of times each year. New partners usually contribute capital equal to the amounts contributed by all equity partners. Like all businesses, law firms are capitalised at an amount considered by the partners appropriate to fund the operation of their day-to-day business. Per-partner capitalisation differs among firms. It is influenced by the nature of practice, cash flow history and the willingness of partners to take on debt (the only alternative to capital funding as law firm partnerships cannot retain pre-tax profit under Australian tax legislation). Partner capital contributions usually range between A$130,000 and A$300,000. It is usual practice for the firm to assist an incoming partner to obtain their capital contribution from the firm's financiers. Upon departure, the partner's capital contribution is returned to the partner and subsequently any bank debt required to fund the retiring partner's share of capital is repaid. There is no intangible asset (goodwill) transaction.

In their first year of equity, new partners receive profits of an amount equal to 25–50% (depending on the firm) of a full share (the lowest starting allocation among the firms in this study is 25%; four firms commence the lock step at 50%).The timing of progression to full entitlement varies from firm to firm, although allocations at a certain percentage are usually for a 12 months. In all lock step firms, lock step partners progress in locked step with fellow entrants, acquiring an increasing proportional entitlement until they reach full entitlement, so-called 'full parity partnership'. This progression normally takes 5 to 10 years, depending on the firm. Full parity partners' annual drawings are all equal.

Equal sharing is implicit to the nature of partnership. Partners contribute capital equally and share business risk equally. Equal-sharing firms accept that, at times, some of their specialised services will enjoy greater or less demand than others. Equality offers highly specialised lawyers the opportunity to minimise longer-term risk by partnering with other specialist providers (Gilson and Mnookin, 1984). As commercial advice, such as corporate merger and acquisition, services cycle with economic activity; litigation-

based services, such as insolvency litigation, enjoy counter-cyclicality. Those committed to equality believe that such risk mitigation will provide better financial outcomes over sustained periods and are willing to accept any short-term consequences or inequities of this system.

'Lock step' is, in many respects, a personification of the significance accorded both seniority and collegiality by the legal profession. In the past, law firm letterhead often listed partners in order of seniority (until the number of partners rendered their pronouncement on the firm's letterhead farcical; the practice ceased when partners' names would no longer fit on one page). Gilson and Mnookin (1985, p.313) recount an interesting anecdote taken from The Wall Street Journal in 1980. It tells of the funeral of one of the senior partners of Cravath, Swain & Moore (the firm widely credited for pioneering lock step to equality) and reflects the firm's commitment to lock step seniority:

> Some years ago, mourners at the funeral of a Cravath Swain & Moore senior partner were treated to a singular spectacle. Thirty five Cravath partners, all honorary pall bearers, marched down the aisle for their fallen comrade in a solemn procession, two by two, in precisely the order their names appeared on the firm's letterhead.

Partners in 'lock step firms' appear to place high regard on collegiality. Although individual success is subordinate to collective success, performance monitoring and control are an important element of the partnership culture (Greenwood and Empson, 2003). In large part, individual performance in such firms is regulated by social control mechanisms such as the circulation of monthly performance reporting and regular meetings that focus on these reports. Performance is measured across a range of parameters. High performers are acknowledged by others in the partnership and high performers enjoy high status among their colleagues. Sustained poor performers are usually counselled and, on occasion, sanctioned. In extreme situations, underperformers may be asked to leave the partnership, even the firm.

Soon after the popular adoption of lock step (by 1985 all large Australian law firms used a variation of lock step), criticism of the model emerged, in the main from consultants and researchers who wrote influentially about the benefits of performance-

based approaches to profit sharing (explained below) that emphasised individual partner performance (Hodgart Temporal, 1992; Maister, 1993). For Maister (1993, p.257), LSE systems "fail to recognise and reward differences in performance among partners of equivalent tenure and thus creates an environment that can be extremely discouraging to a number of partners. 'Why', they ask 'should I strive for outstanding performance, when such efforts are neither rewarded nor acknowledged?'" Despite these criticisms, many successful Australian firms have remained committed to LSE.

2.4.2 Performance-Based Sharing (PBS)

Performance-based profit-sharing models (hereafter called PBS) vary from firm to firm (Gilson and Mnookin, 1985; Maister, 1993). In most PBS firms the performance of individual partners is assessed against a set of performance criteria. These criteria usually include financial performance factors, leadership, business development activity and other considerations relevant to the strategy of individual firms. Some firms attach different weightings, or significance, to each of these generic performance considerations; others rely on financial performance alone as an indicator of overall performance. In the case of the latter approach, there is an assumption that individual financial performance is the best indicator of success in subjective performance elements.

In PBS firms, new partners also contribute capital equal to the amount contributed by all partners; however, profit sharing occurs according to a partner's relative performance. Under a PBS system, any partner (new or senior) may in theory receive the maximum profit allocation, subject to his or her individual performance. In the majority of firms, however, seniority still plays a role in the distribution of profit. Equity (relative share entitlement) commences with an initial allocation that grows over time to a maximum allocation. Profits are usually distributed according to this allocation with an additional allocation determined by relative individual performance. In a small minority of firms, seniority is not a factor; profits are allocated entirely on the basis of assessed performance.

Some firms assess performance and adjust compensation annually. Individuals are usually assessed by a remuneration committee consisting of three or four partners, one of whom is usually the Managing Partner. Employed Practice Managers may also participate in this committee. The assessment process usually involves a submission by the partner under review, interviews take place, remuneration committees make their recommendations and, as is often the case, the appeals commence. Other firms require sustained high performance over a number of years before compensation is increased. Such firms prefer not to assess the entire partnership annually; instead, they make adjustments to relative shares as needs dictate, citing significant monitoring costs (both economic and social) inherent in annual assessment as the primary reason for their chosen model.

Performance-based models have enabled aspiring mid-tier firms to grow their partnership through lateral recruitment. Such schemes are reputed to have acted as an incentive to partners from outside the firm to join. These partners, termed ‘lateral hires’, are usually attracted to PBS systems which maximise their return for their perceived effort.

2.4.3 Hybrid Lock Step Schemes (HLS)

In firms that use a hybrid lock step system (hereafter referred to as HLS), progression is no longer dependent on time alone. In the recent past, some pure lock step firms (with whom I have been directly involved) have, in the main, introduced the possibility of advancement ahead of time for high performance and demotion for poor performance. Some of the large firms in this study have introduced what they describe as ‘performance gates’ at intervals along the traditional lock step. This has the effect of ensuring that partners do not progress beyond a certain step unless they meet performance criteria, effectively placing partners in a ‘holding pattern’ for a period of time (or permanently) and quite significantly individualising a process that has historically been underpinned by a collegiate principle of collective reward for collective achievement.

Lock step has at its core the principle of entering partners all progressing in unison over time (Gilson and Mnookin, 1985). It could be argued that any hybrid lock steps are, in fact, not lock steps at all but performance-based sharing arrangements that include time in the partnership as a major performance measure. This argument is discussed in chapters 5 and 6.

This study examines how the managers of large Australian firms perceive the different profit-sharing methodologies to influence phenomena such as partner behaviour and performance, partner retention, and the participation and advancement of female partners. The study also examines the perceptions of firm managers on the relative merits of two-tiered partnerships compared to traditional equity partnerships. It draws on agency and archetype theory to predict likely behaviours and outcomes with existing systems and contrast those predictions with the observations of Managing Partners and CEOs of actual behaviours and outcomes.

2.5 Outcomes of profit-sharing systems under investigation

This research deals with the strategic consequences of selected models, how the firms themselves see partnership mechanics and profit-sharing methodology impacting significant challenges germane to all firms to draw conclusions and guide industry policy that might assist other firms as they contemplate change. These significant challenges are outlined below.

2.5.1 Partner retention

In their excellent analysis of profit sharing alternatives Gilson and Mnookin (1985) tell us that partnership was traditionally considered to be a permanent, long-term appointment. Although Gilson and Mnookin were reflecting the experience of the legal profession in the USA, there is no evidence to suggest that the Australian experience was any different. During the 1980s and the early 1990s partners rarely moved from one firm to another; in fact, partner attrition did not warrant attention in comparative analysis surveys until 1996 (FMRC Human Resource Economics Survey, 1996).

During the last 10 years, the typical large Australian law firm has experienced a significant growth in partner profit and a significant growth in partner attrition. Partner mobility has become a significant feature of the modern profession, a phenomenon accompanied by the industry of legal recruitment. As early as 1990 these changes were observed in the USA: “Until recently, lateral mobility from firm to firm was virtually unknown. Firms tended to be socially homogeneous, cohesive and stable; each was imbued with its own distinctive culture” (Galanter and Palay, 1990, p.747).

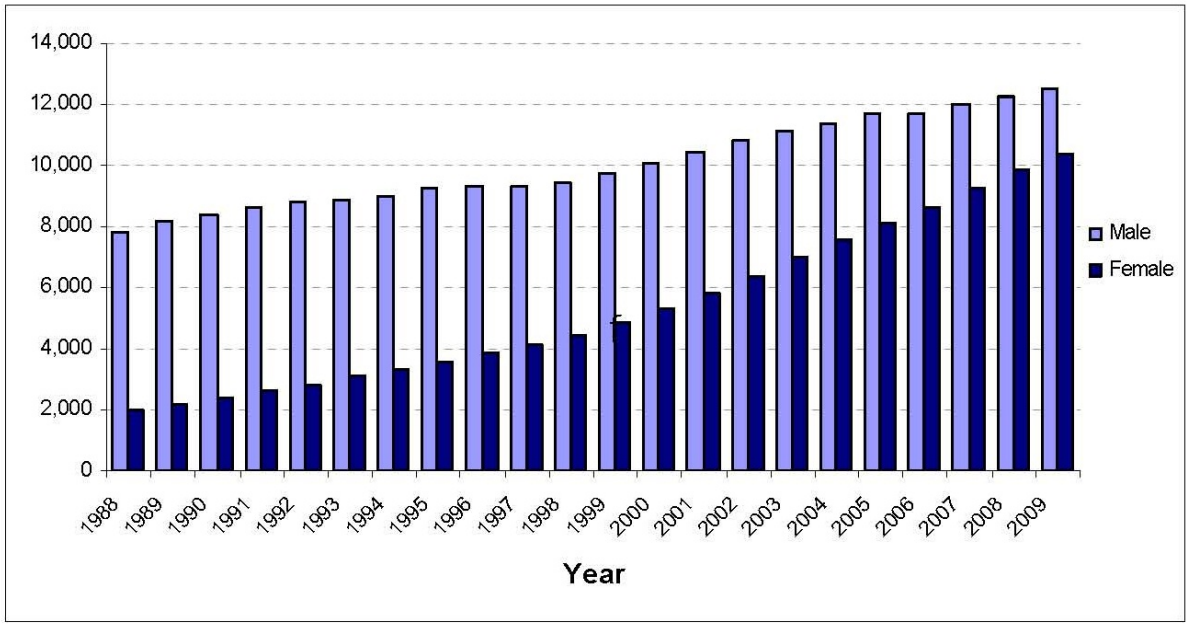
The legal media in Australia report weekly on individual partners leaving one firm, attracted by the offer of another, both the Australian Financial Review and the Legal Affairs section of The Australian publish a ‘partner movements’ column. In many cases these columns report partners taking several of their colleagues with them to a new firm. This lateral movement within the profession comes with significant economic and social costs to the firms departed, their staff and clients. On the other hand, it has enabled firms that attract the ‘lateral recruit’ partners to grow significantly by attracting capable partners.

Although it is often regrettable, if one partner exits from a large partnership where they may be 1 in 100 the impact is relatively minor compared to the situation of a partner exiting from a smaller firm where a single departure may be measured as 10%, 25% or even 50% of the partnership. The research questions in this thesis require an examination of the perceived drivers of retention and attrition and the relationship they bear to sharing methods.

2.5.2 Changing demographics and greater inclusion of female partners

In recent years the gender demographics of the Australasian profession have changed, as data from the NSW Law Society indicate (Figure 1).

Figure 1 Gender demographics of NSW Solicitors 1988–2009



(NSW Law Society data as at 2009)

Figure 1 illustrates the increasing significance of female lawyers to the NSW profession. As NSW is the largest legal market in Australia with the most lawyers, these demographics may be indicative of the national market, although data on gender demographic trends were not available from the other state law societies. All of the firms that participated in this study now employ more female lawyers than male lawyers, in every employed lawyer category. Interestingly, though, female lawyers have scant representation among equity partner ranks. In 2007, large Australian law firms reported that 62.82% of their employed solicitors were women, 53% of their associates were women, yet only 11% of equity partners were women (FMRC Human Resource Economics Survey Report, 2006–2007).

There is a growing international literature focusing on the experience of senior female lawyers (Phelan et al., 2007; Bolton and Muzio, 2009). Researchers (Bolton and Muzio, 2007; 2008, p.294) have suggested that women solicitors will form a cadre of relatively cheap non-partner labour, possibly rising in the ranks but not to equity partner. They speculate that those women who become partners have done so by adopting “masculine ways”.

Although the plight of aspiring female lawyers is generating increasing attention from researchers abroad (Phillips, 2005; Gorman, 2006; Bolton and Muzio, 2007, 2008; Noonan et al., 2007) there has been little focus on the impact that changing gender demographics may have on the maintenance of traditional promotion to partner career paths in Australia or elsewhere. The research questions of this thesis examine these phenomena, their likely continuance and the relationship they have to profit-sharing methodologies.

2.5.3 The significance of partner performance

The success of firms ultimately depends on the performance of partners. Although partners are outnumbered by their employed professional colleagues in most Australian firms by an average of 3 to 1, their economic contribution is significant. Partners charge significantly more for their time than employed fee earners; for example, current partner rates at top-tier law firms are around A$700 per hour, while associates at the same firms are charged at approximately A$330 (FMRC *Legal Charge Rate and Salary Survey 1989–2009*). Partners generally achieve significantly greater utilisation rates (meaning that more of their available time is billed to clients each year), partner's time may be less likely to be discounted (the discounting decision is usually taken by partners, regardless of who does or did the work) and, given their direct pecuniary benefit, partners may be more likely to work harder. Hitt et al. (2001, p.15) consider that "partners own the most human capital in a firm and have the largest stakes in using the firms resources to the greatest advantage". It is also widely accepted both inside and outside the profession that partners control and effectively 'own' client relationships. What this means is that many clients form an attachment to individual partners and are likely to follow them from one firm to another, underscoring the importance of individual partners to the success of any firm and the cost of voluntary attrition among partners.

In many firms, equity partners are set budgetary expectations to bill in excess of seven hours each working day. In addition to this, they are responsible for the billings of their direct reports. In 2009 an average partner in an average large Australasian firm was responsible for a 'book of business' (annual fees for which a partner is responsible that

may be earned by the partner or by one of the employed solicitors that they are responsible for supervising) in excess of A$2 million (FMRC, 2009–08 and AFR Partner Survey, 2010).

2.6 Chapter conclusions

This chapter has provided background information on Australian law firms and their partnerships. It has explained the nature of partnership, how partners share profits and the intended outcomes of profit-sharing systems under investigation.

The next chapter reviews the literature relating to the management of law firms. It examines the literature on professional service firms, the changing nature of law firms and law firm partnerships, profit sharing in law firms and strategic phenomena occurring around profit-sharing systems.

Chapter 3 Literature review

3.1 Introduction

This chapter examines literature on and around the evolving nature of law firm partnerships, changes to traditional models of organisation and profit sharing. A review of the legal practice management literature explains, in part, why some firms are changing their partnership structures and profit-sharing arrangements and why some firms are not changing.

The purpose of this literature review is multifaceted. Primarily it aims to assess how the literature addresses the challenges faced by the large law firms in transition from equality-based to performance-based profit sharing, to show the limitations and thus assist in formulating the research questions and contextualising the study's purpose.

This chapter explores how the phenomena around profit-sharing arrangements and their associated outcomes might be best understood by Australian practitioners. It does this by reviewing the contributions of several streams of thought in the international legal practice management literature.

The literature review starts by examining changes that are occurring more broadly in professional service organisations, many of which have direct implications for the management of Australian law firms. To fully appreciate the implications of changes that have occurred to partnership structures and compensation models it is important to explore insights into the nature of law firms: how they exist, the organising forms they have chosen and why they were selected. The literature review also examines the evolution of partner profit-sharing models and current debate around partner attrition, partner performance and the participation of female partners in male-dominated equity partnerships.

The literature review is organised as follows:

1. Changes in professional service firms

2. The changing nature of traditional law firm partnership
3. Theoretical explanations for law firm behaviour
4. Partner profit sharing in law firms, from traditional to contemporary
5. Strategic phenomena impacting practice.

3.2 Professional service firms

Professional service firms (PSFs) have traditionally consisted of qualified knowledge workers who are generally in the business of selling their knowledge. Greenwood et al. (2005, p.661) define professional service firms as "those whose primary assets are a highly educated (professional) workforce and whose outputs are intangible services encoded with complex knowledge".

In the Australian economy these professionals are often regulated by statute and are always regulated by professional regulatory authorities; for example, Chartered Accountants are regulated by Australian Accounting Standards and by the Australian Society of Accountants. It is usual for PSFs to consist of professionals from one discipline, supported in their work by non-professional support staff.

It is widely acknowledged that a high degree of organisational and behavioural homogeneity has traditionally existed within and among groups of PSFs (DiMaggio and Powell, 1983; Greenwood and Hinings, 1993; Cooper et al., 1996). This phenomenon is best explained with a brief, preliminary examination of institutional theory. Institutional theory offers "an explanation of the similarity (isomorphism) and the stability of organisational arrangements in a given population or field of organisations" (Greenwood and Hinings, 1996, p.1023). Institutional theory has evolved from the early 1960s (Clarke, 1960) through the work of DiMaggio and Powell (1983) and Scott (1994) to what is now known as neo-institutionalism.

Greenwood and Hinings (1996, p.1022) explain how *institutional theory* and *neo institutional theory* may be differentiated:

> In the old institutionalism, issues of influence, coalitions and competing values were central, along with power and informal structures (Clark, 1960, 1972;

> Selznick, 1949, 1957). This focus contrasts with the new institutionalism with its emphasis on legitimacy, the embeddedness of organisational fields and the centrality of classification, routines, scripts and schema (DiMaggio and Powell, 1983). Scott (1987) suggested that institutional theory was at the stage of adolescence. Later he saw considerable progress, namely "I see convergent developments among the approaches of many analysts as they recognise the importance of meaning systems, symbolic elements, regulatory processes and governance systems" (Scott, 1994, p.78). It is this convergence around multiple themes, the coming together of the old and the new institutionalism that we have come to call neo institutionalism.

At the core of neo institutionalism is the principle that institutionalised contexts, a PSF for example, contain prescriptive patterns for organising, that is, widely held understandings of appropriate structures, systems and processes for practice. These understandings are considered to be socially constructed archetypes (DiMaggio and Powell, 1983; Scott and Myer, 1994; Zucker, 1997).

There are explanations for this behaviour in the literature that pertain directly to this study. DiMaggio and Powell (1983, p.150) identify forces at work within and among organisational fields; they describe these forces as the "mechanisms of institutional isomorphic change", and identify three such mechanisms: coercive isomorphism, mimetic processes and normative pressures.

Coercive isomorphism describes pressures exerted on organisations by other organisations upon which they depend, and wider societal pressures to conform. Such pressures may be legislative, regulatory or collusive. Legislative, coercive pressures could describe legislated requirements such as those imposed by the respective state Legal Profession Acts and for partnerships, those prescribed by The Partnership Act, 1892. Regulatory, coercive pressures could describe professional regulations such as those of the various state Law Societies (for example the NSW Law Society solicitor practising requirements) that seek to regulate the professional conduct of solicitors. Collusive, coercive forces could be those that firms agree among themselves.

Mimetic processes are considered to be those that manifest as one organisation mimicking another, usually a more successful organisation operating in the same field. DiMaggio and Powell (1983) explain this behaviour as a natural reaction to uncertainty. Mimetic processes might include organisation, structuring, management practices and, in the case of law firms, profit-sharing arrangements.

Normative pressures (DiMaggio and Powell, 1983) are thought to stem from professionalisation. In the case of the legal profession there is a readily observable degree of homogeneity in the education of lawyers, their training, career development and day-to-day interactions, the latter being regulated by professional standards.

Through a combination of professional regulation and an understanding between specific professionals of practising norms (DiMaggio and Powell, 1991), PSFs have become highly institutionalised. DiMaggio and Powell (1991) observe that PSFs have increased their survival prospects by converging around socially legitimate forms. These forms manifest in a variety of ways in Australia. The markets in which PSFs operate are often protected markets; a non-lawyer may, for example, represent himself or herself in any Australian court but he or she is prevented from representing any other person or entity. PSFs organise as partnerships where knowledge workers are simultaneously owner and worker, as incorporated entities or as publicly listed companies. The primary assets of PSFs are the knowledge they sell, contained in and owned by highly portable human assets. Finally, a significant knowledge imbalance exists between firm and client, making the latter dependent on the former (Greenwood et al., 2005). It is a combination of these factors that are thought to contribute to the nature of PSFS, the strategies they employ and the high degree of uniformity in the way they operate. Cooper et al. (1996) observe that institutionalised organisations are likely to resist change; however, once legitimised change spreads rapidly, firms follow one another in quick succession.

The unique nature of PSFs relative to other industries is widely discussed in the literature (Mills et al., 1983; Cooper et al., 1996; Greenwood and Empson, 2003; Ackroyd and Muzio, 2007; Greenwood et al., 2007 and others). Much of this literature is dealt with in the literature review in an applied fashion, by examining the nature of partnership and, quite specifically, law firm partnerships.

Organisational theorists have for some time been examining changes that are occurring among PSFs, specifically those that are occurring around organisational archetypes, the way they organise and manage. Greenwood and Hinings (1993, p.1052) define an organisational archetype as "a set of structures and systems that reflects a single interpretive scheme". An interpretive scheme can be defined as a set of values and beliefs that underpin and typify the more observable aspects of organisational form. Brock (2006, p.158) adds, "structures and systems do not constitute a disembodied organisational frame but rather are infused with meanings, intentions, preferences and values". It follows that an understanding of archetypes requires examination beyond structure and systems that includes the beliefs, values and ideas they represent (Brock, 2006). The structures, systems and interpretive schemes define the archetype; for example, the P2 (defined below) archetype is considered to be prevalent in law firms (Greenwood et al., 1990).

The debate around why organising forms of large law firms are manifesting the way they appear to be is addressed in some detail in Section 3.3. It is appropriate, though, to discuss the consensus view on how professional service firms are changing organising form.

Greenwood et al. (1990) identified the prevalence of what they termed the 'P2' form of organisation:

> Our thesis is that professional partnerships constitute an organisational type by virtue of their distinct strategic management practices. The configurations of control used by their centers differs from previously identified patterns (p.748).

Greenwood et al. (1990, p.750) make an important observation on the use of collegiate vehicles as the basis for organising:

> Professional partnerships because of their governance arrangements and the work that they do, are organised differently from corporate bureaucracies. Collegial vehicles in professional partnerships, whether they are committees, task forces or individuals represent attempts to provide alternatives to hierarchical authority. In a professional partnership, the motivation behind the use of committees and task forces is to respect professionals' desires for

> autonomy, to maintain the principal of partnership, and to promote acceptance and cooperation.

Cooper et al. (1996) later observed evidence of an increased managerialism among large Canadian law firms. The term ‘managerialism’ describes a set of values “which are becoming organised into a coherent interpretive scheme about the professional service firm as a business” (Cooper et al., 1996, p.625). One possible manifestation of such a set of values might be a shared belief among partners that their law firm is first and foremost a business and that they should behave accordingly.

Increased managerialism was not suggested to be replacing the characteristics of traditional professional partnership but was suggested to be layered on top of traditional approaches, values and practices (Cooper et al., 1996). There is some debate (Pinnington and Morris, 2003; Ackroyd and Muzio, 2007; Brock, 2008) as to whether these observations constitute further archetypal change, as suggested by Cooper et al. (1996) with their proposal of the managed professional business (MPB) archetype. What remains largely uncontested, however, is the observation that PSFs are unique, are changing and are becoming increasingly influenced by managerialism.

Although this thesis is concerned with Australian law firms the implications of chosen partner profit-sharing methodology are germane to other PSFs. Changes to sharing arrangements brought about, in part, as a consequence of values that reflect managerialism have implications for phenomena such as partner performance, partner retention and gender equity. The implications of changes to profit-sharing arrangements are, however, not fully understood.

To assist in the development of management practice in Australian law firms, this study examines changing profit-sharing arrangements to ascertain why they are occurring – whether as a consequence of increased managerialism, as an example of neo institutionalism or for some other reasons that remain as yet unexplored.

3.3 The changing nature of traditional law firm partnerships

Professional partnerships have been written about from a number of perspectives and for a significant period of time. In an examination of the literature pertaining directly to law firm partnerships, one finds Gilson and Mnookin (1985) and Morris and Pinnington (1998) on profit-sharing methodologies; Greenwood et al. (1990) on management practices in law firms; Galanter and Palay (1991) on promotion to partner tournaments; Greenwood and Empson (2003) on partnership as a governance structure.

In addition to organisational and behavioural differences, traditional partnerships have some legislative differences from other forms of corporate governance structures. Partners share commercial risk and liability for any losses jointly and severally. Each partner is individually and collectively responsible for the debts of the partnership and the undertakings and encumbrances of any. Professional bodies have recently sought to minimise risk with respect to professional negligence through Law Society limited liability schemes (see NSW Law Society *Solicitors Limited Liability Scheme, 2006 to present*), but to date these schemes remain untested by the courts.

The nature of partnership has attracted significant attention in recent times (Greenwood and Empson, 2003; Greenwood et al., 2007). The only Australian firms that have altered their business structure away from partnerships are small firms. Although incorporation under federal corporations law has been permitted for more than eight years (NSW Legal Practice Act, 2004), all large firms remain in partnership. At the time of writing, only one unique firm has become a public company[5].

Greenwood and Empson (2003) identify the superior nature of partnership over any other organisation structure (such as a corporation), highlighting lower agency costs, more efficient control processes, superior incentives for experts to share knowledge and superior career incentives resulting in higher effort. They also postulate that partnerships may be less efficient than alternative vehicles as a result of increasing firm size and increasing capital intensity.

[5] In 2007 Slater and Gordon were listed on the Australian Stock Exchange (www.slatergordon.com.au, May 2007)

For Greenwood et al. (2007), partnerships have outperformed public corporations as a result of the monitoring efforts of owners and the desire of employees to achieve an ownership stake. Behaviours around these career progression patterns have given rise to pressures which have been said to resemble competitive tournaments (Galanter and Palay, 1991), as employed professionals compete for limited partnership positions.

Although law firm partnerships may be collegial, law firms have traditionally been and remain hierarchical (Galanter and Palay, 1990), recruiting graduate solicitors, often prior to admission as a practising solicitor, and promoting them over time through associate ranks to equity partner. Equity partners own the firms and enjoy such benefits of ownership as firm profit, participation in decision making and control, and social benefits such as status and marketability. In recent times many large firms have lengthened the time required for progression from graduate solicitor to equity partner (Ackroyd and Muzio, 2007).

Seeking to explain recent changes to the English legal profession, Ackroyd and Muzio (2007) considered why the rise of the non-equity partner and the ever-lengthening progression from junior solicitor to profit-sharing partner has occurred. The researchers observed that this shift to controlling career progression can be observed as a form of internal organisational closure, a strategy designed to protect the income and status of incumbent equity partners, termed by Ackroyd and Muzio (2007) as professional elites. Although researchers have successfully observed significant changes in traditional law firm partnerships, the implications of such a significant structural change to career progression and profit-sharing arrangements among partners (both non-equity and equity) are not fully understood.

Agency theorists (Alchian and Demsetz, 1972; Eisenhardt, 1989) have succinctly explained relationships between labour and capital and the inherent power imbalance that exists in this relationship. Agency-related forces are considered to be among those that affect employee productivity, behaviour and, ultimately, performance. Although agency significantly aids the understanding of how and why law firm partners are abandoning traditional equal-sharing models to share profit by relating performance to reward (Gilson and Mnookin, 1985), when overlaid with Ackroyd and Muzio's (2007) observations of ever-increasingly elongated career progression, it also contributes to our

understanding of why firms have been structured the way they do. By lengthening the progression to partnership (prolonging employment and traditional agency relationships) and by changing from traditional equal-sharing models to performance-based sharing (creating new agency relationships), firms have sought to improve lawyer performance and, ultimately, profit.

3.3.1 The leveraging of human capital

In an attempt to contribute to the law firm management literature, this thesis is concerned with the worlds that open and close to firms from different law firm profit-sharing arrangements. It is therefore necessary to achieve an understanding of two significant contributors to profit: professional leverage and competitive success tournaments in traditionally configured partnerships.

The commercial success of any law firm depends, to a large extent, on the leveraging of human capital (Sherer, 1995; Hitt et al., 2001). Lawyers sell their professional time. Time is a limited resource. In a price-constrained market (where the price charged for an hour of time must remain competitive) the only means of achieving returns beyond those realised through the sale of one's own available time is to acquire additional units of professional time for amounts less than its market worth and sell it at its market worth. This process is referred to as professional leverage (Hitt et al., 2001) and has been widely embraced by many large law firms in the UK and the USA (Hitt et al., 2001) and in recent times by Australian firms.

Leveraging has been interpreted from the perspective of the resource-based view of the firm (Barney, 1991). Hitt et al. (2001) observe that relative performance is directly attributable to variances in the quality of a firm's resources and capabilities, namely the quality and quantity of human capital measured by the law school partners attended. By hiring suitably qualified lawyers, training them, giving them access to the firm's physical resources and sourcing clients for them, partners can increase profits by onselling their time at a margin. It has been argued (Price, 2003) that the differential between an employed lawyer's salary and benefits and the value of their professional time in the market represents a deferred payment. This deferred payment is recouped as

a lawyer's pay increases over time, culminating in equity partnership when their personal returns exceed their value in the market (Price, 2003).

Although this analysis takes an interesting perspective, it ignores the important distinction between human capital and firm capital (Sherer, 1995). It is quite possible that the differential between an employed lawyer's value in the market and their compensation represents a return on firm capital. Firm capital follows brand equity and organisation reputation. Nonetheless the leveraging of human capital has become standard practice in the business of law (Ackroyd and Muzio, 2008).

As law firm associates build their personal human capital they compete for a limited number of partnership places. To crystallise their investment, employed lawyers must 'make' equity partner but the number of equity partnerships available in any one year is invariably less than the number of equity partnership aspirants (Price, 2003). It is this apparent competitive promotion process that has been likened to an internal success tournament. Traditionally non-partners have competed for equity partner positions. Traditionally, equity partners have shared the firm's profits equally. More recently in many firms, employed solicitors compete to be promoted to associate, associates compete for partnership, non-equity partners compete for equity partnership and, in performance-based firms, equity partners compete annually for a greater equity share. These dynamics effectively extend Galanter and Palay's (1991) tournament for partnership way beyond an employed lawyer's initial appointment to partnership. The implications of such tournament-like behaviour are complex and pose several challenges. Success tournaments may give rise to internal competition for client work, promote more aggressive 'dog eat dog' cultures, compromise the pursuit of collective interest by placing greater emphasis on the pursuit of self-interest and introduce a counterproductive, political competitiveness (Galanter and Palay, 1991).

It is thought that this tournament limits the agency costs of shirking (doing less than one's agreed share while benefiting from the hard work of others) (Gilson and Mnookin, 1983); reduces the need for monitoring (measuring and influencing individual performance) (Greenwood and Empson, 2003); and produces a stronger than usual work ethic among aspiring associates (Galanter and Palay, 1991; Price, 2003), non-equity and equity partners.

Such was the success of encouraging a strong lawyer work ethic produced by such a tournament, many large law firms embraced an ‘up or out’ approach (Galanter and Palay, 1991; Price, 2003). Under such a policy an employed lawyer is promoted from solicitor to associate thence senior associate, non-equity or salaried partner and ultimately partner. Should he or she fail to attain promotion to partner he or she is exited from the firm, ensuring strong internal competition remains.

Critics of tournament theory (Kordana, 1995; Rutherglen and Kordana, 1998) claim that law firm organisation cannot be explained by tournament theory, suggesting that the tournament ends when an associate becomes a partner. However many tournaments extend beyond partnership. Even beyond promotion to equity partner in PBS firms and beyond equality in LSE firms, internal competition continues (Gilson and Mnookin, 1984). Observations to the contrary assume that all partners are equal in every respect and that the tournament is for personal financial reward alone, ignoring important motivators like career achievement, recognition and power within the political machinations of partnership.

Partnerships are political. Examples of the lived reality inside law firms provide some examples. Day Haight (2003) argues that senior professionals in law firms sometimes resort to devious pre-screening of candidates to ensure that the best applicants are passed over, thus ensuring their rank remains protected. Kandel and Lazear (1992) explored the operation of peer pressure in partnerships, concluding that factors such as shame, guilt, mutual monitoring and empathy create various incentives. Given these observations, it is likely that any success tournament will continue, I suggest, beyond promotion to partnership in traditional partnerships. Be that as it may, some traditional partnerships are changing. By embracing PBS models, firms appear to be seeking to extend competitive tournament-like behaviour for the entire duration of a legal career. If this is indeed occurring it may lend significant weight to tournament theory as an explanation of how and why firms structure as they do.

While anecdotally it appears that partnership tournaments remain unchallenged by current circumstance, the changing gender mix of the legal profession (NSW Law Society Annual Snapshot of the profession, 2009) and the emerging needs of a new

generation of lawyers, such as a desire for better work-life balance (McGraw and Heidtman, 2009), may in time present a challenge to this system of promotion.

One significant change to traditional Australian LSE partnerships and the leveraging of human capital is the creation of the position of 'salaried partner' or 'non-equity partner'. Recognising the benefits of a competitive, ambitious labour resource, law firms have created this new employment category within their partnerships. Salaried partners are promoted from the ranks of associates or recruited from outside the firm. Salaried partners are held out to be partners of the firm although they are employees, not owners, of the firm. Salaried partners enjoy the status that comes with their title but at significant commercial risk. Non-equity partners have been shown to be legally considered employees[6]. With the title of partner, however, they risk joint and several liability for the full debts of the partnership. It seems unlikely that aspiring (risk-averse) lawyers would agree to such a position if the partnership tournament concluded as one was promoted from associate to partner. The position of salaried partner seems absurdly juxtaposed to the widely held belief that lawyers are inherently risk averse (Huddart and Laing, 2005) and that partnership itself is a risk-minimisation strategy (Gilson and Mnookin, 1984).

For any tournament to equity partnership to succeed as a strategy for firm success, associates and salaried partners must be willing to participate (Price, 2003), that is, employees must be willing to compete with their peers to achieve promotion – they must want to do it. Even in an ever-tightening market for talent in which high levels of associate attrition and opportunity abound, the applicability of tournament theory endures as an explanation of firm growth and success. Not all firms use an 'up or out' system (Morris and Pinnington, 1998; Sherer and Lee, 2002). Some create long-term, senior employed professional status through positions such as senior counsel, but the prospect of promotion to partner remains a significant motivator in firms of all sizes, particularly large firms (Sherer and Lee, 2002) where annual partner incomes often exceed A$1 million (*Australian Financial Review*, September 2007, September, 2011).

[6] Salaried partnership was considered in ARTISTIC BUILDERS PTY LTD & ANOR v NASH & ORS [2010] NSWSC 1442. On the particular facts his honour found that a salaried partner was not, in fact, a partner, but an employee.

Within the framework established by the neo-institutional theorists and after consideration of the literature focusing on professional service firms and the changing nature of traditional law firm partnerships, two propositions can now be advanced;

> Proposition 1 *Despite a changing demographic among employees (established in Section 2.7) and, potentially, partners, large Australian law firms maintain traditional beliefs about the utility of success tournaments.*

3.4 Theoretical explanations for law firm behaviour

A body of established literature collectively explains why law firms structure and share profits among partners as they do. The literature also offers explanation for why large firms have grown as they have. This literature is discussed in this section.

3.4.1 Portfolio theory

Portfolio theory (Gilson and Mnookin, 1985) has been used to explain why lawyers practise in partnership with other lawyers. It is suggested that this strategy facilitates risk minimisation and the maximisation of personal returns over time.

Portfolio theory has its roots in capital markets analysis (Sharp, 1970) as Gilson and Mnookin (1985, p.322) explain:

> By combining assets in a diversified portfolio the investor can reduce the level of risk without reducing the level of expected returns. The rational investor will then select the portfolio of assets that offers the most desirable combination of risk and return.

A lawyer's most significant asset is his/her human capital (Greenwood et al., 1990). Just as an investor may seek to minimise their investment risk by diversifying an investment portfolio among different asset classes, owners of human capital wishing to minimise risk may also seek to balance their portfolio. A lawyer may, for example, choose to practise in a number of areas that are subject to different levels of demand at different times. Human capital, however, cannot be easily diversified without jeopardising

apparent gains to specialisation (Gilson and Mnookin, 1984). It follows that lawyers practising in partnership and pooling their shared gains, regardless of the relative demand for their services, stand to achieve higher long-term returns than they otherwise would as specialised sole practitioners, where they would be more exposed to fluctuating demand risk.

Portfolio theory explains big firm growth by emphasising the mitigation of risk as a driver for growth. By diversifying investments into a portfolio of assets (specialisations) as distinct from investing all of one's wealth in one asset (specialisation), an investor will minimise risk and, over time, maximise return. Thus, when an individual lawyer chooses to practise as a specialist, he or she assumes a level of demand risk. A merger and acquisitions specialist is likely to be in greater demand during periods of economic growth. An insolvency and liquidation expert is likely to experience less demand during such periods. The inverse situation is likely to apply during times of economic recession. By practising in large firms, specialists can reduce any risk exposure to their annual income.

Although portfolio theory offers some explanation for the form of the large legal firm, it is a normative theory that requires a long timeframe to function in a pragmatic way. For example, significant shifts in the demand for a particular specialist service have not occurred in the Australian legal market for several years and appear not to occur over short timeframes. The Australian economy enjoyed a strong growth cycle for more than 10 years. During this time the majority of large law firms have changed their profit-sharing arrangements, moving away from LSE sharing toward PBS or LSE systems, reducing if not eliminating any risk sharing advantages and, in effect, personalising any market demand risk that has traditionally been borne by the partnership as a collective. This is a significant change that has occurred in some firms while others have remained steadfastly committed to traditional LSE sharing systems.

The very nature of practice in Australia is changing. The legal media such as *Lawyers Weekly*, *The Australian* newspaper and the *Australian Financial Review* regularly report partners leaving firms to start new firms or join other large firms (see, for instance, 'appointments' at www.lawyersweekly.com.au). Traditionally most lawyers in Australia holding practising certificates where employed in the private profession, practising as

solicitors. The Corporate Lawyers Association and state-based Law Societies all report significant increases in in-house legal counsel (Law Council of Australia Annual Report, 2009; NSW Law Society Annual Report, 2009). Partners are moving between firms and from firms into industry at ever-increasing rates. It would seem that lawyers see themselves as an independent resource prepared to commit to an organisation while ever they experience positive marginal utility from so doing. Explanations such as portfolio theory remain valid, even though the assumption that law firms consist of risk averse individuals (Huddart and Laing, 2005) appears questionable as firms expand into unfamiliar, relatively risky jurisdictions and areas of practice such as China, India, Taiwan and other developing Asian economies (Pinnington and Gray, 2007). The attrition of law firm partners could be influenced by profit-sharing arrangements. Partners may be leaving one firm and joining another in an attempt to maximise their personal return on their knowledge assets in a shorter timeframe than traditional, long-term partnership allowed.

Portfolio theory offers an explanation of why lawyers may choose to practise in partnership with other lawyers. Diversifying a portfolio of knowledge by adding additional, complementary units of knowledge minimises demand risk and consequently maximises long-term returns. However, the apparent rate at which partners now leave one firm for another would seem to act against such risk aversion and may be symptomatic of a change toward self-interest and away from collective interest as reflected in traditional partnerships.

3.4.2 Neo institutional theory

As discussed earlier, neo-institutional theory seeks to explain how organisations increase their chances of success by gathering around socially legitimate forms (DiMaggio and Powell, 1991). Such behaviour is likely to give rise to traditions that, over time, become standard form and practice. In the law, DiMaggio and Powell's (1991) ideas about conformity around legitimate forms are convincing. All solicitors must be qualified, must be experienced prior to admission (and entitlement to practice)

and are all regulated by statute and professional bodies. State-based law societies enforce both how practitioners should behave and how they shall behave[7].

Institutional theory explains the "processes by which individual organisations retain, adopt and discard templates for organising" (Greenwood and Hinings, 1996, p.1023). Institutional theory throws light on how groups of organisations, such as the legal profession, respond to change. Greenwood and Hinings (1996) observe that institutional theory offers an explanation for the similarity and stability of organisational arrangements in certain populations or institutional fields. Institutional theory seeks to explain how firms change, and why they do so with observable uniformity (Greenwood and Hinings, 1996). Deephouse (1999, p.147) broadens our understanding of organisational conformity by drawing attention to the desirability of balancing similarity and difference: "by being different a firm benefits because it faces less competition, by being the same a firm benefits because it is recognised as being legitimate".

Many aspects of a modern firm reflect tradition. Dress (particularly court attire in the higher courts), titles, hierarchies, performance expectations and even the nomenclature of the current industry reflect days past. Greenwood and Hinings (1996, p.1047) conclude that the pace of change in organisations subject to institutional factors was slow, describing it as "evolutionary not revolutionary". Much of the slow pace of change observed by Greenwood and Hinings (1996) stems from the "normative embeddedness of an organisation within its institutional context" (p.1023). Legislation and professional regulations have dictated how lawyers practise. Such regulation has, until relatively recently, restricted firm size, business structure, the nature of practice, business promotion, lawyer training and admission, risk management and geographic reach.

There is little doubt that law firms are evolving. Once legitimised, change occurs rapidly with new forms and practices being embraced by other firms (Cooper et al., 1996). In highly institutionalised fields, widely adopted approaches may become 'legitimate' without any rigorous analysis and regardless of the desirability or

[7] Practising solicitors face sanction for unprofessional conduct, as defined by law societies and disqualification from practice for professional misconduct.

effectiveness of such approaches for a particular firm (Cooper et al., 1996). This research adds to the literature by exploring the implications of changes in profit-sharing arrangements.

The discussion now turns to the debate taking shape about how lawyers organise their businesses and management practices and whether these organising modalities continue to evolve. Researchers have for some time considered homogeneity of behaviour within industry sectors (Deephouse, 1999). Within organisational theory, researchers are seeking to explain tightly integrated and sustained dynamics (Mintzberg, 1973) characteristic of an industry. The primary aim of this research is the classification of organisations (Dess et al., 1993). Greenwood and Hinings (1996, p.1023) see institutional theory is an "explanation of the similarity and stability of organisational arrangements in a given population".

Law firms are of particular interest to researchers because of their similar structures and management practices and the manner in which the profession collectively confronts and adapts to strategic challenges. Ackroyd (1996, p.604) notes that law firms "may be called extra organisational organisations which are organised outside the employing organisation as well as inside". A significant role is played by professional organisations (such as Law Societies and the courts), informal organisations (such as solicitor interest groups like Law Australasia, a group of similar firms that exchange ideas and acquire some resources collectively) and internal organisation (practicing groups or teams) in creating a highly organised, closed industry (Ackroyd, 1996).

Ackroyd (1996, p.600) identifies a "double closure" mechanism at play in modern law firms. Evidence of such a mechanism in Australia includes regulation by law societies of admission to the solicitor profession and the gaining of an unrestricted practising certificate, enabling one to become a partner, combined with internal regulation over career progression.

3.4.3 Archetypal change and the professional service firm

Archetype theorists have espoused a trend in professional service firms towards managerialism (Brock, 2008), a philosophy of business organisation and management seen to be replacing traditional professional practice behaviours. This change was originally observed (Greenwood et al., 1990, p.725) as an archetypal shift towards a "P2 form" of business, involving strategic business practices occurring simultaneously with traditional aspects of partnership governance and professional ethos (Brock, 2008).

In considering the application of organisational theory to law firms in particular, Greenwood et al. (1990, pp.729–730) note:

> Professional partnerships differ from other types of organisations in regard to two features: the structure of ownership and governance and the nature of the primary task ... A partner is an owner of a firm, is involved in its overall management and is a key production worker.

It is the involvement of law firm partners in all of these aspects of practice that gave rise to the P2 archetype as a distinct organisational form.

At approximately the same time as Greenwood et al. (1990) were proposing their theories, changes were occurring in legal practice. Greenwood and Hinings (1996, p.1) write of "the complexity of political, regulatory and technological changes confronting most organisations", as legal practice the world over faced greater competition, increased commoditisation, increasingly informed and discerning clients, supply or resource constraints and a changing regulatory environment. Nonetheless, large firms continued to grow. These realities, coupled with ongoing growth and both external and internal forces, brought with them a process that has been termed 'sedimentary development' (Cooper et al., 1996). The analogy, taken from geology, illustrates how changes are layered on changes and occur gradually, over a long time. These layers of change have accumulated to such an extent that researchers have observed what they consider to be an archetypal change, the observable managerial professional business (MPB) (Cooper et al., 1996). The difference between a traditional professional partnership and the new MPB is that "[t]he underlying orientation of this archetype is to see the organization as a business" (Cooper et al., 1996, p.630).

A change to the MPB had implications for firms:

> The MPB archetype interprets a professional as business like, as providing value adding services and as being responsive to the client. The attributes which sociologists of the professions used to identify as the hallmarks of a professional, such as education, vocation, esoteric knowledge, self regulation and civility, have been replaced or at least augmented, by an interpretation that stresses punctuality, style, dynamism, financial success and entrepreneurialism (Cooper et al., 1996, p.631).

A change to the MPB also had implications for individual partners:

> In the MPB, a partner is a team player, one who trusts the leadership and works for the common good, for example by transferring work to the person who is most competent or short of work (Cooper et al., 1996, p.631).

Cooper et al. (1996) base these observations on two Canadian firms, noting an archetypal change to an MPB that had come about through a process analogous to sedimentation. They suggest that law firms move from one archetype to another by laying down change upon change over time, culminating in an eventual shift. Importantly, they also note that change is constantly occurring.

In Australia, large law firms grew simultaneously to develop the top tier of the profession (Pinnington and Gray, 2007), adopting and rejecting many management structures, strategies and tactics at approximately the same time. A high degree of management homogeneity exists among these elite firms. In his doctoral thesis, Gray (1998), one of the few scholars working on and among Australian law firms, concluded that most medium- to large-sized Australian firms adopt “an organising mode approaching MPB” (Gray 1998, p.379).

There is consensus that large Australian law firms have increasingly adopted managerial values and systems and, as a consequence, individual and collective focuses on performance (Pinnington and Gray, 2007), which may be reflected in changes that have and are occurring to profit-sharing systems. Why these changes have occurred, how widely they have occurred and the consequence of these changes are central to this thesis. The research questions of this thesis have been framed to contribute to our understanding of these issues.

Ackroyd and Muzio (2007) suggest that commentary emphasising archetypal change exaggerates the legal profession's change to managerialism. Their analysis suggests that changes to the legal profession (including a more sophisticated approach to management) evolve around ever increasing 'closure mechanisms' designed, they assert, to quarantine the high incomes of 'the elite'. They conclude that the profession has essentially remodelled hitherto existing organising modes rather than developing entirely new archetypes.

Ackroyd and Muzio (2007) present the alternative explanation articulating a new archetype they call the reconstructed professional firm (RPF), reasserting the importance of professionalism. They maintain that changes to the profession should not be explained by the creation of new organising modalities aimed at achieving greater efficiencies, but rather by a partner's desire to create greater professional closure, further limiting the supply of legal services and increasing equity partner incomes.

Ackroyd and Muzio (2007) build on their thesis of closure by highlighting the apparent dispensability of non-lawyer support staff in the English legal profession, observing a marked decline in their relative numbers over time. However, Brock (2008) argues that Ackroyd and Muzio's (2007) conclusions are at odds with a significant body of theoretical and empirical work pertaining to PSFs. Brock (2008) cites aggressive objective setting by PSFs (Covaleski et al., 1998), the globalising trend of PSFs (Brock et al., 2006) and the changing nature of partnership (the use of salaried partners, for example) (Sherer and Lee, 2002) as evidence of a clear shift towards professional managerialism. Much of this cited work, however, is concerned with PSFs in general and not law firms specifically.

Relating closure to declining proportionate non-lawyer support numbers appears problematic, as there are other explanations for a proportionate decline in support staff numbers in law firms. The nature of practice has changed dramatically in recent years. Email communication, lawyers' keyboard skills, voice recognition software, and efficiency measures such as precedent data bases and outsourcing through global networks have made traditional secretarial services decline in significance. At the same

time new support services such as marketing, HR and knowledge management have emerged, lending significant credibility to the MPB argument of Cooper et al. (1996). In an account of the history of the "magic circle"[8] firms in London, Galanter and Roberts (2008) show how structure and strategy reflect the values and social practice of society. It is not surprising that in class-rigid 19th century Britain, firms were closed, nepotism was the norm and career progression was unusual. At the same time, firms in the upwardly mobile USA were implementing the first 'up or out' tournaments with the promise of reward for effort[9]. Labour resources similarly move with the times. Ten years ago document production, file management and client correspondence required quite different support structures than they do today.

In Australia, the rise of professional management can be observed in real time, both in changes to statute and in the behaviour of firms and partners. In most Australian jurisdictions, business management training for solicitors has been mandated prior to admission as well as annually[10]. The office of the legal services commissioner is empowered to audit the management systems and practices of incorporated firms to determine rigor and suitability. In 2005 the Australian Association of Law Firm Practice Managers was formed, and now boasts more than 1500 members. All of these relatively recent changes suggest a change in the way professional management is valued in Australian law firms, suggesting increased managerialism within the profession.

This march toward managerialism is not isolated to a handful of large firms. Sherer and Lee (2002, p.102) observe that "when an organisation departs from standard practice and innovates, it is common to see other organisations in its organisational field or

[8] For a detailed description of the arrival of the term "magic circle" see Galanter and Roberts (2008); this term describes the largest five firms in London, some of whom have expanded to become global law firms.

[9] Swain (2007, pp.1–12) explained the principles of what became known as the Cravath system in the second volume of the history of the Cravath firm:

> Early law firm hiring practices paid associates nothing other than what they introduced themselves .By 1910, the Cravath firm commenced hiring lawyers on an annual salary. Collusion among law schools and law school graduates led to uniform starting salaries across firms from the end of World War 1 until World War 2.

Only partners had permanent employment and as long as an associate was promotable, they were able to stay. Those who were not suitable for promotion were dismissed in the 'up or out' policy. Partners and associates were not permitted to work on matters outside the firm (a common practice in the early 20th century). There were no part time partners or associates.

[10] See mandatory professional development requirements for NSW and QLD Law Societies and Law Institute of Victoria, and respective state Legal Practice Acts.

industry adopt the innovation early on and still other organisations adopt it later". Pinnington and Morris (2003) observe significant movement towards more business-like behaviour among law firms of differing size in the United Kingdom. They also observe that in this environment of increased managerialism "core elements of the traditional form of professional organisation have not been transformed" (p.85); specifically, the role of partners as the core producers, decision makers and owners has not changed. These observations suggest that, although characteristics of the MPB archetype can be evidenced, archetypal transformation – sedimentary or otherwise – is unlikely to have occurred across the entire profession to the extent that researchers have observed in other jurisdictions. Central to this thesis is Pinnington and Morris's (2003, p.95) observation that "the underlying values of partnership are not erased by the MPB characteristics" evident in their research. In short, partners continue to value partnership and to behave as traditional partners, albeit within an environment of increased managerialism.

One might conclude from the literature that firms yet to change from traditional sharing methodologies are likely to contemplate change as they observe others that have changed, as well as those they know are contemplating change as an inevitable accompaniment to a change to more 'business-like practices'. Morris and Pinnington (1998, p.23) observe that traditional forms of profit sharing are "under attack" and at the same time "more business like methods of managing the firm and its core professionals have been observed". Morris and Pinnington (1998, p.23) raise the question of "whether, and how far, these changes go together".

For Maister (2003, p.255):

> Partner compensation is the most troublesome topic in professional service firm management. A firm may live happily with its system for a long time, but when the topic comes up, and it inevitably does, the ensuing debate can be the most bitter and divisive the partnership ever faces.

It is therefore timely to examine more fully the implications of changing from traditional, equal sharing to differential sharing based on partner performance, and the extent to which these changes are occurring. Are firms approaching change with a high degree of homogeneity as the literature suggests?

It is this question that advances the second proposition:

> Proposition 2 *Because of the impact of coercive, normative and mimetic dynamics in the institutional field of law, a high degree of homogeneity exists in the way large Australian law firms share profits among partners.*

3.5 Partner profit sharing in law firms, from traditional to contemporary

In many respects the model selected for partner compensation says much about a law firm. Compensation and profit-sharing systems provide a clear indication of what a law firm values and the behaviours they seek to promote and reward. For Baker et al. (1988, p.1), a thorough understanding of compensation and incentive structures "is critical to developing a viable theory of the firm, since these incentives determine to a large extent how individuals inside an organisation behave". Burrows and Black (1998) argue that firm-client relations and internal firm dynamics can be understood fully only if partners' incentives, as determined by the firm's profit-sharing schemes, are known.

Historically, in traditional LSE profit-sharing systems all law firm partners shared risk, profit and losses equally. As law firm partnerships have expanded, traditional, equal profit-sharing methodologies have encountered criticism (Abowd, 1990; Hodgart Temporal, 1992; Maister, 1993 and others). Much of this criticism comes from those favouring more contemporary models that have been developed to reflect accepted economic theories such as agency theory (Lambert and Larcker, 1987; Aggarwal and Samwick, 1999). Agency theory and its implications for sharing arrangements are examined below after a brief explanation of sharing methodologies.

With the notable exception of some analysis during the 1980s (Leibowitz and Tollison, 1980; Gilson and Mnookin, 1985) and 1990s (Morris and Pinnington, 1998), profit-sharing methodologies among law firm partners have remained confidential to individual firms. "The internal organisation of law firms, and especially the critical issue of profit division has been not only neglected by scholars but veiled in silence" (Gilson and Mnookin, 1985, p.313). Nelson (1988, p.191) agrees, observing that "the

debate on reward is remarkably uninformed by data on how firms actually do compensate". For Morris and Pinnington (1998, p.23) "little is known about actual patterns of profit sharing particularly outside the USA". A citation search using 'Google Scholar' yielded 440 citations of Gilson and Mnookin's (1985) paper, considered an authoritative source by researchers studying law partnerships and profit sharing since its publication. These citations include those by Galanter and Palay (1990) in a paper explaining tournaments to partnership; by Burrows and Black (1998) in a study of profit sharing among big 6 accounting firms; by Morris and Pinnington (1998) in their analysis of profit sharing among UK law firms and their study of promotion to partner processes, and in papers (2002 and 2003) concerning archetype change; by Huddart and Liang (2005) in a study on profit sharing and monitoring in partnerships; by Brock (2006) in an examination of changing archetypes; and by Empson (2007) in her book '*Managing the Modern Law Firm'*. None of these papers take issue with Gilson and Mnookin's observations; rather, their paper remains an authoritative account of how US law firms share profits.

It is widely accepted that the legal profession has seen significant change in the last 20 years (Sherer and Lee, 2002; Ackroyd and Muzio, 2007; Greenwood et al., 2007 and others). Although the detailed analysis of Gilson and Mnookin (1985) provides us with excellent background and remains an authoritative and frequently cited theoretical explanation of law firm profit-sharing methodologies, their analysis draws exclusively on published accounts of firms within the USA and an analysis of accepted economic theory. Their paper does not include input from the firms under investigation or secondary sources, drawing heavily on legal media accounts. Gilson and Mnookin (1985) conclude: "to our knowledge there has been no systematic empirical study of how large law firms, either currently or historically, have allocated partnership profits". More recent empirical studies have measured the proportion of firms in the UK that share profit one way or another (Morris and Pinnington, 1998), concluding that UK firms have not changed to PBS in significant numbers, as they have in the USA. The majority of firms surveyed by Morris and Pinnington (1998) have retained LSE profit-sharing systems.

To explain why law firm partnerships share profits as they do, Gilson and Mnookin (1985) sought to compare and contrast equal profit sharing and performance-based

profit sharing with accepted economic theory, whereas Morris and Pinnington (1998) sought to measure how firms in the UK have adopted particular profit-sharing systems. This thesis takes up the challenge laid down by Gilson and Mnookin (1985) by providing a detailed analysis of actual institutions in the Australian legal profession, testing theoretical approaches by asking why some firms are changing their sharing arrangements and why others are not, and exploring the perceived consequences of change.

A search of databases (Academic search primer, Business source primer, Emerald management plus, Factiva, JSTOR) suggests that there is no literature that deals directly with the important issue of profit sharing among Australian law firms. Morris and Pinnington (2002) observe clear differences between the UK and US legal professions, concluding that there is little empirical evidence of UK firms changing from LSE to PBS. Cultural differences such as relative attitudes to work ethic, different industries' propensity to litigate, the social standing of lawyers and law firms, and legislative differences governing structure, practice and pricing may limit the generalisability of both US and UK findings to the Australian legal profession. The lack of an Australian perspective represents an opportunity to add to the international literature.

It is appropriate to examine in some detail the theoretical explanations for profit sharing presented by Gilson and Mnookin (1985) before expanding the discussion to include other researchers. Gilson and Mnookin (1985) identify two primary alternatives for profit sharing: lock step to equality and performance sharing. They explain how the essence of lock step to equality is seniority, whereby a partner's relative profit share increases annually, until he/she reaches full share entitlement, thereafter sharing equally with other full share partners. The essence of performance sharing is marginal productivity (the measurement of productivity beyond that of the average partner). Gilson and Mnookin (1985, p.313) observe:

> A sharing model (LSE, for example) capture gains from diversification and avoids the divergence between profit maximisation for the firm and profit maximisation for the individual partner that accompanies any productivity formula (PBS).

The researchers' aim is not to identify a superior methodology but rather to explain how lawyers share profits and to present some of the economic theory related to the two primary alternatives. Central to their analysis is an interesting conundrum, one that remains valid today:

> The puzzle becomes more complicated upon the examination of the experts claim that a seniority system is inconsistent with firm success. Several of the most successful firms remain committed to lockstep, seniority based compensation systems and yet seem to be more profitable than ever (Gilson and Mnookin, 1985, p.341).

Lock step is best understood as a means of sharing risk, capturing potential gains from diversity. Gilson and Mnookin (1985) use portfolio theory to explain this strategy:

> Under a lockstep seniority system, an individual lawyer, upon being admitted to the partnership, is quite literally exchanging his human capital for a participation in a portfolio of human capital diversified both with respect to the personal characteristics of the lawyers and with respect to the speciality. Indeed it is striking just how well diversified the portfolios of established firms are (p.342).

In order to function well, under an LSE sharing system each unit of diversified human capital (each partner) must continue to contribute to the best of his or her ability. Not to do so would adversely affect the individual profit draws of the collective and involve a reneging on the agreement to contribute and share equally. An individual partner contributing less than an agreed equal share may be an inevitable occurrence in a large firm partnership. It is primarily as a result of what has been interpreted as being inevitable behaviour, inherent to equal sharing, that consultants and commentators (Hodgart Temporal, 1992; Maister, 1993) have become critical of seniority-based sharing (such as LSE), favouring methodologies that place a greater emphasis on individual partner performance (Morris and Pinnington, 1998).

To explain the problems inherent in lock step to equality Gilson and Mnookin (1985) point to agency theory:

> An agency theory of organisation focuses on how organisations maximise the gains from cooperation by adopting structure which reduce the potential for

> participants to pursue their individual rather than their collective self interest (p.333).

It is the successful management of individual and collective self-interest that is said to describe the 'ethos' of a partnership (Empson, 2007). Empson (2007) has identified the importance of partnership ethos to the sustained success of law firms. These observations are strongly supported by Angel (2007), Managing Partner of international law firm Linklaters LLP in his paper "*Sustaining your partnership in the 21st century: the global law firm experience"* (in Empson, 2007). Angel (2007) credits the continued existence of lock step among magic circle[11] global law firms as a significant driver of an ongoing partnership ethos. Linklaters are a firm that remains committed to an LSE profit-sharing system and credits its retention as a significant contributor to their firm ethos (Angel, 2007).

In their study of the UK legal profession, Morris and Pinnington (1998, p.33) found that "the evidence for innovation in profit sharing is rather modest". They add that:

> generalised accounts (by consultants) that assert innovation in profit sharing occurring in conjunction with the rationalisation of management of the professional fail to understand the complex way in which firms of professionals respond to change.

Morris and Pinnington (1998) conclude that, unlike the law firms in the USA, UK firms have not widely embraced PBS systems, yet they remain extremely profitable.

The literature on profit sharing does not conclude that any one profit-sharing system is superior in its ability to improve the profitability per partner of law firms, which advances the third proposition:

> Proposition 3 *The type of* p*rofit-sharing systems adopted will have little impact on the financial success of a large law firm.*

[11] For a detailed description of the arrival of the term "magic circle" see Galanter and Roberts (2008). This term describes the largest five firms in London, some of whom have expanded to become global law firms.

Accepting or rejecting propositions 1, 2 and 3 will provide answers for the following sub questions:

- How are some firms changing profit-sharing arrangements?
- Why are some partnerships changing the way they share profits more fundamentally than others – what is the rational for this change?
- What is the impact of change on organisational performance?

3.5.1 Agency theory

Agency theory (Alchian and Demsetz, 1972; Eisenhardt, 1989) seeks to explain the power imbalance that exists between principal and agent. The theory explains the costs involved in structuring, monitoring and enforcing agreements between principals and their agents (Alchian and Demsetz, 1972). Agency theory explains the relationship between incentives and employee performance. It is this theory that underpins assumptions about the utility of performance-based pay. By aligning the incentives of agents and principals (owners), the agency problem is said to be minimised.

Some theoretical examinations of law firms and their profit-sharing arrangements assume the firm is the principal and the individual lawyer, possessing specialised knowledge, is the agent (Gilson and Mnookin, 1985; Greenwood and Empson, 2003). Several unique relationships exist in a law firm – solicitor-client, lawyers-the firm, the firm-clients and partner-peers – all of which can be classified as agency relationships, complicating the neat application of agency theory in law firms.

Law firm partners are different from other executives in that they are both principal and agent simultaneously, selling their human capital to the firm and benefiting from the ownership of collective firm capital. In the absence of monitoring and control (Huddart and Liang, 2005) and after any apparent risks are minimised through time, self-interested individuals have significant incentive to renege on any agreement to contribute equally by shirking (doing less than their agreed share). The extent of a partner's willingness to act on these incentives could be influenced by their firm's profit-sharing arrangements.

Agency theory highlights the likelihood that those lawyers who are more successful than their peers will threaten to leave the firm unless they receive their fair value in the form of an annual profit dividend commensurate with their perception of their individual effort. For Gilson and Mnookin (1985) the agency problems of shirking (doing less than one's fair share while enjoying the benefits of equal sharing) and grabbing (demanding more than one's agreed share and leaving) pose significant challenges. In an ideal world the correct choice of compensation structure could minimise the impact of, if not control, all three observed agency problems: grabbing, shirking or leaving. Commentators (Abowd, 1990; Hodgart Temporal, 1992; Maister, 1993) have suggested that partner-sharing arrangements that involve monitoring and rewarding individual performance are more likely to succeed in the management of the agency-related costs identified by Gilson and Mnookin (1985).

A law firm whose organisational form minimises these agency costs will have a competitive advantage (Huddart and Liang, 2005). In the wider industry context various tools exist for minimising agency costs, such as performance-based compensation and other rewards linked directly to organisational performance (Prendergast, 1999). In the environment of a law firm partnership, however, such arrangements require complex measurement and analysis (not to mention an agreed understanding of 'performance'). Gilson and Mnookin (1985, p.313) highlight the problem of determining a profit-share formula: "we confront the problem that any formula will always create incentives to maximise the factors that it weighs, to the detriment of the goal whose attainment is its purpose". Such complexity must carry with it significant economic and social cost (Huddart and Liang, 2005).

Agency theory has also been used to predict likely future forms of law firms. Alchian and Demsetz (1972), in a pioneering agency theoretic analysis of partnerships, conclude that partnerships will be small and most likely occur among relatives or longstanding acquaintances. Time has, of cause, proven this to be far from true. By all accounts large Australian law firms have been big, professionally managed businesses for decades, managed initially by a suitably qualified and experienced senior partner and more recently by a specialised Managing Partner and occasionally by a non-lawyer CEO (Gray, 1998; FMRC Legal Large Firm Survey 1999–2009).

Adding to the literature on agency, Greenwood and Empson (2003) compared partnership with other forms of corporate governance and found that partnerships are more efficient than public corporations because they generate lower agency costs. These insights build on the observations that a competitive hierarchy within a large law firm assists in lowering monitoring costs through increased self-monitoring (Galanter and Palay, 1991).

The universal applicability of agency theory to partnership profit sharing and law firm performance is far from settled. The literature fails to explain why some firms employing strategies to mitigate agency problems such as performance-based compensation fail to outperform others who share profits equally among 'full parity' partners, irrespective of their individual performance (FMRC Legal Large Firm Survey, 1999–2009, AFR Annual Partner Survey, 2011). In the Australian Financial Review's annual Law Firm Profit Survey (16 September, 2011) the top three performing firms said that they use a lock step profit-sharing system.

3.6 Incentive and remuneration

For Prendergast (1999, p.7) incentives are "the essence of economics". A growing literature supports the belief that individuals respond to incentives (Baker et al., 1988; Morris and Maloney, 2005; Encinosa et al., 2006). What is not clear is the exact nature of the response. Heywood et al. (2005) found that profit sharing induces peer pressure and mutual monitoring, eroding both trust and job satisfaction. Goodale et al. (2008) identified a number of 'professional service influence factors' that moderate against the success of outcome-based compensation schemes. These factors include those that are internal to a particular firm (systems and processes), those that are germane to the profession and those that arise as a result of the legal education process. Goodale et al. (2008) observed that the complex nature of the solicitor/client relationship, and the degree of specialised knowledge required to practise, introduce variables that limit the utility of traditional agency models and strategies that flow from them, such as performance-based compensation.

The theoretical attraction of performance-based pay couples with the reality of successful equal sharing firms to prove Maister's (1993) point that profit sharing is

among the most difficult bundle of issues confronting PSFs. If economic theory is consistently generalisable to law firm partnerships Morris and Pinnington (1998) would not have observed that in the UK only 24% of firms with more than 10 partners share profits based on performance.

When a firm moves away from a traditional lock step to equality they often implement a profit-sharing formula. Financial performance is relatively easy to measure. The many subjective factors that make a partner productive are by their very nature difficult to measure and compare. One partner may be a ‘rainmaker’ (work attractor) and another good at maintaining long-term client relationships. Formulae used to determine contribution and income are subject to another set of agency issues: partners are given an incentive to maximise their own income by maximising the factors measured by any formula, rather than maximising their total productivity (Huddart and Liang, 2005). In other words, they ‘game’ the system.

Any profit-sharing model is likely to be subject to issues of perceived fairness among partners. Distributive justice theories (Scott and Colquitt, 2008), like equity theory (Adams, 1965), concern the fairness of outcomes distributed by an organisation. These outcomes involve compensation, promotion and intangibles such as courtesy and respect (Adams, 1965).

According to equity theory, any individual will form a ratio of outputs divided by inputs, for instance compensation relative to performance or effort (Terpstra and Honoree, 2005). This individual will compare his ratio with what he perceives to be that of comparable others. Equity is said to exist if his ratio compares equally to that of his colleagues (Terpstra and Honoree, 2008). Tensions produced from perceptions of inequities are likely to prompt one of several actions. An individual might change his inputs to restore equity, giving rise to the agency problem of shirking (Gilson and Mnookin, 1985). Alternatively, the individual might increase effort regardless of equity, he might change his perceptions of himself or others or he might leave the field (Adams, 1965). Although equity theory does not predict which of these alternatives an individual might select, Adams suggests that the chosen alternative will be the one of maximum utility.

Any assertion of comparison among partners, concerned with equity and fairness, would be consistent with a wide range of literature from the social sciences. Nickerson and Zenger (2005, p.3) consider that "perceptions of inequity trigger a set of behaviours that are costly to the firm", and conclude that the costs associated with equity perception will inevitably produce diseconomies of scale, thus limiting firm growth.

From an incentive perspective, effort and outcome in law firms are not adequately addressed by economic modelling. In her review of the literature on incentives, Prendergast (1999) observes that the underlying assumption in the literature is that individuals respond to contracts that reward individual performance. However, the enduring success of many of the world's largest law firms, which have more collectivist systems[12], makes these economic assumptions appear counter-factual. Prendergast (1999) concludes that agency theory provides an important framework for understanding compensation issues, but the literature lacks any rigorous testing of the model, particularly in contracts involving knowledge workers where outputs (such as quality of advice, contribution to firm culture and maintaining client relationships) are largely subjective.

Adding to the understanding of compensation and incentive and stepping beyond agency, Lazega (2000) explored a 'lateral control regime' in operation in an equal-sharing law firm. This system relied on social mechanisms to reduce the cost of shirking and monitoring. Encinosa et al. (2006) argue that 'the sociology of groups', specifically mutual help, mutual monitoring, guilt, envy, shame, greed and peer pressure, influence both the design and outcome of performance contracts in a professional service environment. This suggests that the culture of a partnership (Muir et al., 2004) built up over many years is a stronger determinant of success than any particular profit-sharing model.

This study shows that many Australasian law firms have evolved towards performance-based sharing, while others have not (see Chapter 5). It could be concluded from weekly media reports (*AFR; The Australian; Lawyers Weekly*) that some continue to grow and

[12] In *Managing The Modern Law Firm* (2007, p.205) Tony Angel, Managing Partner of Linklaters LLP, a highly successful global law firm, writes:

> the continued existence of lock step within the magic circle global law firms is a strong driver, not just of partnership ethos but of the behaviours key to the success of the firms strategies.

prosper, while for others partners are leaving, profits are declining and some are being forced into mergers, presumably believing that size will provide a solution to the challenge of maintaining market share and profit performance.

Although the literature describes various methodologies for the distribution of profits among law firm partners, there appear to be no clear answers for the preference of one model over another in the Australian legal profession. Further to this, the literature does not address the strategic implications of profit-sharing methodology for firms, nor does it explore the lived experience within Australian firms. Our lack of understanding of the impact that profit-sharing models have on partner performance, partner retention and gender equity at partnership present an opportunity for study.

3.7 Phenomena impacting the practice of profit sharing

Australian firms of all sizes are being confronted by a common set of challenges. In an analysis of strategic issues facing the UK profession, Muir et al. (2004, p.179) observe that lawyers "are operating in a cut throat competitive environment, alien to many long standing employees in the profession" and are facing many pressures in both their internal and external environments.

A 2001 discussion paper produced by The Law Council of Australia (*Challenges for the Legal Profession, 2010: A Discussion Paper*) highlights similar challenges to the Australian profession. The Law Council of Australia identifies an increase in consumer awareness and expectation, increased competition from abroad, increased competition from outside the legal profession and changes within the profession itself, including demographic change. The authors also foresee challenges arising from "the expectations of women (who continue to constitute the majority of graduates from law schools) and 'Generation X', including factors such as an appropriate work-life balance and a preference for recognition, variety and challenge over money" (Law Council of Australia, 2001, p.9).

To further elaborate on these trends, this thesis examines the perceived impact of profit-sharing systems on some of the challenges to contemporary practice. Specifically, the

retention of partners, partner performance and behaviour, changing demographics and greater inclusion of women in partnerships are explored from the perspective of large firm leaders whose beliefs shape policies which in turn impact on the working lives of Australian lawyers.

3.7.1 Partner retention

Partnership in a law firm was traditionally considered to be a permanent, long-term appointment. During the 1980s and the early 1990s partners rarely moved from one firm to another. During the last 10 years the typical Australian law firm has experienced a significant growth in both partner profit and partner attrition. The various explanations commonly offered by members of the profession, advisers and researchers are best summarised by Greenwood et al. (2005) in their study of accounting firms:

> The professional carries and generates the knowledge encoded in the services being offered and he/she develops relationships with clients critical for a sustained flow of work. Professionals within the firm, in other words, are the human capital of the firm and generate its social capital. Yet these resources are mobile to an extent not found in settings where capital assets are extensively used. Retention is thus a prime challenge (p.665).

Whether partner mobility is a direct function of profit-sharing methodologies or a result of other influences is unclear. Some scholars have sought to explain it through portfolio and agency theory (Gilson and Mnookin, 1985), and economic scholars through a variety of economic modelling guided by the principles of agency (Huddart and Liang, 2005; Goodale et al., 2007; Ittner et al., 2007 and others).

Law firms in Australia are currently managing in a rapidly changing market place. The competition for talent is becoming increasingly global and intense. In other jurisdictions researchers have observed that senior employed lawyers and equity partners are more mobile than ever before (Hitt et al., 2007). In the UK researchers have found that firm-specific capital – most notably brand equity, the strength of a firm's brand – appears to do little to reduce the agency cost of leaving (Greenwood and Empson, 2003). On the contrary, it seems to increase it. Partners who have worked for large, branded firms are

highly employable. Employers in law firms abroad appear to believe that an element of firm-specific capital is portable from one firm to another. Research on the reasons for partner attrition is limited to practitioner research (FMRC Annual Law Firm Attrition survey, 1990–2010); scholarly research into this seemingly rising phenomenon is absent.

There is little doubt about the significance of large law firms to the Australian economy and their significance to the enterprises they advise. The enduring success of large law firms depends on several strategic considerations, some external to any one firm, others internal and controllable. One such factor is the stability of human capital. Human capital, particularly that of the partners, is a professional service firm's most valuable resource (Hitt et al., 2001). To be sustainable a firm must have stable, motivated partners who are prepared to offer their services to advance the objectives of the firm.

'Up or out' cultures and profitable leverage structures require a committed, stable group of associate solicitors. In 2006/07 the FMRC Legal Human Resource Economics Survey found that the annual attrition rates of senior lawyers in large Australian CBD firms was 48.35%, salaried partner attrition was 20.98% and equity partner attrition was 9.8%. In subsequent years only small reductions in attrition have been achieved (FMRC Human Resource Economics Survey, 2009). Retention in legal services attracted little direct research attention prior to 2003, although the antecedents of retention have been studied for many years in the wider business community (Carsten and Spector, 1987 on job satisfaction; Narayanan, 1985 on incentives; Kerr, 1974 and Coff, 1996 on reward; Keaveney and Nelson, 1993 on role stress and others).

Galanter and Palay (1991) observed that Law firms, in the USA have experienced higher attrition rates of professional labour since the growth of the large law firm. Pinnington (2011) proposes that this may be due to high employee bargaining power and strong preferences, among lawyers for autonomy. Several large multinational firms and many UK-based firms annually recruit directly from the Australian market at all levels, including partners. These firms maintain a high profile in the Australian legal media and at careers fairs. Professionals are more likely to be attracted to a generic set of satisfaction drivers that may well be found in many firms and are not unique to any particular firm but rather to the profession itself. This is magnified by the autonomous

nature of the work undertaken by many lawyers and their loyalty to their clients over the firm.

Non-attachment to an organisation would most likely increase the propensity to move (Saks, 2006), even more so considering a typical lawyer's desire for career advancement. This heightened propensity to move was the subject of Kirschenbaum and Goldberg's (1976, p.357) study of professionals that identified the "career mobile cosmopolitan" who was influenced by organisational environment and HRM strategies but who was nonetheless highly mobile as a result of career motivations and the nature of international professional markets. Gilson and Mnookin (1985) observed in the USA that "every issue of the legal press now carries stories of individual partners leaving one firm to join another, groups of partners splitting off to establish their own firms and internal squabbles over the division of profits" (p.315). A consideration of employee turnover and retention literature is both applicable and important because of the complex nature of agency in law firm partnerships, as discussed above. Partners are owners and in this capacity principals but also key producers, effectively working as agents for the wider partnership, and certainly for their clients.

We can deduce from Hertzberg's (1966) classic motivation theory that one likely antecedent to attrition is job dissatisfaction stemming from 'hygiene factors' such as compensation. Similarly we can deduce from equity theory that another likely cause of attrition among law firm partners is perceived inequality of contribution and compensation within a partnership (Terpstra and Honoree, 2008).

The literature on retention has its roots in the work of March and Simon (1958), who found that retention and 'voluntary turnover' are a direct function of the ease of movement and available job alternatives. They argue that retention is more likely to occur in circumstances where job shift is difficult and alternatives unavailable; in other words, employees are more likely to stay if they have little or no alternative. Professional service firms in general and law firms specifically do not typify such an environment; that is, professionals are not constrained by a lack of alternatives. Researchers (Greenwood et al., 1990; Cooper et al., 1996) have recognised the portability of a professional firm's knowledge capital. A tightly contested market for talent like the Australian legal profession, where opportunities abound and job shift is

relatively easy (Law Council of Australia, 2001) provides an example of March and Simon's (1958) conclusions, that turnover is related to alternative job opportunities.

The implications for law firms of high levels of attrition and the costs associated with it are multifaceted. In a study of firm economics, Sigler (1999) relates retention to agency theory, highlighting the advantages of retention to economic success. In their April 2007 Law Office Management and Administrative Report, The Institute of Management and Administration (IOMA) calculated lawyer turnover using investment costs, separation costs and replacement costs, highlighting the multifaceted nature of the cost of attrition. The escalating costs associated with attrition have forced organisations to better understand and manage it.

Incentive-based compensation (be it salary, bonus or share options, tied to performance measures) has been found to advance retention in corporate (for-profit) organisations (Sigler, 1999). Within the profession, among law firm managers and advisers, however, performance-based pay (PBP) remains an extremely complex issue. Solicitors' commencing salaries in Australia are as high as A$95,000 and partner incomes exceed A$1 million in some firms (FMRC Annual Large Firms Survey, 2009). At the same time the incidence of depression among lawyers is also rising (*AFR*, April 2007). The Australian legal media regularly report that more employees are concerned less with money and more with quality of life (as predicted in the Law Council of Australia Discussion Paper, 2001). If this is the case, the applicability of Sigler's (1999) findings to Australian law firms could be questioned. More recent studies, finding that income is negatively related to perceived life quality, particularly for successful, high-earning males (Li-Ping Tang, 2006), bring into doubt the effectiveness of PBP as a means for promoting retention.

Buck and Watson (2002) found a direct positive correlation between HRM strategies and organisational commitment, concluding that commitment equates to retention. Organisation commitment, the force that binds an individual to an entity (Meyer and Herscovitch, 2001), contributes significantly to retention. Applebaum et al. (2003) have studied the powerful effect of organisational commitment, noting that commitment has many positives that relate to organisation goals and that "highly committed employees are less likely to leave" (p.272). This notion has been further endorsed by Meyer,

Becker and Vandenberghe (2004) in their study comparing intention to quit, absenteeism and performance. Promotion to partner was traditionally thought to bind a lawyer to a firm for life. These findings are problematic as there are few measures of commitment stronger than ownership; however, attrition remains a challenge at partner level for many large legal firms.

Relationships between people within an organisation have led to another construct: job embeddedness (Mitchell et al., 2001). This concept explores the links between people within an organisation and the economic and emotional cost associated with leaving it. Research concludes that staff retention is more likely with a greater degree of embeddedness. This construct has been an important addition to the understanding of retention because it deals with organisational culture factors (Mitchell et al., 2001). The relationships between partners may also involve degrees of embeddedness. Although a particular firm's partner profit-sharing system has the capacity to influence embeddedness and ultimately partner retention, the nature of these apparent relationships remains unexplored in the legal practice management literature.

Many law firms are able to offer employees flexible work arrangements such as part time work, rostered days off or extended holiday time. Other firms remain committed to more traditional employment models. Maxwell et al. (2006) found a positive impact of more flexible arrangements on retention and several other desirable outcomes linked to the policies and practices of an organisation. They also found that flexible work arrangements contribute to organisational commitment, further reinforcing retention.

An investigation of selected retention literature identifies direct, discrete attributable explanations for why people stay. Some, however, study turnover activity and "assume that workers who stay are somehow satisfied or at least resigned to their jobs" (Taplin and Winterton, 2007, p.5). In their analysis of turnover models Steel, Griffeth and Hom (2002) focus on the impact of developing a formal retention policy. They say that such a policy should utilise data from quit surveys, industry salary surveys, exit interviews and surveys from valued leavers and stayers to generate policy.

Ing-Chung et al. (2006) conducted a meta-analysis of a selection of retention literature. They identify that most studies show retention is determined by individual-based, firm-

based and market-based factors. They conclude that firm-based factors dominate individual factors with economic cycles being significant. Empson (2007, p.23) provides an example of Ing-Chung's(2006) firm-based factors emerging as a potential retention force within law firms in her book *Managing The Modern Law Firm.* She discusses the importance of a partnership ethos, achieved through the correct balance of individual and collective self-interest, and describes how firms achieve this through a process of socialisation effectively preparing lawyers for life inside the partnership:

> "This process of socialisation is fundamental to the partnership ethos which requires the interests of the individual to be reconciled with those of the collective. The individual must demonstrate that he or she has the necessary confidence and strength of character to exercise independence and to behave with authority towards clients, at the same time the prospective partner must show that he or she can be trusted to act in accordance with the wishes of the partnership as a whole".

Despite many of the above contributions, it remains unclear why a partner would leave one successful firm to go to another and why, as it was observed as early as 1985 in the USA, they do so with such apparent regularity (Gilson and Mnookin, 1985). Empson's (2007) question of whether or not retention strategies found to work outside the legal profession and in other countries enjoy equal utility within the Australian legal profession is yet to attract research attention. The significance of partner income relative to partnership ethos in achieving retention within a law firm partnership also remains unknown. Are partners leaving firms because of perceived inequities in compensation, insufficient relative compensation, a lack of embeddedness (Mitchell et al., 2001) and can this embeddedness be achieved through profit sharing and/or partnership ethos (Empson, 2009); or is the management of partner attrition simply a matter of mechanics such as flexible work practices (Maxwell et al., 2006)? Answers to these important questions remain unclear. This research will add to our understanding of these critical issues.

3.7.2 Changing demographics and the greater inclusion of women in partnerships

It is easy to conclude that women are under-represented in large law firm partnerships. Precisely why this is the case is not clear. In 2007 FMRC Legal reported that in large Australian law firms 63% of all 'employed solicitors' and 53% of all 'associates' were women. Despite women forming the majority of the cadre of salaried lawyers (56%) employed by firms, only 11% of equity partners were women (FMRC Legal Human Resource Economics Survey 2006–2007). In other jurisdictions researchers have observed that traditionally the road to partnership has not been an easy one for women. Bolton and Muzio (2007, p.286) observe that "[w]omen now represent the majority of salaried solicitors, yet they represent a mere quarter of partners" in the UK. The authors argue that 'defence mechanisms' built on gender segmentation have been developed to ensure an increase in professional employee leverage, particularly among female employees giving rise to a privileged, male- dominant elite (the equity partners). In a survey of US law school graduates at several stages in their careers, Noonan et al. (2007, p.157) report that "roughly 90% of women reported experiences of sex discrimination." In their 2006 study, Wass and McNabb (2006) found that women solicitors in Great Britain receive on average 58% of the incomes enjoyed by their male colleagues.

There is a growing literature centred on gender inequities (Hull and Nelson, 2000; Gorman, 2006; Wass and McNabb, 2006; Bolton and Muzio, 2007; Noonan et al., 2007) and family-friendly issues (Jacobs and Madden, 2004) in law firms. Gender inequity at partner level is occurring in Australia and abroad. Noonan et al. (2007, p.176) observe that "sex discrimination is alive, and persists in Law. We find large, persistent and unexplained sex gaps in partnership rates, as well as a disquieting number of women law graduates who report having experienced sex discrimination". In Australia we don't know if partner profit-sharing methodologies act as 'closure mechanisms', discouraging women from joining equity partnerships, or whether current equity partners perceive any need to instigate profit-sharing arrangements that cater to the needs of the growing population of women solicitors. The research questions of this thesis have been framed to contribute to our understanding of these issues.

Hull and Nelson (2000) tested three competing hypotheses derived from the apparent gender differences in attainment: assimilation (the extent to which a female lawyer's career will converge with that of a male lawyer over time, potentially becoming equal), choice (choices made by female lawyers themselves) and constraint (the choices and behaviours of employers), arguing that constraints continue to affect the career prospects of aspiring women lawyers. In contrast to these alarming observations, others argue that gender disparity may be a function of the very nature of legal work. Gorman (2006) found that problem variability, strategic indeterminacy and dependence on autonomous actors (for instance, clients) weaken the association between ability and performance. This, she argues, makes decision makers in US law firms more likely to weight gender heavily in promotion decisions.

This research examines in part how large Australian law firm partnerships are changing or not changing their sharing arrangements to achieve greater equity and a lack of gender discrimination. It also examines whether or not the leaders of large firms see any need to change their profit-sharing arrangements to assist in the management of changing lawyer demographics.

3.7.3 Partner performance and job satisfaction

Equity partners are the owners of a law firm. They are also fee earners. Partners charge significantly more for their time than employed fee earners, partners generally achieve significantly greater utilisation rates (chargeable time as a proportion of available time), partners' time may be less likely to be discounted and, given their direct pecuniary benefit, partners may be more likely to work harder than non-partner lawyers (Greenwood et al., 2007). For Empson (2007, p.24), "The innate drive of most professionals, together with their sense of commitment to the partnership, ensures that they continue to generate and maximise profits on behalf of their firms". It has been suggested that the enduring success of firms ultimately depends on the performance and behaviour of partners, individually and collectively (Gilson and Mnookin, 1985).

In many of the large Australian firms equity partners are 'required' to bill in excess of seven hours each working day. In addition, they are responsible for the billings of their direct reports (the employed solicitors they delegate to and supervise). In 2008 an

average partner in an average large Australian firm was responsible for a fee base (total fees billed by partner and direct reports) in excess of A$2 million (FMRC, 2009–08 and AFR Partner Survey, 2010).

In smaller firms the importance of partner performance increases. As there are fewer of them, the impact of their performance becomes more critical and the consequences of their behaviour more pronounced.

Maister (1993) has written extensively on the importance of individual partner performance to overall firm financial performance saying that partner performance is critical to success. For Hitt et al. (2001, p.13), “performance differences across firms can be attributed to the variance in the firms resources and capabilities”. The researchers go on to say that “the human capital embodied in the partners is a professional service firm’s most important resource” (Hitt et al., 2001, p.15). We can conclude that partners matter, and it could also be concluded that they are vital to a firm’s success. Despite this obvious conclusion, research into why individuals join or leave a particular structure and compensation model has not progressed beyond assumptions based on theory (Gilson and Mnookin, 1985, Morris and Pinnington, 1998).

The processes that influence a partnership to select one compensation model over any other must at some stage move beyond retention and entertain the construct of relative utility, what makes partners satisfied or dissatisfied with their current profit-sharing arrangement. It is argued that most, if not all, decisions are motivated by the pursuit of subjective wellbeing or, more broadly, happiness (Hsee and Hastie, 2006). Paradoxically the large and growing literature on income relative to happiness clearly indicates that we regularly fail to choose what makes us happy (Binswanger, 2006). Hsee and Hastie (2006) argue that this is due to a failure to accurately predict the outcomes of available options or because we fail to make choices based on the predictions, or both. These findings are relevant to the trial-and-error nature of partner profit-sharing system selection by law firms.

Numerous studies report that happiness, life satisfaction and subjective wellbeing do not increase linearly with income growth (Kaun, 2005; Binswanger, 2006 and others). Despite this, large firms appear to be managing toward profit maximisation, striving to

increase partner compensation. Kaun (2005) continues the arguments of Easterline (2001) and others (for example, Kahneman, 1999; Struzer, 2002) that aspiration increases with income, negating the benefit of income growth while fuelling the desire for more.

The literature around the phenomena impacting the practice of profit sharing advances the fourth proposition:

> Proposition 4 *Profit-sharing systems are not perceived to influence partner attrition, partner retention and greater gender equity in Australian law firm partnerships.*

By addressing this proposition and accepting or rejecting it I expect to answer the sub question:

- What do leaders of firms perceive are the human and cultural consequences of change for the phenomena surrounding sharing?

3.8 Conclusions and research agenda

This chapter has reviewed and analysed the literature relating to law firm partnerships, their management and changes that have occurred and that are occurring in the legal profession. Particular attention was paid to the literature on some of the phenomena surrounding profit-sharing arrangements, specifically partner retention, partner performance and the inclusion of female partners in equity partnership. An apparent lack of research explaining partnership management in the Australian legal profession encouraged the analysis of international research, in particular from North America and the United Kingdom. What is clear from this review is that law firms in several jurisdictions are in a state of change and that some of the strategic challenges, such as ongoing firm performance, partner attrition and gender equity at partnership, are not fully understood.

The literature review has shown that Gilson and Mnookin (1985) have articulated the alternative primary methodologies for profit sharing and identified that law firms in the

USA were changing their sharing arrangements as far back as the 1980s. Thirteen years later Morris and Pinnington (1998) measured the use of particular profit-sharing models in the UK legal profession, surveying a large sample of firms and concluding that UK firms are not changing from traditional sharing models with the same frequency as their US counterparts during the 1980s. All these researchers observe that there appears to be no obvious positive correlation between sharing methodologies and relative success; some high-performing firms share equally and others use performance-based sharing. So why are Australian firms changing? This research adds to the work of Gilson and Mnookin (1985) and Morris and Pinnington (1998) to examine Australian law firms to increase our understanding of why law firms are changing their sharing arrangements and what the leaders of those firms perceive are the consequences of changing. This research also investigates the relationship between alternative profit-sharing systems and the relative success of firms that adopt different systems.

The methods of organising are not the focus of this thesis. Rather, the study draws on the discussions of different archetypes to inform an investigation into increased managerialism, an undisputed aspect of the debate and the relationship the observed archetype may have to the selection of various profit-sharing methodologies. The study does so to increase our understanding of the impact of a greater performance focus in Australian law firms on partner retention, partner performance and gender equity in partnerships.

In an explanation of why large firms get larger, Galanter and Palay (1990) described the mechanics of the promotion to partner tournament. Twenty years on it is appropriate to examine the validity of success tournaments as an explanation and motivation for aspiring partners and the relationship that success tournaments may have to law firm profit-sharing arrangements.

Strategic phenomena evidently impact day-to-day practice and continue to challenge many firms. Partner retention, changing lawyer demographics and gender equity, together with ongoing partner performance, are further challenges. This thesis seeks to add to our understanding of these phenomena by ascertaining their relationship to profit-sharing arrangements.

Within the framework established by the law firm management literature four propositions have been advanced:

Proposition 1 *Despite a changing demographic among employees and potentially partners, large Australian law firms maintain traditional beliefs about the utility of success tournaments*

Proposition 2 *Because of the impact of coercive normative and mimetic dynamics in the institutional field of law, a high degree of homogeneity exists in the way large Australian law firms share profits among partners.*

Proposition 3 *Profit-sharing systems have little impact on the relative financial success of Australian law firms.*

Proposition 4 *Profit-sharing systems are not perceived to influence partner attrition, partner retention and greater gender equity in Australian law firm partnerships.*

By investigating these four propositions, I answer the central question of this applied research project:

What are the likely experiences that open up or close down to large law firms as a result of their chosen partner profit-sharing system?

I also examine several sub-questions.

First, building on the work of Cooper et al. (1996), Greenwood et al. (2002), Pinnington and Morris (2003), Muzio and Ackroyd (2005), Brock (2008) and others examining change in northern hemisphere law firms, I examine in Australia:

How are some partnerships changing the way they share profits?

Second, building on the work of Gilson and Mnookin (1985) in the USA and Morris and Pinnington (1998) in the UK, I examine Australian firms to determine:

Why are some partnerships changing the way they share profits more fundamentally than others – what is the rationale for this change?

Third, building on the work of Galanter and Palay (1990) in the USA and Greenwood and Empson (2003) in the UK, I examine Australian firms to determine:

> What is the impact of change on organisational performance?

Fourth, building on the work of researchers examining retention, gender equity and partner performance, I examine Australian firms to determine:

> What do leaders of firms perceive as the human and cultural consequences of changing a profit-sharing method?

The following chapter explains the research methodology used to guide the study.

Chapter 4 Methodology

4.1 Introduction

This chapter details the methodology used in the research, why it was selected, how it was conducted and how it was justified.

I have been serving the legal profession as a management consultant since 1989. I am a principal of FMRC Pty Ltd, a business that conducts comparative financial analysis of top and mid-tier law firms in Australia, consults to law societies, firms and government in issues pertaining to the business of legal practice, and conducts continuing professional development training in related areas. We also provide management training for new partners wishing to obtain an unrestricted practising certificate in NSW. As such we are key advisors to the profession in issues of policy and practice.

For more than 30 years FMRC has been gathering and interpreting financial performance data from major Australian law firms. Each year FMRC collects detailed productivity, expense and lawyer performance data. Each month FMRC collects activity, market share and debtor data. These data enable us to draw general conclusions about the various phenomena based on an analysis of the performance of the firms who participate in the surveys, relative to one another. Comparative performance data alone, however, present a single dimension of organisational performance, telling us nothing about the lived experience in large Australian law firms, specifically how changes in profit sharing and the effect of profit sharing are perceived by respondents within firms.

Increasingly, my organisation is being called upon to assist law firm partnerships with structuring and partner profit-sharing advice. It is evident from the literature that the legal profession in the USA is considered to be highly institutionalised (Greenwood and Hinings, 1993). Similar levels of institutionalisation have been observed in the UK (Ackroyd, 1996; Pinnington and Morris, 2002; Ackroyd and Muzio, 2007). It may be likely that the Australian legal profession is also similar. In these institutionalised professions researchers have found that once change occurs in an organisation, other organisations follow (DiMaggio and Powell, 1983). Accordingly it is likely that smaller

firms will follow the large firms in seeking to change their profit-sharing arrangements. This research examines the changing phenomena around law firm partnerships, their structuring and profit-sharing arrangements with a view to informing and improving my advice and that provided by other members of my organisation to law firms seeking to change their profit-sharing arrangements. By 'improving' I mean the way in which a particular profit-sharing methodology opens and closes the way in which the world is perceived and experienced by the members of the law firm who identify with that methodology.

The study does not aim to draw a definitive conclusion regarding the superior nature of one profit-sharing system relative to another. Instead it seeks to build on our understanding of the relationship between profit-sharing methodologies and the lived experience within Australian law firms. Accordingly, I embraced a social constructivist paradigm and a phenomenological strategy of enquiry. These terms and the reasons for selection are discussed in Section 4.2.

This chapter commences with a discussion of the research problem and an explanation of the paradigm or 'world view' (Creswell, 2009) I adopted. I then explain the study's strategy of enquiry and discuss the data collection methods, interviews, and present the justification for this choice. This is followed by a description of the strategy adopted for data analysis, and finally a discussion of the limitations and ethical considerations.

For Creswell (2009, p.5), "research involves philosophical assumptions as well as distinct methods or procedures". Creswell (2009) suggests that research design involves explanation of the researcher's philosophical world view, the selected strategies of enquiry and the research methods employed. Each of these is discussed in turn below, following an initial discussion of the research problem.

4.2 The research problem

The previous chapter reviewed and discussed the literature on and around law firm profit-sharing systems. Much of the literature available to those interested in legal

practice management concerns jurisdictions outside Australia. This research seeks a greater understanding of the experiences of managers inside large Australian firms.

The study seeks to build on the existing law firm management literature by describing the "lived experience" (Creswell, 2009, p.13), that may ensue as a consequence of selecting one profit-sharing methodology over another, from the perspective of law firm Managing Partners. The study is concerned with the likely consequences of choice. It seeks to describe the likely experiences that will open up to a firm having selected a particular sharing system and the experiences that are likely to close to them.

I am particularly interested in the likely impact of profit-sharing methodology on the phenomena of partner performance, partner attrition and gender equity in partnerships. In addition, the study addresses law firm performance, the position of salaried partners and the use of competitive success tournaments as an employee motivation strategy.

The central research question prompts examination of the selection of a particular profit-sharing system, what individuals in firms are likely to experience and how performance, attrition, equity, salaried partners and success tournaments are likely to be affected. In answering the central research question, the study describes the world that sharing systems open and close to individuals and to firms. The notion of opening and closing possibilities as a consequence of paradigm choice is detailed by Spinoza et al. (1997).

4.3 The paradigm and strategy of enquiry

For this study I embraced a social constructivist paradigm (Creswell, 2009). The term 'paradigm' has been used to refer to alternative models that reflect a driving force in arriving at a researcher's orientation to research and practice (Guba and Lincoln, 2000). The paradigmatic perspective through which a study is carried out determines the orientation to research and knowledge (Plano Clarke and Creswell, 2008). Open-ended studies (those that seek to draw no specific conclusion) seeking understanding and lived experience are seen as reflecting a 'constructivist' paradigmatic stance (Guba and Lincoln, 2004). For Creswell (2009, p.8), "social constructivists hold assumptions that

individuals seek an understanding of the world in which they live and work ... The goal of the research is to rely, as much as possible, on the participant's views of the situation being studied".

Crotty (1998) in Creswell (2009, p.8) identified several assumptions of constructivism:

> 1. Meanings are constructed by human beings as they engage with the world they are interpreting. Qualitative researchers tend to use open ended questions so that the participants can share their views.
> 2. Humans engage with their world and make sense of it based on their historical and social perspectives. Thus qualitative researchers understand the context or setting of the participants through visiting this context and gathering data personally.
> 3. The basic generation of meaning is always social, arising in and out of interaction with a human community. The process of qualitative research is largely inductive, with the enquirer generating meaning from the data collected in the field."

Under a social constructivist paradigm the researcher's objective is to interpret or make sense of the meanings that others have about the world (Creswell, 2009). In this study, I aimed to interpret the perceptions that interview participants had of their profit-sharing systems and those of others, and the likely consequences of selecting one system over another.

To build a rich understanding of the impact of different profit-sharing systems, this study adopted a phenomenological strategy of enquiry and utilised interview method to collect data. The purpose of a phenomenological approach is to illuminate phenomena through the perceptions of actors in a given situation, to describe lived experience and the meaning it holds for each subject (Drew, 1989). Phenomenology is the study of human experience, from the actor's particular perspective (Knaack, 1984).

Phenomenology is both a 20th century school of philosophy associated with Heidegger (1976) and Husserl (1970) and a type of qualitative research method (Merriam, 2009). In Collis and Hussey (2003, p.47), Morgan (1979) suggests that the term *phenomenology* can be used at three different levels:

> at the philosophical level, where it is used to reflect basic beliefs about the world; at the social level, where it's used to provide guidelines about how the researcher should conduct his or her endeavours; and at the technical level where it's used to specify the methods and techniques which ideally should be adopted when conducting research.

This study embraces all three levels. Ontologically, the version I use assumes that meaning is varied and multiple (Creswell, 2009), as perceived by study participants. Epistemologically, dialogue and thus interaction with the study participants determines the way in which knowledge is developed. Axiologically, the research is value-laden and biased. Methodologically, it involves an inductive process with conclusions about the phenomena under investigation emerging during the research process. Though context-bound, the research develops an understanding of the phenomena under examination. It is focused on describing phenomena rather than explaining either phenomena or principles of verification or falsification.

The version of phenomenological enquiry used in presenting the findings of this study comes from hermeneutic phenomenology and has its roots in the work of the German philosopher Martin Heidegger (Laverty, 2003). A traditional phenomenologist embarks on a process of self-reflection in the context of conducting his or her research (Colaizzi, 1978). The purpose of this self-reflection is to gain awareness of one's own biases and assumptions so that they can be set aside or 'bracketed' in order that the research can proceed without preconceptions (Laverty, 2003). This assumption can protect the research from imposing assumptions or researcher bias on the study.

Contrastingly, hermeneutical phenomenology "asks the researcher to engage in a process of self-reflection to quite a different end than that of phenomenology. Specifically the biases and assumptions of the researcher are not bracketed or set aside, but rather are embedded and essential to interpretive process. The researcher is called on an ongoing basis to give considerable thought to their own experience and to explicitly claim the ways their position or experience relates to the issues being researched. The final document may include the personal assumptions of the researcher" (Laverty, 2003, pp.18–19). Indeed, this is why hermeneutic phenomenology offers the researcher the opportunity to improve his or her practice. For it is by reflecting on practice that the

researcher has the opportunity to become aware of and challenge his or her own assumptions. This is precisely the kind of enquiry in which I am engaged.

4.4 Method of data collection

Merriam (2009, p.25) suggests that "the task of the phenomenologist is to depict the essence or basic structure of experience" and, to achieve this end, "the phenomenological interview is the primary method of data collection".

I selected interviews as the method for gathering data. The interview is widely used in qualitative research. By interviewing more than one person (Glesne, 1999), one can obtain general information from a group of people who have experience and knowledge of the key issues under investigation (Stewart and Shamdasani, 1990).

Interviews need to be sufficiently flexible to enable phenomena to be explored from different angles; they should not be rigid and unchangeable (Merriam, 2009). At the same time, interviews need to be consistent from one participant to the next. Semi-structured interviews are ideal for meeting these criteria (Bailey, 1982), as they allow exploration of the connection between lived experience and the underlying paradigm or set of assumptions. Interviews are appropriate for looking at the relationship between lived experience and the participants' assumptions (Easterby-Smith et al., 1991) or, more to the point of this thesis, between lived experience and the assumptions underlying profit-sharing methodologies.

All interviews took place in the business premises of the participants, most in the firm's board room and some in interview rooms (visiting the participant's context, as recommended by Crotty, 1998). All interviews were recorded with the permission of the interviewee. All interviewees were assured of confidentiality as a condition of participation, and they were assured that that neither they nor their firm would be identified in my thesis. Signed consent forms were obtained from all participants.

I explained in detail the objectives of the study and the broad subject areas of interest to all participants. The interviews were semi-structured (Collis and Hussy, 2003; Merriam,

2009) and the questions open-ended (Crotty, 1998). The interviews were also broad and general, enabling discussions to focus as much as possible on the participants' views of the subjects being discussed, an approach consistent with a social constructivist paradigm and a hermeneutic phenomenological strategy of enquiry (Creswell, 2009).

According to Merriam (2009, p. 89) semi-structured interviews take the following form:

- Interview guide includes a mix of more and less structured interview questions
- All questions used flexibly
- Usually specific data required from all participants
- Largest part of interview guided by list of issues or questions to be explored
- No predetermined wording or order.

Merriam (2009, p.25) suggests that hermeneutic phenomenological scholars should prepare for interviews: "prior to interviewing those that have had direct experience with the phenomenon, the researcher usually explores his or her own experiences to become aware of personal prejudices, viewpoints and assumptions". Were the interviews to proceed after setting these assumptions aside, this would involve the process that has become known as 'bracketing' (Cassell and Symon, 2004). As I employed a hermeneutic phenomenological strategy of enquiry, I used a bracketing technique to become aware of my assumptions, not to set them aside.

My role in the profession and with many of the firms involved in the study necessitated my participation in interview discussions as a participant observer (Glesne, 2006). A participant observer is someone who needs to go inside a culture or a context in order to reflect on that context. The observer needs to experience the world of the other. In reflecting on the world of the other, they develop a narrative about the world of the other and about their own assumptions about the world of the other. As a participant observer, I endeavoured not to influence the perceptions of each participant, only reflecting on my perceptions of the topics of interest after each participant had fully and frankly expressed their views. Given the complexity of many of the phenomena discussed, my advice was usually sought on my perceptions and those of other firms. These were shared in a confidential and general way. This effectively facilitated an

iterative process as the interviews continued, raising both complementary and different related issues as more interviews were completed (Hussy and Hussy, 1997).

To prompt further and deeper reflections, I discussed the conclusions from the literature review with each participant to validate the conclusions drawn and to gain their perceptions on issues arising from the literature. All interviews were informal, which added to participants' candour. Consequently data were both voluminous and rich.

I transcribed the recording at the conclusion of each interview. All participants were assigned a reference code for the purpose of identification and ongoing correspondence. Participants' responses informed subsequent interviews.

4.5 Purposeful sampling

This study involved purposeful sampling (Patton, 2002):

> Purposeful sampling is based on the assumption that the investigator wants to discover, understand and gain insight and therefore must select a sample from which the most can be learned (Merriam, 2009, p.77).

A hermeneutic phenomenological strategy of enquiry is concerned with "understanding human behaviour from the participants own frame of reference" (Collis and Hussey, 2003, p.53). At the core of the strategy is the 'lived experience' of participants (Knaack, 1984). It follows that the participants in the study needed to be managing firms or in strategic positions within large partnerships where the changes in partnership structuring and profit sharing were being manifest. In addition, participants needed to have been in their positions for some time, thus ensuring that respondents had a good understanding of the relevant issues: "The aim in participant selection in phenomenological and hermeneutic phenomenological research is to select participants who have lived experience that is the focus of the study" (Laverty, 2003, p.18).

Twenty-five firms were invited to participate. Three of the invitees had recently changed or were in the process of changing Managing Partner and therefore declined to participate on the basis that they felt that their input would involve supposition, not

experience. Three of the invited firms declined to participate due to time constraints. Nineteen firms chose to participate.

Of the 19 firms that took part, five describe themselves as top-tier firms, while the remaining 14 perceived themselves to be second or mid-tier firms. All of the interviewees were highly experienced, having performed their respective roles for many years, some for other firms, prior to joining their current firm. All participants were male.

4.6 Analysis of data

Data analysis methods vary among phenomenological researchers (Knaack, 1984). The goal of all phenomenological data analysis, however, is "faithfulness to the phenomenon" (Knaack, 1984, p.111).

For Miles and Huberman (1994, p.8):

> Phenomenologists often work with interview transcripts, but they are careful about condensing this material. They do not, for example use coding but assume that through continued readings of the source material and through vigilance over one's presuppositions one can capture the essence of an account.

To assist phenomenological researchers with the process of data analysis, Colaizzi (1978) provides seven steps:

1. Read through the entire protocol (each participant's interview transcript) transcript for a sense of the whole.
2. Extract specific statements that pertain, directly to the investigated topic (the particular phenomenon under investigation).
3. Formulate meanings as they emerge from the significant statements. This involves creative insight which remains faithful to the original data.
4. Repeat the above steps for each protocol and organise the formulated meanings into clusters of themes:
    a) validate the themes by reefing back to the original protocol,
    b) contradictory themes may be real and valid, do not ignore them.

5. Integrate the results of the analysis so far are then integrated into an exhaustive description of the investigated topic.
6. Formulate the description from step 5 into a statement identifying its fundamental structure.
7. To validate the analysis, return to each subject and ask them if the statement describes their experience.

The data were analysed in a process guided by Colaizzi (1978), with the data studied in their entirety at the conclusion of each interview. When all the interviews were completed, the data were sorted into those from LSE firms and those from PBS firms, and they were then re-read in their entirety. The data were then sorted around each of the phenomena being explored (partner performance, partner attrition, gender equity, salaried partners and the use of competitive tournaments). These were each re-studied to a point when a single statement could be produced for each and the results could be written up using a hermeneutic phenomenological distinction between the opening and closing of possibilities. The idea of opening and closing new worlds is central in phenomenology and is to be found in the work of Spinoza et al. (1997). The principle here is that our world is framed by our assumptions (or the profit-sharing systems in the context of this thesis), that the assumptions themselves are neither correct nor incorrect but that each set of assumptions allows one to see and behave in the world in one particular way and not other ways. That is, in terms of a particular set of assumptions we will see and behave in a particular way and not in another way and that we will see one possibility and not another (Spinoza et al., 1997).

Knowing the assumptions inherent in a particular profit-sharing system allows us to know the world that is opened up to the firm, and thus the researcher becomes able to advise law firm clients on the basis of the way in which their assumptions create a particular set of possibilities or options for behaviour in practice.

4.7 Validity and reliability

High validity occurs when research findings accurately represent what is actually happening (Collis and Hussy, 2003).

Reliability refers to the extent to which research findings can be replicated (Merriam, 2009). That is to say, if the study were to be repeated, would it produce the same findings? At face value, positivists have an easier path to reliability than phenomenologists. Hussy and Hussy (1997) consider that reliability may be more important in quantitative studies than it is in qualitative studies:

> It is not important whether qualitative measures are reliable in the positivist sense, but whether similar observations and interpretations can be made on different occasions and or by different observers.

Reliability and validity are two features of research where the criteria of logical empiricism (Beck, 1993) appear to be imposed on the research method of phenomenology (Giorgi, 1985) as though they were of general applicability. Giorgi (1985) raises challenges associated with inter-paradigmatic communication, principally because the same word may hold different meanings under different paradigms. “One cannot assume that reliability and validity have the same meaning in the two paradigms of logic empiricism and phenomenology” (Beck, 1993, p.255).

Merriam (2009, p.25) explains:

> Qualitative research is not conducted so that the laws of human behaviour can be isolated. Rather, researchers seek to describe and explain the world as those in the world are experiencing it. Since there are many interpretations of what is happening, there is no benchmark by which to take repeated measures and establish reliability in the traditional sense.

Beck (1994) provides a concise summary and contrasts the recommendations of Colaizzi (1978) and Giorgi (1985) to highlight the disagreements that exist regarding validity issues in phenomenological research. Colaizzi’s (1978) suggested method steps were outlined above in Section 4.3. Colaizzi (1978) considers that validity is best achieved by involving the original source (interview participants in this case) in the verification process. Colaizzi (1978) recommends that the researcher should construct a statement that describes the fundamental structure of the formulated descriptions (the essence of the phenomenon), and then revisit the source to confirm that the constructed statement does indeed describe their experience (Beck, 1994).

Giorgi's (1975) method of data analysis is similar to that of Colaizzi (1978); however, his nomenclature and categories of analysis differ (Knaack, 1984). Giorgi (1975) "describes the first step as determining natural meaning units followed by a simple statement of the theme expressed. The next step involves asking the specific research question formulated for the study. Next, the researcher ties together the descriptive themes with a descriptive statement, these themes are presented as a description at a general level or developed more fully at the situated level" (Knaack, 1984, p.112).

Rather than seeking verification from the original data source, Giorgi (1988) argues that validity in phenomenological research has been achieved if the essential description of a phenomenon truly captures the "intuited essence" (Beck, 1994, p.258). To this end findings were discussed at length with my consulting colleagues at FMRC to ensure that they reflected their individual and collective experience of many years.

Beck (1994, p.258) suggests that "reduction is the reason that no additional empirical judges are required. No reality claims are being made. Instead every reader of the phenomenological research study becomes a critical evaluator of the investigators essential intuition". In other words, Beck (1994) sees validity lying in how vivid and faithful the final descriptions are to the lived experience. When this occurs, the insight becomes self-validating and if done satisfactorily other readers will see the text as a statement of the experience itself (Husserl, 1970).

Reliability is said to have been achieved when the essential descriptions produced can be used consistently (Beck, 1994). Under positivist methods of enquiry, validity can readily be achieved through repetition (Collis and Hussy, 2003). In a study using a phenomenological method of enquiry, which seeks to describe lived experiences, exact replication is problematic (Merriam, 2009). "Thus the chief point to be remembered with this type of research is not so much whether another position with respect to the data could be adopted (this point is granted beforehand), but whether a reader adopting the same viewpoint as articulated by the researcher, can also see what this researcher saw, whether or not he agrees with it" (Giorgi, 1975, p.96).

The reliability and validity of the content of this thesis is constructed in terms of the distinction and the relationship between the assumptions of a profit-sharing system and

the perceptions and behaviours that are opened or closed by this methodology. It is the contention of this thesis that different profit-sharing systems allow for different views of the legal world and make different actions possible. It is important to note that what is seen in terms of one sharing system will not be seen in terms of another sharing system. Thus each profit-sharing methodology not only has limitations or blind spots but it closes insights and options for action. Each methodology opens the world in certain ways and closes the world in others. I outline the way in which each of the primary sharing systems does this later in the thesis.

The philosophical basis for the relationship between profit-sharing systems, perceptions and behaviours is to be found in Thomas Kuhn's notion between a paradigm (which in hermeneutic terms would be called a set of preconceptions as they are, for the most part implicit rather than explicit in practice) and the lived world observed and experienced by a scientist (Nickles, 1943). Against empiricism, Kuhn argued that experience can never be the basis for testing basic assumptions, as people always filter experience through a set of assumptions which form the necessary but not sufficient condition for a paradigm. Kuhn argued that the world shows up differently in different paradigms and that what a person sees in terms of one paradigm will not be seen in terms of another (Nickles, 1943).

An example that Kuhn himself uses (Nickles, 1943) and is often used in text books (Doyal and Harris, 1986) is the relationship between a western medical healer and a traditional healer. Kuhn maintains that there is no standard by which to compare the two sets of assumptions and thus no possible way of evaluating them in relation to each other (Horwich, 1993). They are what he calls 'incommensurable'. The western healer will, for example, see death as a result of biological conditions whereas the traditional healer may see death as a consequence of evil spirits. There is no common standard between them so that they can be compared. In each case the respective healer's world is disclosed in mutually exclusive ways. They just cannot see the world in the way the other sees the world, yet each opens a world to be seen.

Others such as Richard Rorty (1980) have pointed out that this does not mean that it is not possible to hold two different sets of assumptions, for a competency of being human is the art of redescription and redescription is the art of being able to see the world

through different sets of assumptions. Indeed, a consultant needs to be able to hold two sets of assumptions in order to advise clients about the relationship between their assumptions, behaviours and perceptions, thereby enabling them to change their behaviours and perceptions through examining their paradigm, assumptions or profit-sharing system. In this sense the role of a consultant is to enable clients to move backwards and forwards from assumptions to perceptions and behaviours, and vice-versa. For Rorty (1980) the choice of paradigm is pragmatic; it depends on a person's – or in this case, a law firm's – situation.

In line with this, critical ways of testing my claims include an appreciation of the relationship between a profit-sharing system and the kinds of perception and action that are opened or closed from that perspective. Sense making or incommensurability is an important criterion for testing this thesis. I show that certain perceptions or behaviours that are not possible from one profit-sharing system are, in fact, possible in terms of another profit-sharing system and, conversely, what makes sense from the other does not make sense from the first perspective. The relationship between the parts and the whole, the assumptions and the perceptions and behaviour, is like a hermeneutic jigsaw puzzle; the whole and parts fit together but one needs to be able to move backwards and forwards between the parts and the whole to see how they fit. This fitting together of the whole and the parts, the assumptions, perceptions and behaviours is part of the definition of hermeneutics (Palmer, 1933–1969). Putting this in phenomenological terms, the relationship between paradigm and perceptions is the relationship between lived experience and the invariant essences that underpin and make the lived experience intelligible.

Thus the reliability of this thesis is assured by the fact that this study is repeatable; it is possible for a fellow researcher to examine the relationship between paradigms, perceptions and behaviours. In terms of validity, it is always difficult to assess whether a researcher is in fact measuring what they claim to be assessing. In the case of hermeneutics and phenomenology, the way to deal with this is to be constantly aware of the preconceptions, the assumptions and paradigms that the researcher is bringing to his or her examination. Thus built into this thesis is a description of my own assumptions, and the way they affect my perception and judgment. While this does not guarantee certainty, it does allow for the conversation to continue by identifying and examining

assumptions often taken for granted. Hermeneutically, for both Gadamer (Dockhorn and Brown, 1980) and Rorty (1980), creating 'conversation space' for the continuous unpacking of perceptions or assumptions is a sufficient condition for research.

4.8 Limitations and delimitations of the study

All research has limitations. A limitation is any potential weaknesses in the research design (Collis and Hussy, 2003). All types of data collection methods carry unavoidable, inherent limitations (Flick, 2002). Interviews are no exception. Participants could present biased observations, slanted toward any vested interest that they may carry and the interviewer may fail to ask appropriate or sufficient questions to fully explore the concepts being investigated. Prior knowledge of the phenomena and a mastery of interview technique can mitigate against this limitation; however, it cannot be eliminated entirely.

This study explores perceptions of phenomena and decisions taken by managers around day-to-day practice. Day-to-day practice is in a constant state of change. Perceptions may vary over time and with other impacting variables. If large law firms were confronted with a sharp, industry-wide decline in profitability per partner, for example, perceptions of the phenomena that form the subject of this thesis may change.

The vast experience of the participants in this study also creates some bias and there is inherent limitation. Long-serving professionals eventually retire. Future generations of Managing Partners may have perceptions of phenomena that differ from their predecessors. Short of repeating the study every 10 years, there is little that can be done about generational change.

Ideally, participants should be involved in a hermeneutic phenomenological study in an ongoing capacity, their perceptions being sought and re-sought and their interpretations of perceptions confirmed, as Koch (1995, p.35) explains: "hermeneutics invites participants into an ongoing conversation, but does not provide a set methodology. Understanding occurs through a fusion of horizons, which is a dialect between the pre understandings of the research, the interpretive framework and the sources of the

information". The roles performed by the participants (managing partners of major legal firms) and the size of the sample made this impossible. I was not able to re-access the participants several times over an extended period to enable them to validate the findings.

Delimitations refer to the focus of a study being in one particular area (Collis and Hussy, 2003). There is limited generalisability beyond law firm partnerships, for example to other professional partnerships; however, direct applicability may be questioned given the unique nature of law firms apparent in the literature. There is, however, reasonably high generalisabilty intra-professionally, particularly if smaller firms follow large firms in various aspects of partnership management.

The unit of analysis of this thesis is the firm leader. Were the unit of analysis the firm it would be desirable to obtain the perceptions of several partners and perhaps rising partners or salaried partners. Nonetheless, interviewing a single respondent from one large law firm must involve some respondent bias; after all, interviewees were asked to comment on strategies and procedures that they potentially implemented or oversaw as managers and leaders. To mitigate against these circumstances, interview questions were both specific to a respondent's firm and general in nature, pertaining to large law firms in general.

4.9 Ethical considerations

Confidentiality is particularly important to law firm partnerships. One of the reasons that I was granted access to the participants and their firms is that my organisation and all of the firms involved have had, for many years, formal, mutual confidentiality agreements in place. These interviews were perceived to be an extension of existing confidentiality undertakings; however, additional confidentiality agreements were signed using the Macquarie University ethics committee consent form.

Consent forms and all data were and are secured in locked cabinets in my home study, and data backups were and are stored securely in my business premises. Electronic data were deleted from my file server after transcription, and only backup copies remain.

Diary record of appointments has been kept only where travel out of Sydney was involved. These records are securely stored and will be destroyed seven years after the travel date. All diary records of local interviews have been destroyed.

All participants were assigned a code. Transcribers were aware only of the code, not the respondent's name or firm. The codes are only known to me and any notes matching participants with their coded identity will be destroyed on completion of the thesis.

4.10 Summary of research design

This chapter has discussed the methodology of the study. The research was carried out with a social constructivist world view, using a phenomenological strategy of enquiry. Semi-structured interviews involving open-ended questions were used as the data collection method and data were interpreted through a hermeneutic phenomenological lens. After data were collected and transcribed they were analysed using a combination of the approaches of Colaizzi (1978) and Giorgi (1985). The strategies used by phenomenologist to achieve reliability and validity were discussed. Finally, the chapter discussed limitations and the way ethical issues were addressed.

Phenomenological research can use several methods of data analysis (Miles and Huberman, 1994). Laverty (2003, p.20) summarised three alternative approaches. Vann Kaam (1966) utilised 'expert judges' to review research analysis and kept only those descriptive conclusions that were consensually validated by the judges. Colaizzi (1978) supported studying all research participants' descriptions and then revisiting them with significant statements extracted by the researcher. When as exhaustive a description as possible was created, it could be returned once again to each of the research participants for their final validation. Giorgi (1985) relied predominantly on the experiences and insights of the researcher who worked through all data collected to achieve a sense of the whole and then discriminated meaningful units arising from the descriptions of the phenomena under examination. Further analysis would produce a synthesis of meaning units into a statement regarding the participant's experience, known as the 'structure of the experience'.

In contrast, hermeneutic phenomenology may take a slightly different approach. Again, Laverty (2003, p.21) summarised two different approaches. Allen (1995) insists there cannot be a finite set of procedures to guide and structure the interpretive process, principally because interpretation arises out of pre understandings and a dialectical movement between the parts and the whole of the participants' texts (interview transcripts). Interpretations emerge as a fusion of the text and its context, as well as the research participants, the researcher and their contexts. Gadamer (1989) sees hermeneutic research requiring self-reflexivity, an ongoing dialogue about the experience while at the same time living in the moment, actively constructing interpretations of the experience and questioning how those interpretations arose. For a hermeneutic phenomenological study, the multiple stages of interpretation from which patterns emerge, a discussion of how interpretations emerge from the data and the interpretive process itself are all critical (Koch, 1995)

Interview data were initially analysed hermeneutically, that is, looking at the relationship between the parts and the whole. The data were then organised into themes around the two primary profit sharing systems (PBS and LSE) to achieve an understanding of the lives lived under each model. The data were then categorised according to the phenomena under examination: performance (firm and partner), partner attrition, gender equity, salaried partners and success tournaments.

FMRC comparative financial analysis data were used to provide a greater awareness and understanding of 'context'. These data enabled the researcher to address Proposition 3:

> Proposition 3 *Profit-sharing systems have little impact on the relative financial success of Australian law firms.*

A decision to share profits among partners a particular way carries with it a set of assumptions about the profit-sharing system. By examining the worlds that open and close to individuals and firms as a consequence of selecting a particular profit-sharing system, and adopting the assumptions inherent in so doing (in other words, by examining the relationship between assumptions, which may be correct or incorrect, and

the world that open and close as a result of these assumptions), I was able to address propositions 1, 2 and 4:

> Proposition 1 *Despite a changing demographic among employees and potentially partners, large Australian law firms maintain traditional beliefs about the utility of success tournaments*
>
> Proposition 2 *Because of the impact of coercive normative and mimetic dynamics in the institutional field of law, a high degree of homogeneity exists in the way large Australian law firms share profits among partners.*
>
> Proposition 4 *Profit-sharing systems are not perceived to influence partner attrition, partner retention and greater gender equity in Australian law firm partnerships.*

The following chapter presents and analyses the data.

Chapter 5 Results and data analysis

5.1 Introduction

This chapter presents an analysis of the data collected from the 19 semi-structured interviews with law firm leaders, as detailed in Chapter 4. It also discusses FMRC comparative financial analysis data collected between 1999 and 2009 from firms whose managing partners participated in the study; these data provide a wider context for the analysis because I was able to examine each firm's profit performance.

Section 5.2 presents an analysis of how the participating firms share profits, and then outlines the perceptions of participants from LSE and PBS firms. Section 5.3 deals with non-equity partnership, a subset of many profit-sharing systems, and presents an analysis of perceptions of salaried partnership. Section 5.4 then addresses some of the strategic phenomena around profit sharing, specifically partner attrition, the conduct of partner performance, changing practice demographics and the ongoing utility of success tournaments. Finally, Section 5.5 presents the comparative financial analysis data to facilitate a greater understanding of the likely impact of profit-sharing methodologies.

5.2 How the firms share profits among partners

The first stage of data analysis involved determining how participants describe their profit-sharing systems and examining their descriptions of their experiences, under their chosen model. The sample frame of large Australian law firms is relatively small, as discussed in Chapter 4. Some aspects of a firm's profit-sharing system – for example, the performance parameters assessed and their relative weighting, the positioning of 'performance gates' within lock steps, the proportion of profit allocated to partners at the commencement of a lock step and the duration of the lock step – may enable individual firms to be identified in much the same way that three well-chosen descriptors would enable the identification of an individual person among a small population. Consequently, a detailed description of each firm's sharing methodology was unnecessary; instead, sufficient detail of the system used by each firm was provided to enable the hermeneutic analysis process to proceed. The primary features of a firm's

sharing model are sufficient to describe how PBS or LSE open up and close down worlds, and so the identifying intricacies of each sharing system are not included here.

I also include here a description of their experience, as interpreted from their response to the question 'How do you feel about your profit-sharing system; tell me about your experiences to date?' and the subsequent conversations.

Participant 1 uses a performance-based profit-sharing system that overlies a time-based equity allocation. Partners share profits according to their allocated "equity units". Incoming partners are allocated an initial allocation of equity points. All incoming partners receive the same allocation. A partner's equity units increase in equal amounts for the first three years of their partnership. Additional equity units (and therefore profits) are allocated across the partnership on the basis of assessed performance. Partner performance is assessed with a "balanced score card" approach. Non-equity partners are paid a fixed annual salary.

Participant 1 perceives PBS to be the "correct way" to manage a modern organisation, expressing incredulity that some of his peer firms have only just commenced doing this and others are yet to start. Participant 1 was responsible for introducing PBS into the firm and expressed satisfaction with the system, highlighting his firm's ability to provide a high level of flexibility in working arrangements for partners, particularly women, and recognising the ability of the system to formally acknowledge and compensate higher performance. An annual formal assessment process involves a committee of reviewing partners. Participant 1 perceives this review of all other partners as integral to the success of the firm and the "health" of the partnership. The performance criteria used in individual partner assessments are the result of an eight-year refinement process and were still perceived to be a "bone of contention" among partners, particularly among partners outside the Sydney office.

Participant 2 was in the process of change. His firm has used an LSE system, with a bonus pool that operates by setting aside a small proportion of profit each year to reward high performers. All equity partners are eligible to participate, and must nominate and be assessed by a committee of partners. It has become standard practice for all equity partners to nominate themselves, regardless of performance. Participant 2

and his partners were changing to a PBS system, due to occur the following year (2010). Under the new system partners were to be assessed across a range of performance parameters with the greatest significance attached to personal billings.

Participant 2 is dissatisfied with LSE for a number of reasons. Partner performance in the firm is perceived to be large. Equal sharing is perceived to be the primary reason why two high-performing partners have left the firm in recent years, citing the partnership's inability or unwillingness to "deal with underperformers". The assessment process associated with the allocation of the bonus pool produces significant "disquiet" among partners and takes excessive management time to conduct (including the management of the "fallout" from the assessment committee's decision). Participant 2 assumes that a PBS system will provide greater transparency and a greater capacity to reward high achievers, at the same time providing a "stick" to manage underperformers by taking the performance management process out of the hands of the wider partnership and placing it under the responsibility of "the management team". Participant 2 assumes that PBS will provide a more flexible approach that will assist with lateral partner recruitment and the retention of high-achieving partners.

Participant 3 uses an LSE system and is "steadfastly committed to it". Participant 3's firm introduces new equity partners at an equal equity allocation to all other new partners. Partners then progress over five years to equality in equal annual increments. Partner performance is monitored by management and by all partners. Under-performance (perceived to be rare) is managed by the leaders of the firm through a coaching or counselling process. Partners have been expelled from the partnership on rare occasions when this process was perceived to have failed.

Participant 3 has experienced a "strong partnership culture"; he has not worked elsewhere and nor have many of his partners. The firm has had very low levels of partner attrition and "can count the number of laterally recruited partners over the last 20 years on one hand". Participant 3 perceives LSE to be a significant contributor to partnership culture, what is interpreted as desirable behaviour and a "strong, committed work ethic" among partners. His firm's perception of what others in their market were doing at the time prompted them to examine other profit-sharing systems. The

partnership took advice from a “leading international consultant” and chose to reject it, preferring the status quo.

Participant 3’s experience with LSE includes a level of collegiality among partners; a greater willingness to share clients and matters than, it was perceived, would occur under a different system; sufficient flexibility to accommodate the small number of part-time partners; and what was described as a “partnership-wide feeling” that performance is not a primary focus of the firm, merely a background issue that was dealt with by exception after it had manifest for a “number of years”. Participant 4 describes himself as a “traditionalist” and sees financial success as a by-product of “traditional, professional legal practice” (by this he means servicing clients at their expectation and providing accurate advice cost effectively).

Participant 4 uses a performance-based profit-sharing system that overlies a time-based equity allocation. Partners share profits according to their allocated “equity units”. Incoming partners are allocated an initial allocation of equity points. All incoming partners receive the same allocation. Additional equity units are allocated on the basis of assessed performance. Seniority or experience is seen as a significant performance criterion and is weighted equally with personal fee performance in the assessment process. The performance of direct reporting employees also forms part of the assessment process. Profit shares are allocated for a twelve-month period and annual adjustments are made, not with a blank sheet but with reference to the prior year.

Participant 4 expressed high levels of satisfaction with this system. This system replaced an LSE system two years before the interview. The perceived strength of the new system is the ability to pay “at risk” partners more (that is, partners who are at risk of leaving due in part to perceived inadequate pay) to assist in their retention. PBS is also believed to be critical to recruiting lateral hire partners into the firm. “Greater flexibility” and perceived “best practice” were the significant reasons for changing from LSE to PBS.

Participant 5’s firm had recently changed from LSE to PBS. Incoming partners receive an equity allocation equal to that of all other equity partners. Thereafter profits are allocated according to performance. Each partner’s performance is assessed annually.

The assessment process contains a significant weighting towards personal financial performance.

Participant 5's experiences with lock step were "unsatisfactory". A number of partners, considered to be high performers, left the firm in the same year that the data were collected. Participant 5 perceives that the departures occurred because the high performers felt under-remunerated and frustrated that their fellow partners did not perform at the same levels that they did. An ability to retain high performers was a primary driver of changing to PBS. Participant 5 perceived equal sharing to be unfair, in effect subsidising senior partners who were seen as unwilling to work as hard as other partners.

Participant 6 uses an LSE profit-share system and has done so for more than 20 years. He describes himself as being "steadfastly committed to lock step". Partners enter the partnership on an allocation of profit equal to 50% of those at full parity (full-parity partners are those on full profit share entitlement). Lock step partners progress in equal increments over five years to full entitlement. All full-parity partners share equally. The firm's management monitor partner performance and underperformance is managed through a coaching/counselling process. Partners who continue to underperform are expelled from the partnership, a "very rare" occurrence. Partner selection is perceived to be a significant component of performance management.

Participant 6 is a strong supporter of LSE profit sharing. He perceives that his firm has a collegiate partnership with a consistently high work ethic, and that the partnership culture has been established over many years, in large part as a result of equal profit sharing. He acknowledges that his firm has had difficulty retaining female partners and that this may be as a result of what he describes as the firm's "collegial culture" or the work ethic effectively demanded of partners. Although high levels of collegiality exist among male partners participant 6 is speculating that female partners may feel excluded from what they perceive to be a male dominant or overtly 'blokey' environment.

Participant 7 uses a performance-based profit-sharing system that overlies a time-based equity allocation. Partners share profits according to their allocated "equity units". Incoming partners are allocated an initial allocation of equity points. All

incoming partners receive the same allocation. Additional equity units are allocated on the basis of assessed performance. Profits are allocated according to the equity units held. Performance assessment involves financial performance and a subjective judgment made by a remuneration committee. The remuneration committee's allocations are made subject to appeals by individual partners. The appeals process involves partners justifying to the committee why their allocation should increase. After appeals, allocations are settled and profits distributed retrospectively for the year. The process is repeated annually.

Participant 7 is satisfied with his firm's system. He perceives that it is transparent and fair, indeed "democratic". The advantages of this system were perceived to be the flexibility it provided, particularly in managing part-time partners, attracting lateral hire partners and rewarding high-performing partners.

Participant 8 uses a flexible LSE system. Partners enter the firm on a profit allocation equal to 30% of full parity allocations. Partners progress in equal annual increments to 60%, where their performance is assessed. Subject to performance they then progress, in equal increments, to 80%, where performance is again assessed. Those deemed satisfactory then continue to full-parity partnership. Subject to performance a partner's progression, from 30% to 100%, takes "about 8 to 10 years". A small number of partners remain on 60% or 80%, most of them voluntarily.

Participant 8 perceives that this system offers the "best of both worlds". The "performance gates" (assessment at 60% and 80%) are perceived to provide an opportunity for the partnership to take a "second look" at a potential equal-sharing partner, safeguarding against "poor performers getting through to parity". In Participant 8's firm, partner performance occurs through social mechanisms, particularly peer pressure, most of which occurs at practice group level. Management monitor partner performance and actively manage it when necessary (by exception rather than all partners annually) through coaching and mentoring. "Occasionally" partners are "managed out of the partnership". Participant 8 perceives that there is a strong commitment to equality in his partnership and that those most committed to it are the highest-performing partners.

Participant 9 has an LSE system that he perceives to be unsatisfactory. Our interview took place while he was seeking to change the system. The LSE system used introduces partners at either 60% or 80% of full parity, depending on the particular partner entrant. Those promoted internally tend to enter on 60%, whereas those recruited externally (usually with established practices) enter on 80%. Partners receive an additional 10% annually until they reach full parity. Once at parity, partners share equally. There were no formal performance management processes in place. Informal performance monitoring occurs but poor performance is not managed. Participant 9 perceives that the majority of partners see themselves as owners and therefore as tenured or protected.

Participant 9 has experienced some dissatisfaction with his firm's profit-sharing system and greater dissatisfaction with the level of total profit. The sharing methodology was seen as being incidental to the firm's overall poor performance. Participant 9 has experienced all of Gilson and Mnookin's (1995) agency-related problems – grabbing, shirking and leaving – although he expressed these using slightly different words: "people hoard work, do as little as they think they can get away with or slightly less and, if they're any good, leave". Participant 9 would like to change the system to a flexible lock step that has the capacity to pay high performers more and punish underperformers. Participant 9 sees this change as integral to his firm's survival, beyond the current generation of partners.

Participant 10 uses an LSE profit-sharing system. The system has been in place for more than 20 years. Partners enter on an allocation equal to 30% of full-parity partner entitlement. Partners progress in equal increments to 100%. Partner performance is assessed annually through a process of partner reviews. Each partner is reviewed by management and participates in an annual performance interview. Underperforming partners are counselled and, on occasion, expelled from the partnership or demoted down the lock step. Demotion is perceived to inevitably lead to departure and effectively operates as a "delayed departure".

Participant 10 is satisfied with the system used by his firm although he sees a change to PBS as inevitable, citing "everyone seems to be going that way" as the primary driver of change. Participant 10 perceives his firm to be "focused on high performance". Performance management takes place through a formal process as described above but

strong social controls exist, particularly at practice-group level. Participant 10 perceives that his partners share work on merit, only delegating jobs or sharing clients with those fellow partners deemed worthy. This practice is perceived to add to the effectiveness of peer pressure and subsequently performance.

Participant 11 uses an LSE system. Partners enter at 50% of parity and progress to full parity over five years. Full-parity partners share profits equally. The firm has no formal partner performance system in place. Partners monitor one another's performance. Underperformance is perceived to occur rarely and is tolerated. In participant 11's history with the firm, no partners have been asked to leave.

Participant 11 has some dissatisfaction with the firm's LSE system, perceiving partnership in his firm to be analogous to membership in a club. He considers that this reflects the history of the firm and the desired culture of the majority of the partners. Participant 11 is responsible for the management of the firm, and he sees the culture of the partnership limiting the success of the firm. Among the partners there is no desire to change the sharing methodology.

Participant 12 is in the process of change. Participant 12's firm has been an LSE firm "since the mid-1980s". The LSE system that this firm used for many years mirrors that of Participant 11's system, as did many of his experiences. The firm was changing to a flexible lock step, largely (and consciously) modelled on that of participant 8. Participant 12's firm intended to modify Participant 8's flexible LSE by managing underperformance through sanction. Underperforming partners were to be reduced in their entitlement to 50%, 60% or 80% of the full-parity entitlement. When it occurred, sanction was to be reviewed annually. All partners were to be reviewed formally and annually against a set of agreed performance standards.

Participant 12 experienced dissatisfaction with the firm's traditional sharing system, and sees change providing greater flexibility to deal with lateral hires, part-time partners and perceived underperformers. He does not consider that the firm's intended system would provide partners with "significantly greater incentive to achieve". He does, however, perceive that the change would result in a fairer system for those considered high

performers. Retention of high achievers was also an “important consideration” driving the change.

Participant 13 uses a PBS system. All partners are assessed annually by the managing partner, who makes his recommendations to the remuneration committee. “More often than not the final assessment matches” his recommendations. The firm has a set of agreed performance parameters and performance is assessed “around those parameters”.

Participant 13 likes his system. He has experienced what he perceives to be “maximum flexibility” and sees himself as an aggressive acquirer of lateral-hire partners. Participant 13 perceives that his system has enabled the firm to attract and retain female partners more successfully than any other firm. This success is not attributed exclusively to the sharing system but the flexibility to cater for part time equity partners and different performance levels within the equity partnership is perceived to have assisted attraction and retention of female partners.

Participant 14 uses an LSE system. Partners enter the equity partnership on an allocation equal to 50% of full-parity partners. Lock step partners progress in equal increments, over five years to full parity. All full-parity partners share profits equally. Partner performance is not assessed formally. Partners are monitored by management and ‘receive assistance’ when required. This assistance usually involves coaching and mentoring at a practice group level. No partners have been asked to leave the partnership in the last 10 years.

Participant 14 is satisfied with his firm’s profit-sharing system. He perceives that his partnership has a “strong committed culture”, largely as a result of equal sharing, and that his partners supported one another to an extent uncommon in most firms of comparable size. Participant 14 perceives that “home-grown” partners are integral to maintaining the firm’s culture. The firm has recruited laterally into the partnership only rarely. Participant 14 has experienced “very low levels of partner attrition” and low levels of voluntary attrition among employees. A large proportion of the partnership joined the firm as graduate solicitors and they remain in the firm.

Participant 15 uses an LSE system that introduces partners to equity in an identical manner to firm 14's system. Performance is managed formally through an annual partner-review process. Performance is assessed against agreed standards. Underperformance is perceived to occur rarely, and is managed through a coaching process. "From time to time, partners who feel that they don't fit in leave, but it hardly ever happens".

Participant 15 perceives LSE to produce a strong collegiate culture within the partnership. He perceives a need to cater for partners who wish to work part-time but this is sufficiently unusual to be managed by the firm's existing system. Partnership and firm culture were most important for participant 15. Although partner financial performance is monitored and reviewed, a significant component of the partner-assessment process involved "cultural factors" such as leadership and likability (as assessed by employees). This process was perceived to create a competitive advantage.

Participant 16 uses a PBS system and has done so for two years, having changed from LSE. All partners have the same equity allocation and profits are shared according to an assessment of performance. The performance parameters have been determined with reference to the firm's strategic objectives. Partner performance is assessed annually and any underperformance concerns are managed through a coaching/mentoring process.

Participant 16 designed and implemented the firm's sharing system and is understandably a strong supporter of it. Since the firm changed to PBS, participant 16 has noted a greater awareness of "performance and behavioural issues" among his partners, although he said that this awareness is yet to manifest as increased profit. Perceived legal market "best practice" was a significant driver for changing from LSE to PBS.

Participant 17 uses a performance-based profit-sharing system that overlies a time-based equity allocation. Partners share profits according to their allocated "equity units". Incoming partners are allocated an initial allocation of equity points. All incoming partners receive the same allocation. Additional equity units are allocated on the basis of assessed performance. Seniority or "experience" is seen as a significant

performance criterion and is weighted equally with personal fee performance in the assessment process. All partners participate in an annual performance review and profits are allocated retrospectively as a result of the review process. The system caters for different performance levels and is tolerant of individual partners who may be considered to be underperformers. Profit allocations to the bottom partners are 300% less than allocations to the top partners.

Participant 17 perceives that his system is “fair and equitable”. He has experienced benefits such as greater flexibility to remunerate part-time partners and greater flexibility when negotiating mergers with other firms, such as being able to consider merger partners with greater or lower average partner profit levels.

Participant 18 uses an LSE system where partners enter the partnership with an allocation equal to 50% of full parity partners, and progress over five years to equality. Typical candidates work in the firm for several years to become a partner. Partner performance issues rarely occur. Performance is managed by exception; partners deemed to be performing satisfactorily are ‘left alone’, and only perceived underperformers participate in a counselling process. The need for performance counselling has only occurred twice in the five years prior to our interview, and both counselled partners have left the firm.

Participant 18 is satisfied with his firm’s system. His firm admits few partners, and partners remain in the partnership for a long time. Participant 18 perceives that LSE has created a stable partnership with an “extremely homogenous culture”. He considers that the firm’s high profit levels make it difficult to admit new partners on the basis that they have traditionally been admitted. At the time the interview took place the partnership were considering alternative strategies. Participant 18 perceives that the partnership favoured lengthening the lock step rather than moving away from equality at full-parity partnership.

Participant 19 uses an LSE sharing system with a bonus pool for partners who are acknowledged long-term high performers. At the time of the interview, three partners shared the bonus pool. The partnership does not have a formal performance-management process; monitoring occurs informally. The bonus system was introduced

as a motivation and retention strategy for partners who significantly outperform the average partner. New partners enter the partnership on an allocation equal to 50% of full-parity partners. Partners progress over five years to equality. Underperformance is managed through a counselling process.

Participant 19 is satisfied with his system, though he acknowledges that all sharing systems are flawed in some way. He perceives that partner performance is an amalgamation of "cultural fit and financial performance". Partners have been asked to leave the firm if the partnership consider them "lacking in either or both of these ingredients". Participant 19 has experienced "some frustration" in fitting part-time partners into the firm's model; indeed, "part-time partners are usually salaried partners". The firm has never had a part-time equity partner. Participant 19 perceives that his firm's system enables the benefits of LSE, such as collegiality and "support" (a willingness to share work and clients), and the flexibility to pay the "best partners significantly more".

5.2.1 Data from participants with LSE

Table 1 presents a summary of experiences from those participants using a variant of LSE. There are subtle variations in the models used by firms, best described in three categories: pure lock step, flexible lock step and lock step with a bonus pool.

Table 1

Overview of profit-sharing systems used – lock step firms

Sharing Arrangement	***Lock step to equality (pure lock step)***	***Flexible lock step***	***Lock step with bonus pool***
Characteristics of Model	Partners progress for 5 to10 years in equal increments to equality; May move back down the lock step prior to retirement	Partners progress for 5 to10 years subject to performance; Allows for accelerated progression; Allows for a temporary halt in progression; Allows for a reduction in points prior to retirement	Partners progress for 5 to10 years in equal increments to maximum allocation; A proportion of profit is set aside for a bonus pool; Bonuses allocated annually according to assessed performance; Bonus allocated by partnership after recommendation from a committee of

Sharing Arrangement	*Lock step to equality (pure lock step)*	*Flexible lock step*	*Lock step with bonus pool*
			partners; Allocation an appellant-based system
Number of Firms Using	8	2	1

(continued)

Table 1 (continued)

Sharing Arrangement	***Lock step to equality (pure lock step)***	***Flexible lock step***	***Lock step with bonus pool***
Assumptions of the system	Has always been used; Contributes to collective culture; Provides certainty and stability; Encourages collegiality and team work; Encourages partners to assist one another to develop their practice	Maintains collegiality; Guards against shirking; Mitigates against downturn in demand for some offerings; Comfort in no formal assessment process for adequate performers	Ability to reward sustained high performance; Retention of high achieving partners; Prevent incentive to do enough to get by; Greater transparency
Performance Management Approach	Strong social control; Some use annual partner performance assessments; Some manage performance by exception where intervention triggered by a number of years sustained underperformance; Sustained underperformance sanctioned with expulsion	Strong social control; Performance managed by exception; Underperformers progression halted by partnership after management recommendation; Underperformers receive coaching support to improve; Sustained underperformers expelled from partnership	Social control; Performance assessment by REM committee
Positive experiences	Client sharing and matter sharing; Aids interstate and intra office referral; Partners focussed on legal work not their relative share of profit; Profit sharing seen as peripheral to the main game of client service	Client sharing and matter sharing; Aids interstate and intra office referral; Partners focussed on legal work not their relative share of profit; Profit sharing seen as peripheral to the main game of client service	
Negative experiences	Shunning of acknowledged underperformers; Some partners doing less than agreed standard; Some partners doing sufficient to avoid intervention, no more; Partners may leave if they are offered significantly more than current full parity returns	Some partners doing less than agreed standard; Some partners doing sufficient to avoid intervention, no more; Partners may leave if they are offered significantly more than current full parity returns	

Firms that describe themselves as ‘lock step firms’ admit partners to their equity partnership on a reduced share that increases over time to equality. Although such firms still describe themselves as lock step firms, some firms within this subset have introduced ‘performance gates’ into the lock step, enabling them to halt the progression

of partners, temporarily or, in some cases, permanently. This mechanism is used for partners perceived to be underperforming relative to other partners. Having reached the top of the lock step, profits are then distributed equally, contingent on the partner's ongoing performance. These firms describe their sharing system as 'flexible lock step'. One of the lock step firms in the sample sets aside a proportion of annual profit in a bonus pool that is distributed to partners judged to be 'high performers'. In this firm the bonus pool was shared equally among three partners in 2009. Despite subtle differences in their profit-sharing systems, the firms see themselves as 'equal sharers'.

A chairman of a firm cited tangible benefits to practice that flow from equal sharing, best summarised by the statement:

> *I think the lock step model promotes the work going to the right person and it creates an incentive for everybody to keep everybody busy. (Chairman of Partners, lock step firm)*

Sharing profits equally after lock step is perceived to maximise productivity by ensuring that work is delegated to the most appropriate lawyer. It is seen as a practice that mitigates against work hoarding (keeping work to oneself), which is perceived by some LSE firms to be a weakness of differential or performance-based sharing, as this participant observed:

> *Equal sharing has encouraged our partners to assist one another in building their practices. I don't think that sort of support exists in firms with performance models. I'm told that partners in those firms tend to be protective of their patch. (Managing Partner, lock step firm)*

Critics of lock step systems usually point to ongoing partner performance as its primary weakness. If profits are shared equally, there is always the potential for any partner to contribute at a level that is less than equal, allowing them to maximise their personal return while shirking or 'cruising':

> *A lock step actually involves managing underperformance but a critical problem with lock step normally is a failure to address underperformance. (Managing Partner, lock step firm)*

By “addressing underperformance” this participant is speaking of the strong social controls that must accompany equal sharing for it to function properly in a large partnership. The same participant continues:

> *One of the reasons we’ve succeeded as we have is because performance and work ethic have become engrained in our culture over [many] years. People know what’s required of them. I spend very little time ‘managing partner performance’; it really manages its self. From time to time we need to act decisively and we do. Some of our competitors, and you probably know that I’m talking about [mentions two firms], seem to skirt around performance issues for years, and it shows in the numbers, and they say that they have a performance system! (Managing Partner, lock step firm)*

The performance management process commences in most lock step firms with counselling of an underperforming partner. If the partner does not address their performance, he or she may face expulsion from the partnership and possibly the firm.

Consequently, some lock step firms are acutely aware of the need to maintain performance through a range of measurement and monitoring approaches. In some firms this takes place by exception (reviewing only underperformers), in others by individually reviewing the entire partnership each year. This monitoring has cultural ramifications as one participant observed:

> *Some of my partners would say you are turning the lock step into a de facto merit system. The truth is, if we turn it into a merit system we would get a lot better at outcomes. (Managing Partner, lock step firm)*

This response points to some dissatisfaction with lock step systems among Managing Partners and some dissatisfaction with its unclear and potentially unfair performance management systems among partners.

Regardless of the sharing system employed by a firm, sustaining performance is perceived by all participants to require some monitoring of partner performance. In some firms this relies on self-monitoring and social control (peer pressure). In other systems rigorous partner performance monitoring is perceived to be required. These participants speak of two contrasting approaches:

All partners, including me, go through an annual review process. We have a set of guidelines for all partners and the process involves assessing someone relative to those and what they said they would do the previous year, we use (consultants name) to assist, it's a pretty big job. (Managing Partner, PBS firm)

We hear that other firms spend a lot of time doing partner reviews; we don't. People know what they should do and by and large they do it. From time to time we need to take someone aside and have a chat but it's not often. I've done a couple of those this year. (Chairman of Partners, LSE firm)

Formal control systems such as regular partner reviews take time and therefore cost law firms money, specifically the opportunity cost of partner time and, in some cases, fees paid to external consultants who facilitate the review process. There are perceived economic cost and opportunity cost benefits associated with social controls relative to formalised control systems. The cultural benefits of peer pressure are explained here:

You certainly don't have the distractions we hear some of our competitors have. We hear stories about how much time it takes (firm name) to do their remuneration reviews and how big a distraction that is for management. If you were in a differential system where even if you were performing well, you've still got to have the ruler run over you by management by comparison with somebody else to set your remuneration. I think that's seen as a huge negative of the differential sharing system. (Managing Partner, lock step firm)

This Managing Partner continues with a summary of the support within his partnership for equal profit sharing:

There's sort of an expectation that everyone runs pretty hard. From time to time we have debates about the outperformers but there's not a huge degree of acknowledgement of desire to remunerate the outperformers and, by and large, our outperformers have tended to be some of the strongest advocates of what we call the common system: that we all get the same at certain levels. (Managing Partner, lock step firm)

An alternative view was expressed by one LSE firm Managing Partner. Here he explains that to function well, equal sharers need to "manage performance" within an

acceptable performance range, developing processes for the management of those perceived to be over-achievers (expressed as 'outperformers' above) or those perceived to be underperformers. There is a perception that equality must be accompanied by constant monitoring. This requires significant management time:

> *A lock step firm is probably the preferable model for profit sharing. It builds teamwork, cooperation, but there's a point where the time you're spending trying to manage the extreme highs and lows of that equity base, if you were doing it through a merit system, you'd do it a lot quicker, a lot more transparent, you'd probably get a better outcome and I think probably in five years we'll move to a merit system. (Managing Partner, lock step firm)*

It is the view of one of the respondents that success or failure of any sharing model lies in the culture of the partnership, and others agreed:

> *I don't think you can say there is one scheme for a law firm which is the best way to split profits and we've done all this research and we've finally discovered it. It actually relates very directly to the culture of the firm. (CEO, performance-based sharing firm)*

> *Any profit sharing model can be made to work. The firms that tend to be successful are not successful because they've chosen one profit-sharing model or the other, at the end of the day it comes down to culture. (Managing Partner, lock step firm)*

> *You could have the best remuneration system you and I know, but if you haven't got trust and integrity then the rest of it's just crap! (Managing Partner, lock step firm)*

It is possible that sharing models influence partnership culture and are themselves influenced by it. Some of the participants from lock step firms have 'home-grown' partners, partners that joined the firm as employees working their way up through the ranks, as distinct from partners hired laterally from another firm*:*

> *The overwhelming majority are certainly home-grown partners – it creates a very collegial environment. You get one lateral every 10 years only, at partner level. Almost all home-grown partners are very deeply rooted culturally and are*

sharing equally; it creates a very collegial environment. I think it's at the heart of the type of firm that we are and a significant part of our strength. (Chairman of Partners, lock step firm)

Support for the lock step among those with relatively homogenous cultures, produced primarily through home grown partners, is not, however, unqualified, as this participant observes:

We think that equality delivers commitment to the business, loyalty and common values. We hear that there is a lot of unhappiness that is caused as a consequence of just about all of those other models. Having said that, if this firm fell on hard times, if suddenly our profit is cut by two thirds and in that environment the differential between profit outcomes in one division compared to another is significant, the question you've got to ask is "how would this model fare?" A lot of things can be forgiven when you're highly successful. (Chairman of Partners, lock step firm)

Despite these apparent and perceived benefits of the traditional profit-sharing lock step system, all participants perceived a national trend away from lock step toward performance-based sharing. Why such changes appear to be happening is unclear. Certainly, it is not in response to empirical research that suggests that it is preferable. As one of the large firm partners explained after detailing the benefits of lock step and then reflecting on what he considered to be his firm's contemporaries:

I think we will move to a performance basis in the next five years, you've got to look at the Australian market – apart from us and (firm name) no one's got a lock step anymore. (Managing Partner, lock step firm)

Others wish to approach change more cautiously, articulated here with anecdotal observation:

I go to a conference in the US regularly. Their firms abandoned lock step some time ago but every year it comes up in conversation. I tell them how ours works and I've had them say, "Well if we could go back to lock step, we would". (Chairman of Partners, lock step firm)

This comment reflects the perception of many lock step firms. They recognise many of the perceived benefits of performance-based compensation and many of the benefits of equality. They are reluctant to change from the status quo, perceiving that a change away from equality cannot be undone without effectively penalising the top profit-earning partners. PBS rewards the highest performers, and returning to equality (given the same available profit pool) would reduce the earnings of the top performers and elevate the profits paid to perceived underperformers. The data show that there is a perception that there is 'no going back' once the firm has changed to PBS has played a significant role in the longevity of lock step to equality as a sharing methodology.

5.2.2 Data from participants using PBS

Table 2 presents data for performance-based sharing firms described in section 5.2. Although they describe themselves as performance-based sharers, some firms in the sample have retained an element of seniority in their sharing systems. The following data summarise the perceptions of participants from both performance-based firms that have retained time in the partnership as a performance measure and pure performance-based firms.

Participants who describe their profit-sharing system as 'performance-based' share profits in a variety of ways. However, all the PBS participants responded, "we are a performance-based firm" or "we have a performance-based system", and then went on to describe the features of their model. Although some still see seniority as valuable contribution and therefore a part of 'performance', they identify first and foremost as performance-based sharers.

All but three of the PBS participants have retained some aspect of a time-based progression, overlaid by pure performance-based rewards; others share profits according to formulae applied to all partners, regardless of their seniority. Apart from one firm, all firms that describe themselves as 'performance-based' firms have changed their sharing methodology from equality to performance-based sharing at some stage over the last 10 years.

Table 2

Overview of profit-sharing systems – performance-based sharing firms

Sharing Arrangement	***Performance-based sharing with time in the partnership as a performance measure***	***Pure performance-based sharers***
Characteristics of Model	Partners enter on lower share and progress arbitrarily subject to performance Annual allocation of equity points Partners can move up and down the scale Upward movement more common than downward May use a bonus pool in addition to point allocation Allocations made by committee of partners Allocations may be subject to appeal	Partners share according to allocated equity points Equity points allocated annually based on assessment of performance More common to get more than less Points allocated after performance management process Allocations made by partnership after REM committee recommendations
Number of Firms Using or Changing To	6	3
Reasons of adopting the system	Ability to retain high achievers Incentive to achieve Flexibility for part-time partners Flexibility for lateral partner recruitment Flexibility for differing contribution levels Flexibility to transition retiring partners	Ability to reward desirable behaviour Ability to reward top performers at top of market Ability to retain high achievers Incentive to achieve Flexibility for part-time partners Attractive to lateral partners, this aids recruitment Flexibility for differing contribution levels Flexibility to transition retiring partners
Performance Management Approach	Formal annual assessment Specified or unspecified performance parameters Interview with REM committee to review performance Performance feedback from Managing Partner/CEO	Formal annual assessment Agreed performance parameters Policing of minimum acceptable contribution
Positive consequences	Partners seek to improve performance in assessed criteria Senior partners mentoring junior partners High retention	Signalling what we value to firm Consistently high work ethic Partners seeking to improve subjective contribution as well as financial when measured Partners encouraged to show good people management skills when measured
Negative consequences	Gaming of system to produce best outcome Disagreement over weightings of various criteria Misalignment of perceived personal performance and assessed performance	Partners who feel they have been poorly dealt with leave

Despite the apparent potential for profit sharing as a strategic enabler, only two of the firms in the sample drew an immediate connection between their strategic goals and business plans and the changes they have made to their profit-sharing system. The first of these links sharing arrangements to individual and organisational business plans:

> *It [performance-based sharing] requires every single partner to be focused on the elements of their contribution for the year ahead. The formal annual reviews will focus briefly on last year's performance but most of the time will be spent looking at what they're going to achieve going forward and with what likely outcomes. Now that package, if you will, will be different from partner to partner because, as you know, partners play different roles. Some are rainmakers, some are finders, minders and grinders. So their undertaking for the year ahead has to be tailored to some extent against or within the framework of the published performance criteria. From a strategic point of view, we're able to mobilise the individual partners in alignment with what our overall business plan has to say. (Managing Partner, performance-based sharing firm)*

This was also the case in the second of the two firms:

> *It's really tying the remuneration to essentially the firm's strategy and the practice group business plan. (Managing Partner, performance-based sharing firm)*

In the case of the latter firm, the journey towards a strategic focus was not straightforward.

> *The problem we had was that (international consultants name) had sold them [the partners] the balanced score card performance model, but the trouble is that they didn't have a strategy and they didn't have a plan, so the only thing that they focussed on was the quadrant that had a dollar in it, and since they didn't have any financial tools to manage or review or assess profitability per partner, by a matter of whatever, the end result was they just essentially were paid on gross revenue. (Managing Partner, performance-based sharing firm)*

Several firms had engaged consultants to assist them in developing a performance-based remuneration model. It became apparent from discussions with participants that most consultants have a preferred model or formula for profit sharing and that they favour a

performance-based approach. Although all participants from PBS firms were concerned with maximising profitability per partner, there was little apparent linkage between chosen sharing methodology and strategic objectives (beyond profit maximisation).

All other performance sharers focussed their perceptions of the strengths of performance-based sharing on the management of tactical challenges such as partner retention, the need for flexibility, financial performance, the capacity to 'punish' underperformers and competition from other firms for talented partners with good clients. This perspective was also shared by the two firms with a greater strategic focus.

The maintenance of partner performance, a key driver of success in equal sharing firms, is also integral to performance-based sharers, as three participants explain:

> *...it requires every single partner to be focussed on the elements of their contribution for the year ahead. (Managing Partner, performance-based sharing with time firm)*

> *You float up and down based on what your performance is like and what the potential is like. (CEO, performance-based sharing firm)*

> *Partners who are on the way up see that their performance is going to be valued, respected and financially rewarded. (Managing Partner, performance-based sharing firm)*

Theorists have proposed that partnerships offer the ability to minimise fluctuating demand risk (Gilson and Mnookin, 1985). Not all practice areas grow at the same pace; historically some go up while others go down. In the 10 years preceding the GFC this has changed. During this time Australian law firms enjoyed an almost universal growth market across all areas of legal services. This change in the fortunes of the market has been accompanied by a change in performance expectation and a shift in thinking on risk mitigation. One respondent perceived that individuals are increasingly bearing the risk of market fluctuations, particularly among performance sharers:

> *Well, Neil, in our system we've always said that factors beyond your personal control were a firm risk. A client being taken over, a client going broke, if you had an HIH practice, it's not your fault that they collapsed. So, philosophically,*

the downturn in property development is not a risk that property partners were taking personally. If they've still got all their clients, and their clients are just doing half as much. Philosophically we've said that is a firm risk. Because it could happen to any of our practices, you know, insolvency goes up and down, banking goes up and down, you know, [property] development goes up and down, corporate activity goes up and down. What has been, and you are roughly my age, what has been a little bit different this time is that for many years most areas were going up all the time. Apart from insolvency. So most of the time [in] most areas, there was more work out there if you just went and got it and did the right thing, you could grow your practice. We were capacity constrained as legal providers.

We had a group here doing a new entrance to the financial services industry. They haven't opened a file for a while. We've just made one of those people redundant; we've got rid of one of the other ones, one of them left. Yeah, it's just … Now, if that partner in that group who's still there was equity, which she isn't, how long would people say "We need your area, you understand there's no work, it's not your fault"? Not long I suspect. (Managing Partner, performance-based sharing firm)

This partner's comments are symptomatic of a significant change to traditional models of partnership, perhaps heralding an end to firm growth strategies and potentially calling into question the economic logic of large diverse partnerships discussed in chapters 2 and 3 (Gilson and Mnookin, 1985; Galanter and Palay, 1990). Clearly this participant feels that in a growth market traditional means of minimising risk, explained by portfolio theory (Gilson and Mnookin, 1984), are no longer viable, flagging that economic circumstances have changed attitudes to collegiality.

Maintaining performance is perceived to be a function of reward and punishment. The data show that performance-based sharers take comfort in having the capacity to manage perceived underperformance tangibly, through their profit-sharing system. The following two participants have operated lock step firms, sharing equally once partners reach 'full parity' for many years. They are both currently moving their firms towards performance-based sharing systems:

With a points system [referring to a PBS system that allocates 'equity points' to partners based on assessed relative performance], if you've got somebody who's out to lunch, you know you can move them down 40 points. So you're no longer constricted with parity, you can actually start warning people on the basis of what they are actually doing. (CEO, lock step firm)

Those who have been in the 'run on team' up to now have been able to somehow stand behind the quarterback and look at the game, will actually find themselves in the crunch receiving the ball or somewhere up in the stand, and it's up in the stand where some of them should be. (Managing Partner, lock step firm)

These quotes show that an ability to punish underperformers was seen as one of the main benefits of a PBS system compared to the ability to provide performance incentives – that it was described as having greater benefits as a stick not a carrot.

So why are firms changing their profit-sharing arrangements from LSE to PBS? For firms that changed at some stage during the last 10 years, the change was essentially driven by a perceived pragmatic need, such as placating high performers (believing that they may have left if they did not receive a greater share) or as a part of a growth goal perhaps involving expansion into new state jurisdictions. The following participants give their reasons:

We had a concentration of 'pissed-offedness' at the top end [of the partner performance scale] that was becoming louder and angrier; frankly, we weren't making the money that we were hearing others were and we were in danger of losing some good partners so we engaged (consultants name) to help us sort it out. We felt we couldn't do it on our own; we needed someone to crack some heads. The problem is simply that people contribute at different levels and, if you don't acknowledge that, I think you've got a problem. (Managing Partner, performance-based sharing firm)

Our partnership had a small group of partners that, for whatever reasons, couldn't match the performance of the top group. We didn't want to chuck them out, they weren't that bad and we aren't that type of firm so we created performance bands within the partnership. I review partners annually and

allocate them to a band; it's all pretty harmonious really, people are hardly ever surprised with their allocation. (Managing Partner, performance-based sharing firm)

When the partners decided to expand to Melbourne and Sydney we really had no choice, we had to pay new partners as much as they were getting or more. Equal sharing didn't accommodate that. Lock steps complicate [the hiring of] lateral partners, they want to be in, not half in. (Managing Partner, performance-based sharing firm)

These comments from participants illustrate the perceived utility of PBS as management tool used to assist firms in retaining partners who may otherwise have left.

For firms that are currently traditional LSE firms in the process of changing their profit-sharing systems to PBS, the reasons for change are similar to those above; however, they are clearly influenced by other firms, reflecting mimetic behaviour as explained by institutional theory (DiMaggio and Powell, 1983). Respondents from two firms, one considering change and one implementing change, explain:

I think we will change to a performance model next year, we are certainly talking about it a lot. We need to be able to pay our best partners more and, frankly, equality overpays some of them now. Look at the other firms in our space, I think that they are all performance-based or moving to it, we don't want to be left behind in such a competitive market for laterals. (Managing Partner, lock step firm, considering change)

I'm not going to say that we're changing because other firms are changing but you can't ignore what's happening in your competitors. My partners are certainly aware of the sharing models used by others, just ask them. We're changing so that we can attract practices that we don't have now, particularly in Sydney. Having the flexibility to deal with our best partners and our worst partners will make most people happier. I am also attracted to a model that makes the whole part-time thing easier to manage and more transparent. (Managing Partner new performance-based sharing firm, previously lock step)

5.2.3 Summary

Partnerships are complex social structures; many partnerships struggle to clearly define performance, let alone accurately measure it. They do, however, all perceive themselves as being capable of clearly identifying underperformance and all feel the need to manage it. Performance sharers perceive that their sharing model is the best tool to achieve this. Lock step firms rely predominantly on social controls and recognise the benefits of collegiality and low formal monitoring costs although some appear to be worried that other PBS firms are more competitive.

Seniority is still seen as a valuable performance criterion in the majority of performance-based sharing firms. In these firms, despite describing themselves as 'performance-based', incoming partners receive an initial equity allocation that increases over time to a maximum, subject to performance. The assessment of performance and the allocation of profit occur after consideration of allocated equity points.

Firms that have changed their arrangements from LSE to PBS claim to have done so for several reasons. Few firms link their sharing mechanism to any strategic objectives other than profit maximisation. Reasons for changing to performance-based sharing cluster around the management of perceived underperformance and the attraction and retention of high-performing partners. Some appear to be changing as a consequence of perceived industry trends and are often led by industry consultants and advisors, reflecting the institutional perspectives observed by several researchers (Greenwood and Hinings, 1993, Cooper et al., 1996) and an example of the 'mimetic factors' observed by DiMaggio and Powell (1983) in professional service firms.

5.3 Non-equity partnership (a subset of all sharing models)

Salaried partners are a feature of most profit-sharing systems. The use of salaried partners is worthy of examination in an analysis of how and why some firms are changing while others are not. The practice of non-equity partnership is relatively new. Salaried partners are described differently by firms. The titles 'fixed draw partner',

‘general partner’, ‘salaried partner’, ‘executive partner’ and ‘non-equity’ partner are all used to describe the category of partners that sits below equity partner. In all circumstances these partners receive a fixed annual income instead of a share of the firm’s profits. Some may also receive a bonus payment that is subject to performance. While ‘fixed draw partners’ are considered by their firms to be a part of the equity partnership, ‘salaried partners’ are considered to be employees

Firms tend to differ in their approach to the idea of a two-tiered partnership. Most firms have salaried partners. Some firms perceive that there will be a place for two-tiered partnerships for many years to come while others have, or intend to move back to, an all-equity partnership, citing the cultural benefits that may flow as the motivation for change. Some partnerships are totally inclusive, sharing all financial information with all partners; others limit the circulation of some financial information to equity partners only and conduct regular equity partner meetings, excluding non-equity partners from attending.

Participants differ in their perceptions of the success of a two-tiered partnership. This respondent was the most enthusiastic:

> *In our firm it (*non-equity partnership*) has been a success and there’s no doubt about that and that reflects a number of things including our market position and our retention strategy, in terms of retention, that’s a clear advantage for us. It’s been very successful in terms of our ability to recruit top senior associates from the top tier but, I dare say, there will always be partners who see it as a sort of second prize. There’s no differentiation between the two (*salaried and equity*) and there’s no information that gets distributed amongst the partnership that is directed only to equity partners. In other words, it goes to all partners. All partners vote on the composition of the Board, although one of the few distinctions that we make, for example, is that Board members must come from the equity partner group. (Managing Partner, performance-based sharing firm)*

The above perception is in stark contrast to the following observation from the Chairman of Partners in a lock step firm:

> *They come to all the partnership meetings and quite honestly no-one gives a f***. No-one really knows who’s salaried and who’s not, except them. People*

say salaried partner, fantastic, absolutely wonderful – you can almost guarantee within six months it's not wonderful and they start saying to you, I'm doing a hell of a lot better than these silly old farts who are on multiples of my income. (Chairman of Partners, lock step firm)

In an example of 'try it and see' change, the lock step firm above had only recently appointed salary partners. They say they are likely to move away from the concept in the near future, assessing it to be a poor change. They are joined in their strong views on two tiered partnership by this participant:

People who join the partnership join as equity partners. We do have some capacity to salary partners but the great majority at all times are equity. Where I come down, I suppose, is that I kind of like the sense that you're all in it together and that you're sharing the upsides and the downsides together; if they're good enough to be in, they're good enough to be in. (Managing Partner, performance-based sharing firm)

This quote is an expression of the concept of 'partnership ethos', as described by Empson (2007). It is also symptomatic of an apparent contradiction between partnership ethos (the balance between the pursuit of collective and individual self-interest) and some of the principles of PBS, specifically reward for individual performance.

While most participants acknowledge the many weaknesses inherent in a two-tiered structure, they perceive that they need to persevere with it. Accordingly, over recent years firms have introduced the non-equity partner category for a number of pragmatic, tactical reasons. These include pricing strategies in the face of market commoditisation:

In a lot of firms with an insurance practice, the concept of promoting people who didn't own the client, but ran a nice file, and did their job, and supervised a couple of juniors, to call them a partner meant they could go from $275 to $325 an hour, they looked the same, they smelt the same, you didn't tell them anything. You change their business card, put 'partner' on it, and got $50 an hour more for them. Now you can understand the motivation from that level in saying "Well here's an experienced 40-year-old practitioner, why don't we just call him a partner? (Managing Partner, performance-based sharing firm)

This respondent is using an oversimplification to illustrate his point; however, by promoting an average-performing lawyer, as he explains, the impact on the firm would be to create an approximate additional $67,000 annually, without any accompanying increase in non-salary overheads. Much of the increase in price (all but that paid to the promoted fee earner) would be realised as profit.

Some participants perceive non-equity partnership to be a useful training opportunity, enabling new partners to experience partnership before committing to equity:

> *We've actually got almost as many non-equity partners as we do equity partners. There's only a very, very small handful of them who actually believe that they are ready for equity. But there wouldn't be a single decision taken that doesn't involve all partners. (CEO, performance-based sharing firm)*

> *The non-equity partners we have are saying, "I'm doing my time before moving onto equity, I'm learning a lot more than I used to anyway so I've taken a good pay increase". (CEO, performance-based sharing firm)*

Nonetheless the data show that many of the participants perceive that two-tiered partnerships are sub optimal compared with 'all-equity' partnerships. Despite this, all but four firms continue to use the model and perceive that they will do so for the forseeable future.

Many participants perceive that non-equity partnership should occur only for a small amount of time, with non-equity partners being introduced to equity within two to three years, as this participant observes:

> *It has its pros and cons. I think it's very good for this try-before-you-buy concept, and also it's good for internal promotions, but I think it only works for a certain period of time, because if they're in there as salaried partners for too long, they get a bit, how shall I put it – frustrated. (Managing Partner, performance-based sharing firm)*

This was a widely supported view, acknowledged here by another participant:

> *Approximately half our partners are non-equity. I'm actually not a fan of fixed-draw partners on a permanent basis. I think it's a useful thing for a bit of a trial*

period, but I really think people should be in or out. (Managing Partner, performance-based sharing firm)

This participant, from a firm that has had a two-tiered partnership for many years, summarised the views of many succinctly:

Yeah, I've got to say it's not a great system, to have two layers of ownership or two layers of partnership. (Managing Partner, performance-based sharing firm)

For some firms, equity partner profits are not sufficiently attractive to potential 'lateral hire' equity partners. In such firms, the non-equity partners may, in some years earn higher incomes than the equity partners who own and control the firm. The two firms in the data set that are experiencing this situation do not disclose equity partner incomes to non-equity partners.

Having to pay employed, salaried partners more than equity partner profit creates many complexities that lead to great frustration, as explained here by one of the participants from one such firm:

We have a number of fixed-draw partners earning more than our equity partners. I think everyone having skin in the game is really important, and that is a huge problem for us, especially now with our equity partners taking a hit. I really think it is not good for our business, and especially a firm with our culture, which is a nice place to work and people enjoy working here. It is creating this divide. (CEO, lock step firm)

Many firms in the sample have experienced significant profit growth in the last 10 years (FMRC, 2010). FMRC salary and partner profit surveys clearly show that, although employed lawyer salaries have also grown significantly over this period, the earnings gap between the most senior employed lawyers and the most junior equity partners has widened (FMRC, 1989–2009). In some firms, a promotion from Associate to Partner means an effective increase of 70% to 100% in annual remuneration for the promoted associate. The promoted associate may continue to perform at the same level as he or she did prior to promotion, albeit with increased responsibility and liability. This circumstance has caused some firms in the sample to retain non-equity partnership, in spite of its acknowledged weaknesses. This participant explains:

There was about a $50,000 to $60,000 gap between top level associate and entry-level partner. What happened though in the last five to eight years, unit values have gone up significantly, so to introduce someone at junior equity means they earn $460,000. So you would be lifting a senior associate from $270k to $460k, it's too much. You don't need to do it. Five or so years ago we started our partners as fixed-income partners so top-level associates at $270k go in at $330k. Take a firm like [firm name] – they can't have, you can't have fixed income [*non-equity partners*] *because there's no meaningful gap between a senior associate and equity. There's got to be a big gap to be able to use fixed income partners. (Managing Partner, lock step firm)*

And again, succinctly:

Mostly we've found here people are moving from $300,000 up to $500,000. In a sense, the prize is too much. (Managing Partner, lock step firm)

As partnerships shrink in average equity partner numbers (FMRC, 2010; AFR, September 2011), profits per partner may continue to grow, widening the salary gap further. In this circumstance, it is likely that most firms will continue with two-tiered partnerships.

All of the firms in the data set compete for the same pool of talent, at all levels of the professional hierarchy. Some have used promotion to partner as a retention strategy, enabling them to attract associates from other firms and to retain associates internally, by promoting them to 'non-equity' partner. This participant explains the need for flexibility in a competitive talent market:

Somewhere along the line we introduced the concept of salary or fixed shared partner. The reason we did that was to allow more people into partnership, frankly to see how they were going. There is still a bar you've got to reach but it's a lower bar than being an equity partner. To be a fixed-share partner in this place, you've got to show that you've got a practice, that you're capable of supervising a few people, that you're a good lawyer, you can do a bit of marketing and you've probably got a following or are capable of building one. Normally here, people are fixed-share partners for at least two years but we don't have any rigidity in our model any more. So a lateral partner could come

straight into equity. Most lateral partners have come into fixed-share usually for a year and then become equity if they're any good. Some people may never go beyond fixed-share and sort of accept that and some have been fixed-share for years. The title of partner matters to a lot of people, also even our fixed-share partners are relatively well remunerated. Nobody except the partners knows who is equity and who's not. (Managing Partner, performance-based sharing firm)

The management of non-equity partners and, in particular, their inclusion into (or exclusion from) the culture of the partnership is perceived to be a significant challenge for many firms. So much so that some are abandoning the construct of a two-tiered partnership altogether by lengthening their lock steps and admitting all new partners into their equity partnership on a reduced share, in preference to retaining a two-tiered partnership.

The benefits of so doing are explained here:

There's a difference, in our view, in terms of the way they're perceived internally. We did that [introduced all fixed draw partners to equity, abolishing the category of salaried partner] last year, spent a year sort of doing that with a number of other things and I think we got lift straight away out of it. (Managing Partner, lock step firm)

This respondent is speaking of the immediate positive performance benefit that occurred when his non-equity partners were appointed to equity. This performance increase was perceived to have occurred as a direct consequence of the feeling of inclusion experienced by those promoted to equity partner.

The following participant encapsulates the complexity of the pressures surrounding these choices:

Certainly we were concerned, as many other firms were, that that cohort, the fixed-draw partner cohort, felt dispirited, disengaged, abused, unrewarded, uninvolved and all that sort of stuff. The view personally I took was, well, what's that got to do with the structure? That's got everything to do with the partners managing those people as individuals. Giving people attention motivates them

more than anything else – not the structure. A lot of the reactions to the so-called unhappiness of a fixed-draw partner cohort it seemed to me were being looked at in a very superficial, simplistic, structural sort of way and the answers haven't really solved too much. We've found really giving people individual attention – coaching, finding out how they can make the best contribution in the business – has meant that nearly all of them are now feeling fulfilled. That said, there are tiny things like that which make it plain to everyone in the business that there are partners and partners.

So the partnership as a whole, including fixed-draw partners, meet once a month; a third of them don't turn up, including equity partners, probably more – a greater proportion of equity partners don't turn up than fixed-draw partners and so that in itself is incredibly symbolic. When I think about it, more than cheque signing and all that sort of nonsense – the effect when partners don't respect fixed-draw partners enough to turn up to a general partners' meeting then that can potentially drive a lot of attitudes. (Managing Partner, lock step firm)

All firms value what they perceive to be the positive aspects of their culture. There is, however, evidence of inconsistency within the culture of some firms. Lock step firms (that share equally after lock step progression) all perceive that the collegiality that comes from equal sharing is one of their greatest strengths. Indeed, many of the LSE participants were highly critical of what they describe as an 'eat what you kill' culture that they perceive exists in PBS firms. Despite the perception of collegiality achieved through equal sharing, paradoxically many of their employees, including non-equity partners, are paid with a combination of salary and incentive. This respondent tells the story concisely:

It would be fair to say that over the last few years as the proportion of non-equity partners has grown – that's not necessarily because of size but it's certainly a factor – there has been a bigger disconnect between non-equity partners and equity partners, and some sense of 'them and us', and the non-equity partners were not really partners is what they feel, and I think with some justification. What we've got now is an equal partnership as long as you're in it but, in fact, if you're not in the equity partnership, it feels very unequal, and so we've got sort of a, I think we've probably got a misalignment, really, of what

our objectives are, in terms of, you know, the remuneration model with the partnership model.

I think where we'll move to is either a very, very small non-equity partnership or not one at all, to be a far more inclusive model and actually deliver the cultural benefits, and business benefits that you try to achieve by having an equal partnership. We generally remunerate our non-equity partners based on personal performance, that's nuts. So what happens with our general partners, what do they do? They guard the work, they go "You can't touch that client, that's my client, and I'm going to be, not only is it going to affect my remuneration, I'm not going to get equity unless I do that", so we're ingraining in our new equity partners the exact behaviours that we don't want. (Managing Partner, lock step firm)

This view is shared by many of the lock step firms. The interviews indicate that performance-linked pay for senior employees (such as salaried partners) has been adopted first and foremost as a risk management strategy. These firms are asking themselves, "What if we pay them and they don't perform?" not, "Will they perform better if we provide an incentive?" In such firms non-equity partnership is essentially a test. If candidates pass this test they are subsequently admitted to partnership.

5.3.1 Summary

The preceding quotes suggest that most participants perceive a partnership culture existing among their equity partners that is distinct from the rest of the firm. Consequently, non-equity partners are often treated as senior employees, not partners, and levels of trust between equity and non-equity partners appears to be low. Equity partners in these firms are making different agency assumptions about their non-equity partners than they make about fellow equity partners. Where these differing assumptions do not exist and where non-equity partnership is temporary and seen as a stepping stone to equity, it is more likely to succeed as a retention and attraction strategy.

Although many firms acknowledge the benefits of a 'partnership test', the position of salaried partner does appear to have been created and perpetuated as a strategy to

lengthen the progression from admission as a solicitor to equity partner; however, no participants said that they were using the position of salaried partner to effectively quarantine the equity pool so as to maximise the returns of the existing equity partners. As such, although it is perceived to be 'sub optimal', the position of salaried partner does not represent an example of a closure mechanism as observed by Ackroyd and Muzio (2007) in the English legal profession.

5.4 Changing phenomena around partnership profit sharing

The data show that changes taking place in law firm partnerships in Australia have the potential to create consequences capable of impacting all firms, regardless of their selected profit-sharing model. The research questions of this thesis require examination of selected phenomena, specifically partner attrition, partner performance and changing demographics, including greater proportionate inclusion of women equity partners.

The research questions also require an examination of specific partnership structure issues to ascertain how partnerships are changing and why some may not be changing. Two specific structural issues emerged from the analysis: the use of salaried partners and the use of competitive success tournaments. This section analyses the data relating to these issues. The relationship that these structural issues may have to profit sharing is discussed in Chapter 6.

5.4.1 Profit sharing and partner attrition

Partnership was traditionally considered to be a permanent, long-term appointment (Pinnington and Morris, 2003). Gilson and Mnookin (1985) observed that, in the US legal profession, partners rarely moved from one firm to another prior to the 1980s. The interviews and FMRC comparative analysis data show that during the last 10 years Australian law firms have experienced a significant growth in partner profit and a significant growth in partner attrition (FMRC, 2010).

The market for legal services is perceived by all firms in the study to be significantly more competitive than it was in the 1980s and 1990s. Many firms consider both sharing

methodology and the overall profit earned by individual partners to influence retention. This statement illustrates the magnitude of the challenge:

> *There have been a number of partners that we have lost in the past which we would have preferred not to have lost where remuneration was an issue, ultimately quantum was the driver but methodology had a bit to do with it. If you've got a star who is 35 years old and you're saying, "Son, by the time you're 43 you can earn top whack", they might go, "Well I can go to another firm and do that now". (CEO, performance-based sharing firm with time)*

Relative quantum of profit is perceived to be a catalyst to partners focusing more closely on profit-sharing methodology. The analysis indicates that quantum is more significant than methodology. This was the perception of one participant from a lock step firm:

> *I think the lock step model is more brutal on the retention of partners (meaning that it is harder to retain partners in a lock step firm that is performing poorly)....If our incomes dropped alarmingly compared with our competitors then it would be an issue. It would make it more difficult to retain our stars. (Chairman of Partners, lock step firm)*

For the last 15 years firms have, in the main, become more profitable every year (FMRC, 2010). This participant is reflecting on the potential for the philosophy of equality to endure, should profits fall dramatically:

> *Money, although not necessarily the break issue for partners, and clearly again it's a mix of issues which retain people. But if you're not delivering ballpark profitability per partner into your good partners who would have all been approached by other firms, then it does make it very hard to compete and to retain those people. (Managing Partner, performance-based sharing firm)*

Lending weight to the importance of profitability per partner, and ultimately the quantum of partner income, these participants place an emphasis on partner retention, having lost partners in the past because they were aggrieved about their level of income:

> *There have been a number of partners we've lost in the past, which we'd prefer not to have lost where remuneration was an issue. I think what we've managed to do is firstly improve the profitability per partner of the firm very substantially*

over the last three years. But then also through a tougher approach to the distribution of equity plus a bonus scheme, we're now in a position where we're not losing people for money basically. (CEO, performance-based sharing firm)

To be honest, we were in some trouble, we weren't making enough money and we were in danger of losing some key partners over it and we had far too many people at 100 per cent. (Managing Partner, performance-based sharing firm)

In high-performing lock step firms, partner attrition has not had the same impact that it has had among performance sharers, but participants have no doubt that this apparent success has been achieved because high profits have been maintained, not because lock step is an unequivocally superior system. This participant from one such firm, when asked about the remuneration/retention link, makes this point:

In terms of really regretted departures to other firms where REM (remuneration) has been a driver, virtually none and so at a partner level we've really not seen any attrition. Now if we had a lock step system but we were, say, like (name of other firm) in terms of performance, it'd be a different story. (Managing Partner, lock step firm)

This participant, from a flexible lock step firm, is making the point that his partners have been quite happy with the firm's sharing arrangements to date; however, if the firm's profits fell to the level of one of his competitor firms they may not be so happy.

The data indicate that profit-sharing strategies must be aligned with what participants perceived to be a strong and harmonious culture. This strong sentiment was best expressed as follows:

We think it links into our cultural values in some way and, you know, that's why I've got very low partner turnover, both at the fixed-draw level, I might add, and the equity-partner level and the value of that's almost incalculable, really – that lack of turnover. (Managing Partner, lock step firm)

While all participants emphasise the importance of partnership culture, perceived prevailing marketplace conditions were seen to be influential in shaping the adherence to this principle:

If you are really true to your principles and somebody earned the firm a lot of money but might not quite be in step with the cultural values of the firm or might be a bit of a loner or something like that, you probably ought to kind of cut back what that person's REM income is. In a contestable market, where my partners are being head hunted all the time, I can't really afford to do that too much. (Managing Partner, performance-based sharing firm)

This is a perception that seeks to differentiate the theory of committing to agreed values and the pragmatics of practice in a competitive talent market. The interviews suggest that it is extremely rare for performance-based sharers to financially punish big-billing partners whose behaviour is inconsistent with agreed and often published cultural ideals.

While seeking to minimise partner attrition from their own firm, some participants are seeking to recruit lateral partners from other firms. The need to cater for lateral partner recruitment was perceived to be a significant advantage in performance-based sharing by those that use it and those that don't. Lock step firms were found to recruit few partners laterally, preferring to promote internal candidates familiar with their culture and who were seen by the partnership to fit in.

Performance-based sharers were found to be the most aggressive acquirers of lateral partners:

We have and will continue to admit high-quality lateral partners at our top band which will equate to 1.3 to 1.4 million dollars. (Managing Partner, performance-based sharing firm)

We're an aggressive acquirer of lateral partners. (Managing Partner, performance-based sharing firm)

Summary

Increasing partner mobility is occurring among both PBS and LSE firms, although it is perceived by many participants to be greatest among performance-based sharers. There

are, however, no comments in the data that suggest that attrition is greatest among PBS firms *because* of the profit-sharing methodology.

The participants' reflections do not support a conclusion that it is a causal relationship; that is to say, there is no evidence that performance sharing is likely to give rise to greater attrition as a result of dissatisfaction with the profit-sharing system. However, performance sharers do seem to be more aggressive in recruiting lateral partners and firms utilising this approach are, in the main, newer entities with less clearly defined partnership cultures. The increased voluntary turnover of partners appears to be a function of both quantum of profit per partner relative to other firms, and people's perceptions of partnership culture.

Participants do perceive that PBS is an important tool in the management of partner retention by creating the flexibility to pay high-performing partners more than they would receive if the same firm had retained an LSE profit-sharing system.
Prevailing economic conditions have seen a shift in the burden of service demand risk from the firm to the individual in many PBS firms. This may have caused a parallel shift away from partnership cultures that are collegial to ones that are more individualistic.

Firms start formal performance monitoring at an early stage in a lawyer's career. By the time an employed lawyer becomes an equity partner, they have effectively been in a pay-for-performance system for many years. If partnerships are becoming less collegiate and more individualistic, lawyers conditioned for many years to pay-for-performance systems are less likely to value cultural attachment and more likely to seek to maximise their income by selling their services to the highest bidder. In effect, an increased managerial focus (observed in Canadian law firms by Cooper et al., 1996) has been paralleled by an increasing awareness of individual performance, its measurement and reward. It follows that partner attrition may be exacerbated in PBS firms by the very tool that partnerships are using in an attempt to minimise it, suggesting that PBS effectively sows the seeds of its own destruction.

5.4.2 Profit sharing partner performance and partner performance management

The research questions prompt an investigation of the relationship that may be perceived to exist between a firm's selected sharing system and the performance of partners. Participants' perceptions of the strategic significance of a selected sharing model to performance and behaviour are best summarised by this participant:

> *I think there's a direct link between partner behaviour and performance and the whole question of how profits are shared because sharing outcomes are very much a communication by the organisation of who they value and who they don't and how they sort them in the pecking order. (Managing Partner, performance-based sharing firm)*

Maintaining partner performance is a significant challenge in most firms. This challenge is complicated in large firms by performance differentials among partners, as this participant explained:

> *What happens in a partnership the size of ours and I would argue happens in most, possibly not all partnerships, of a similar size is you end up with very disproportionate levels of performance. (CEO, performance-based sharing firm)*

Partner performance is critical to the success of all law firms, irrespective of the profit-sharing method employed. FMRC comparative analysis data suggest that firms have increased their reliance on employed fee earners in recent years (professional leverage). Nonetheless, partners are perceived to be the most critical of fee earners. Partners' hourly rates are significantly higher than employed lawyers' hourly rates[13]. Partners are perceived to 'own' the client relationship and the fees that flow from it, an observation that is consistent with those made of the US profession by Galanter and Palay (1990). These participants' comments are representative of these trends. They articulate the importance of individual partner performance to all firms:

> *Your performance is probably two-thirds yours and the third practice group because it still is built around individual reputation. (Managing Partner, flexible lock step firm)*

[13] In the FMRC Large Law Firm Survey 2009, a survey of top-tier Australian firms, average partner hourly rates were $632; employed solicitors from the same firms were charging an average of $335.

That's a particularly important factor, I think, for smaller firms because when you get down to 40 to 50 partners to have five or six or seven people under-performing, especially when they're split between two offices, so there are really 30-something partner firms and 15 partner firms. Well it's not just that it interferes with the average, it interferes with the dynamics of the office. (Chairman of Partners, lock step firm)

To assist in the management of partner performance, regardless of their profit-sharing system, all firms in the sample monitor partner performance. In some firms (that may be PBS or LSE firms), monitoring follows a formal, usually annual, process of partner reviews. In these firms, partners prepare a submission that includes a self-assessment of performance relative to agreed parameters. The submission goes before a committee of partners who consider it alongside an assessment of the peers and managers of the partner under review. There is usually an interview-style meeting where the partner under review defends his or her self-assessment. The committee then makes remuneration recommendations to the wider partnership. This process may involve an appeal as well as individual partner coaching. Some firms take a less formal approach, reviewing only partners considered by management to be underperforming, relative to expectation. Those that monitor formally and regularly can be either lock step or performance-based sharers. Monitoring systems that rely solely on informal monitoring occur only in lock step firms within the sample.

This participant's comment illustrates the arbitrary nature of performance monitoring in some lock step firms:

*We look at their client responsibilities and where they've brought work in for other people and how many staff they're looking after and those kind of things. Some of those things can be a bit on the subjective side and it's hard to get some of the reviewers to do anything other than look at the objective numbers. But we basically give people three years to get their shit together. Markets move, you're not going to go dropping your commercial property partner at the beginning of next year because they've had a poor year this year, it's not their fault. We got (*name of consultant*) in, he came in 2001 and we changed our whole structure and adopted quite a lot of his approach to law firm management, not all of it but most of it. He doesn't agree with the way we use the lock step, his view is 'you*

haven't performed in three years, you're out'. Now we're just a bit too collegial for that. (Chairman of Partners, lock step firm)

In contrast to this, partner monitoring in many of the PBS firms takes the form of a published set of performance criteria, relative weighting of criteria and assessment pursuant to weightings. For other PBS firms, performance is perceived to be somewhat opaque but underperformance is clear and obvious.

Many participants from performance-sharing firms list performance criteria but don't weight the relative importance of one criterion against another. This participant explains:

> *Some of my partners say that much more attention is paid to the financial performance than the other qualities. That's probably true. But we don't seek to weight them. It's discretionary and we don't – there's no kind of scientific kind of weighting at all. (Managing Partner, performance-based sharing firm)*

One of the significant changes to performance monitoring in both LSE and PBS firms is the inclusion of 'non-financial', behavioural performance factors. Most participants refer to these as 'soft skills', contrasting them with financial performance, by inference 'hard performance indicators'. One of the PBS firms in the sample is currently determining what behavioural elements to monitor and how heavily to weight various components. In this particular firm, these discussions are perceived to be negotiations, around which all partners have strong views. This firm is seeking to clearly define subjective contribution; other firms let partners define it for themselves, as this participant from another PBS firm observed with amusement:

> *It's interesting the ones that are good billers, they tend to compare themselves with the ones who focus solely on personal performance, they say, "Well, I'm number three on the list of partners in terms of fees billed and blah, blah, blah," and those that don't perform so well on the fees front find other things that they think are important, one put in that he's the Chief Fire Warden of the building, therefore, it's a claim to fame. [Laughs] He does it every year. (Managing Partner, performance-based sharing firm)*

Performance sharers involve all partners in regular performance reviews. Although formal reviews take place in four of the nine lock step firms, the remaining five lock step firms in the sample communicate performance issues by exception, speaking only to 'underperformers' and 'overachievers'. The benefit of this approach is that it is perceived to create feelings of independence which are considered by LSE firm participants to be a strong contributor to their desired partnership culture. This is best articulated by this participant:

> *There's a degree of comfort that, on the one hand, lock step works best when it's run through a fairly narrow band of acceptable contribution and there's an expectation that management manages that high bar and the performance around the high bar. But, provided that partners are generally performing within their band of contribution, they're left alone by management. As opposed to if you were in a differential system where, even if you were performing pretty well, you've still got to have the ruler run over you by management and run over you by comparison with somebody else to set your remuneration. I think that's seen as a huge negative. (Managing Partner, flexible lock step firm)*

Managing performance by exception is not uncommon, even among the largest and most successful firms. This underscores the perceived importance of independence to equity partners. For some traditional LSE firms, newly introduced performance monitoring systems are having a negative cultural impact, as explained here:

> *Some would say it's introduced an element of fear into the partnership but my argument is everyone needs a bit of fear, whether it is management or the partners. And there is this disconnect – how can you expect to earn $1.3 million or more and not be under performance pressure? (Managing Partner, lock step firm)*

There can also be a high social cost associated with not formally managing performance. This is best illustrated through the perceptions of the same participant:

> *Usually partners vote with their feet about non-performing partners. I always say, it's like, it's been like a death in the family and everyone has failed to tell the person that they've died and then management has to come along and tell them that they're dead but their partners have actually voted with their feet. They don't involve them in matters; they don't refer work to them. It's two ends*

of the spectrum. The underperformers get no referrals and the super-high performers get no referrals, the super-high performers don't get referrals because they don't need them and they generate – they're too busy. But the underperformers have all those characteristics, then what happens at the end is their financial performance is crap.

By the time we've gone there as management all the – a lot of the damage has already been done. You actually need the partners trying to help them fix it when it is actually emerging – not management 6 to 12 months later coming in and saying, "Look, clients are crap, your numbers are crap, you've got no team, you've got no skills". (Managing Partner, lock step firm)

Significant monitoring costs are thought by participants to exist in firms with complex measurement systems. Some firms go as far as attaching ownership to referred work by allocating a proportion of the profit on a particular matter to both referring partner and the partner responsible for doing or supervising the work. Lock step firms are quick to point to the inefficiencies of some monitoring systems. In contrast, respondents from performance sharing firms are quick to discuss the perceived brutality and finality with which underperformers are dealt with in lock step firms. These contrasting perceptions are pervasive. Below are examples that illustrate the depth of feeling on these contrasting points.

This participant perceives formal performance management and 'good management practice' to go hand in hand:

*I understand that [name of CEO and firm] for the first time brought in a partner performance system and two years ago for the first time (*name of firm*) partners' performance has been reviewed across the balance scorecard. I can't believe that any modern-day organisation could have a system where at all levels their people weren't being – their performance was not being reviewed. I just can't fathom how it is that an organisation doing 350 million could exist without that sort of system. (Managing Partner, performance-based sharing firm)*

The following participants, both from LSE firms, describe their PBS competitor:

We've probably been nowhere near as rigorous in that approach as [name of firm]. They talk about the night of long knives when the chairman of the day went down and stabbed six of them, got rid of them overnight. (Chairman of Partners, lock step firm)

We were talking to [name of Managing Partner and firm]. He said that his system is very simple. Then after talking to one of their partners who have been on the committee, he said, "It takes about three months, mate, it's just terrible". (Managing Partner, lock step firm)

For this participant, performance management does not necessarily go hand in hand with a PBS system:

If you look at a firm like (name of firm), *what's happening there – they're a merit firm or a mixed-merit lock step and yet have not been able to deal with underperformers. Very bizarre! (Managing Partner, lock step firm)*

These quotes serve to illustrate the high level of interest firms show in one another; they want to know what is going on in other firms. This may indicate a profession that mirrors the highly institutionalised legal professions, observed in other jurisdictions (DiMaggio and Powell, 1991; Greenwood and Hinings, 1996).

There are strong views on the performance expectations of several high-performing large firms (both lock step and performance-based sharers), perceived to exist by many participants from slightly smaller firms, characterised by the following Managing Partner of a 'mid-tier' firm:

I despair over the truth of what goes on in the mega firms, I don't care what their public relations says, I know and I've worked in places – the hard facts of life are what they really do. They say to people quietly, "That's your budget but if you're serious about your career you better double it" and so they are making people work ridiculous hours and kids are leaving the law altogether. (Name of employee) who works with me is now a partner and started here as a summer clerk. Not one of her peers from university is still in the law. They all went into mega firms and not one of them is still a lawyer because they got burned out and

I don't think the firms cared. (Managing Partner, performance-based sharing firm)

Summary

All of the firms in the sample were found to be performance-focussed, particularly at equity partner level. All firms had sophisticated management practices, centralising management in a team of management professionals headed by a managing partner or chairman of partners. All firms measure partner financial performance monthly against agreed budgetary targets. Several firms in the sample use measurement instruments to assess non-financial contribution of partners, including their involvement in marketing and cross-selling activity, leadership and supervision, as well as tangible support for fellow partners.

Researchers (Greenwood and Hinings, 1993) have pointed to archetypal change among law firms, from a P2 archetype to an MPB. The interview data lend weight to this observation by showing an institutional change from traditional collegiate partnership cultures towards performance-based cultures, although measurement, management tactics and tolerance of underperformance differ from firm to firm and change is by no means complete. There is still evidence of partnership involvement in firm governance and partnership ethos, characteristic of P2 organisations (Brock, 2008). Fifteen of the firms in the study had a partner as chief executive, managing in accordance with strategies agreed by the wider partnership. Where firms have engaged a non-partner CEO, the CEO is subordinate to the partnership. Any performance-related sanction against an equity partner or any change to profit allocation is put to the partnership as a recommendation and voted upon by all partners prior to being implemented.

5.4.3 Profit sharing, demographic change and gender equity

An analysis of how and why some firms are changing, while others are not, requires some analysis of practice demographics, in particular the increasing inclusion of women equity partners and what effect, if any, profit-sharing systems have on these changes. One of the most tangible changes to the Australian legal profession in recent years is the significant growth in the number of female practitioners, with female lawyers making

up an increasing proportion of practising solicitors. In 2004, the Law Society of New South Wales sought projections from consultants Urbis Keys Young on the likely demographic of the NSW profession. Their study concluded that by 2015 female lawyers will comprise 52.2% of practising solicitors (Urbis Keys Young, 2004). Every firm in the sample had more than 50% of employed fee earners, including non-equity partners, who were female. The demographics of practice are changing, on several levels. There are more women lawyers than ever before and formerly male-dominant partnerships are shrinking and ageing.

Both LSE firms and PBS firms recognise the need to manage demographic changes, as these participants observe:

> *Looking across the firm 15% of our partners (including salaried partners) are female and roughly 50% of our senior associates are female. I think that practice will change quite a lot and I think that work practices will need to become more female friendly, it's happening more every year. (CEO, performance-based sharing firm with time)*

> *We probably have to look at changing our criteria for making it to equity partnership; we probably need to put it down to take into account family commitments and those sorts of issues. (Managing Partner, lock step firm)*

> *We have to be more flexible - how can I put it, to be more flexible than we are now. We've been able to get a number of female partners but we're not good at retaining them. We've been trying to bring more women into the partnership for 15 years, we are either doing something wrong or there are other factors we haven't yet recognised. (Chairman of Partners, lock step firm)*

Despite the perceived need to change, the data show that gender equity is a challenging issue for firms. The significance of this challenge can be seen in the candour of the significant majority of participants, with their responses being both rich and often contradictory. All participants recognise the importance of female partners for the future of the profession but their perceptions do not necessarily indicate a commitment to greater diversity, as summarised by one participant:

We've actually been better retaining women than men, much better - much, much better. We've got more women, I think, than any of the major firms as partners. But I don't think that it's female-friendly. I don't think it should be. (Managing Partner, performance-based sharing firm)

The data show many frank perceptions that could be considered both traditional and conservative. Thus they are best illustrated by the following verbatim perceptions, reproduced here fully so as to clearly show participants' perceptions, accurately and without bias. These observations are indicative of how firms are not changing.

Most respondents (including all of the following) said that they would like to have a greater number of female equity partners. Most, however, express frustration at the result of their endeavour in trying to bring this perceived ideal about:

Another factor that makes it difficult to appoint and retain female partners, and one that we hadn't previously identified, is that law firms are pretty strong collegial environments (we can interpret this to mean a sort of 'boys club') and that may itself be something of a barrier. (Chairman of Partners, lock step firm)

These two participants perceive an imbalance to be an inevitable consequence of likely career choices made by women and the traditional roles played by men:

A lot of women are smart enough to look at this profession and say you get a much better deal if you want to have a family if you go and work for a corporation or government. There is still a tradition in the world where, in my opinion, the vast majority of women don't see themselves as the primary breadwinner once they're married. When I graduated in '78, half the class were women and I don't reckon one of them was practising five years on, they just married and performed exactly the same role as their mothers.

I don't think that the world has fundamentally changed; there may be a few house husbands around who are content with their lot, in fact, we've got one here I think [he is speaking here of a male associate that works part-time]. But broadly I think men still judge each other and are judged on career success and I don't see that changing. (Managing Partner, performance-based sharing firm)

This participant, one of the few who did not say that he would like to see more female partners in his partnership, perceives that women partners and part-time partners are related partner categories. He sees the management of part-time female partners as a matter of practice economics:

> *I think unless the world radically changes, where clients say to you, "We want you to have 50 per cent of your partners women and we'll pay you an extra $200 an hour to do that because we recognise that economics don't work otherwise. We recognise that people working part-time have got to be able to say to us at 5 o'clock, sorry, we're going home and this will have to wait until tomorrow". But clients won't do that, they say, "I want it now, I want it tonight and it needs to be priced competitively". (Managing Partner, lock step firm)*

For this participant equality means equality:

> *My view is there's no barrier for females to go all the way up firms. It's a question: do they want to do what the guys do? I don't think there's any gender bias or discrimination. We expect the same from women as the men. I would say this of many people who have worked here, particularly women who think that the demands of partnership are too great. (Managing Partner, performance-based sharing firm)*

And, with no irony intended:

> *We've only got one equity partner that's female. She's a bit of a bra burner, but if she came back and said she wanted to go part-time we would definitely do it, but we haven't had that happen to us yet. Unfortunately we're a bit of a blokey organisation, which is something that I'm trying to break down a bit. I'm a feminine type guy. (CEO, lock step firm)*

These participants articulate a lived experience that reflects a traditional, institutionalised, male-dominated profession, aware of changing demographics and the consequences that may flow as a result, but one that appears to be doing little to prevent these consequences from manifesting. Most of the participants asserted that their sharing models were 'female-friendly'; those that did not said that they believed there was no need to introduce female-friendly sharing systems, suggesting that such a

strategy was irrelevant to practice and that true equality is reflected in systems that do not cater to the perceived needs of either gender.

The respondents from PBS firms feel that their profit-sharing systems offer greater flexibility:

> *We do have greater flexibility to manage our gender issues and there I'm talking about our ability to promote and retain female lawyers who are managing their home life and work commitments. So we have a number of part-time equity partners. (Managing Partner, performance-based sharing firm)*

> *Our system caters for part-time partners, we pro rata their quantitative targets and pro rata their draws. (CEO, performance-based sharing firm)*

> *We are completely flexible. We have one part-time female equity partner; in fact I think we've got two. (Managing Partner, performance-based sharing firm)*

It seems, however, that LSE firms are also capable of achieving flexibility within their sharing systems:

> *We've got two women who are four days a week so they get 80% of parity. They're both good performers. (Chairman of Partners, lock step firm)*

For the majority of LSE firms, however, flexibility presents a significant challenge. This participant announcing a first for his firm:

> *This year (2008) we are likely to make up [promote an employee to equity partner] a part-time female partner. (Chairman of Partners, lock step firm)*

All respondents, without prompting, bundled the issue of gender equity with flexibility. The interviews clearly show that participants consider female partners as potential part-time partners and, in many cases, part-time partners as female.

When participants were asked if they saw part-time partnership as a gender-specific issue and whether this was likely to change, perceptions were polarised. Some participants already offer flexible arrangements for both female and male partners:

We've got and have had part-time male partners as well, one or two to meet special circumstances. So I think the pressure will certainly be on for greater flexibility and the way law firms manage that dilemma. It must be the case, the splits between male and female graduates from law school continue to move where the females are now the dominant proportion of high-quality candidates that come through university and apply for positions at law firms. (Managing Partner, performance-based sharing firm)

Others can envisage change occurring but the lived experience indicates that it would be unusual:

Yes, I can see it changing, lifestyle choice possibly, but I still think lawyers are, particularly male lawyers, are pretty competitive and they'll still keep on going full time. (Managing Partner, performance-based sharing firm)

The majority of participants, however, see part-time practice being inseparably linked to family commitments, predominantly the domain of female lawyers and usually temporary, until children reach school age. Despite the potential for PBS systems to cater to the needs of part-time partners, some participants from these firms did not respond to questions in a way that suggested that they feel any different about part-time partners than LSE firms. These participants encapsulate the views of many of the PBS firms:

I think that a lot of the part-time gender issue is really around going and having children. Mothers have a role in raising young children that can't necessarily be substituted by men. So while we do have, we have at least one male partner who is part-time. Generally it's women saying, "I want to continue my career, I'd like to have my child and after 6 months or 12 months or whatever, come back three days a week, work that up to four, maybe never do any more than four". We say, "Fantastic". It's in their interest to make it work and if they can't get their clients to work in with their work patterns, they'll never get their numbers anyway so it kind of sorts itself out, they succeed and stay or they go. (CEO, performance sharing firm with time)

> *It's always going to be predominantly women. How many men want to stay at home and look after babies? Not many that I know. (Managing Partner, performance-based sharing firm)*

Adding weight to the apparent lack of flexibility within those systems said to offer flexibility, one participant perceives that many of the challenges that confront aspirational female lawyers occur, by and large, as a result of their treatment by sister equity partners, many of whom perceive that they 'did it the hard way' and fail to understand why others require flexible arrangements that were not available to them:

> *I was probably rare in my generation because when I started work my wife was working, and she had a better-paid job than I did, and ultimately she couldn't cook and she didn't know anything about the kids, so actually it was probably a better reason for me staying home than her. But I recognise that there's still a lot of women in the law who think that there needs to be a lot more done around those practices and making it a more friendly and supportive environment for them. My problem is, and I've said this to most of my female partners over time, is that they are the problem. Well, to be honest, as I've said to them, "Look you know what's losing us women out of this partnership, is not blokes, it's actually the way you treat women, because you're treating women on the basis that they have to be successful in the way you were". (Managing Partner, performance-based sharing firm)*

The perception of participants from the highly successful lock step firms that have a long-established homogeneous culture, in response to questions about the likelihood of female or male part-time partners, was consistent and precise, summarised by this participant:

> *I think that's very unlikely. (Chairman of Partner, lock step firm)*

The data show that firms have been slow to embrace some work practices, at partner level, particularly at equity partner level, considered standard practice in many other industries. Despite the changing gender demographic, there is wide acknowledgement that law firm partnership is difficult for females; all are aware of the challenges but few are doing anything tangible at equity partner level, beyond tolerance.

Two of the participants, both from lock step sharing firms, were extremely positive about catering to the needs of future generations of partners, women in particular, seeing greater gender diversity within their partnerships and greater flexibility in part-time/full-time arrangements as a definite strategic advantage best articulated by these comments:

> *Our view is that there is incredible opportunity for firms that get the structures right, which makes partnership not only female-friendly but flexible work-friendly. (Managing Partner, lock step firm)*

> *You know I hope, I really hope, that my competitors, our competitors, continue thinking conservatively because if they do we are going to clean up. (Managing Partner, lock step firm)*

Summary

Many large law firms expect a lot from their equity partners. These firms see themselves as elite performers, working as hard as possible for great reward. This perception has created partnerships with high performance cultures that seem to tolerate the needs of a small number of high-performing female partners however they are not changing to accommodate the potential needs of the majority of female lawyers that may aspire to equity. nor do they perceive they should. For these firms, true equality is perceived to be best demonstrated by female partners achieving performance at the same levels expected as those that have been demonstrated by their male colleagues for many years.

Other firms perceive a significant advantage accruing to those who can offer a different model, one that accommodates differing input and performance levels among equity partners. These firms perceive this kind of model to be important to future generations of partners, many of whom are likely to be female. Despite the cited flexibility offered by PBS, these more enlightened views came from two lock step firms.

Most firms in the sample appear not to have adopted a particular profit-sharing system, having retained an existing sharing system with the intention of creating either of these distinct views of practice. Rather, they seem to adopt one of these approaches and

manage their firms accordingly, within (or perhaps around) their sharing system. Only two firms within the sample say that they have designed a sharing model as a specific strategic enabler, around firm and practice group business strategy, aimed at providing greater flexibility to assist in catering to the needs of a changing solicitor demographic. Both of these firms are PBS firms.

There are no clear patterns in the data around gender equity. Firms appear not to be changing their structures or profit-sharing arrangements to achieve greater diversity within their equity partnerships. Nor is there any evidence from the data to suggest that women are being intentionally excluded from equity partnerships. The demographics tabled in Chapter 2 point to a stark contrast in the representation of women in employed solicitor ranks relative to equity partner ranks; however, the drivers of this contrast are likely to be complex and remain unclear.

5.4.4 Profit sharing and success tournaments

Researchers have suggested that competitive success tournaments, such as ‘up or out’ promotion-to-partner tournaments, contribute significantly to the success of large law firms by promoting sustained, long-term performance in aspirants (Gilson and Mnookin, 1985; Galanter and Palay, 1990). In this examination of how and why some firms are changing while others are not, it is appropriate to examine the perceptions of large firm Managing Partners on the intra-firm competitive dynamics that are said to exist among those aspiring to partnership. It is also interesting to examine whether these dynamics continue, in some firms, beyond appointment to equity partner, meaning that high levels of performance continue throughout a lawyer’s entire career with such a firm.

Law firms are, in the main, in the business of selling their time. Many operating expenses, including employee salaries, business premises, technology, management and administration, do not vary with the level of activity or time sold. It follows that price and volume are extremely important to the success of most firms. The more work you do and the more you charge for it, the more profit you make.

Assuming a firm has a supply of sufficient work, how do they get their employed lawyers, including non-equity partners, to work harder than they otherwise might? Some firms link reward outcomes to performance, thus providing an incentive to work hard. Other firms rely on a lawyer's professionalism, hoping that they will strive for client satisfaction. For most, however, high levels of performance are engineered through the promise (or possibility) of promotion to partnership for those that excel relative to their peers. This has effectively created an internal tournament as lawyers compete for a limited number of partner positions.

For a success tournament to succeed as a motivation strategy, lawyers must voluntarily accept its underlying tenets. As Australian firms grew during the 1980s and the 1990s, there was no shortage of lawyers prepared to opt into the tournament. It was most unusual to see associates in their mid to late 40s. They either progressed or they left, voluntarily or otherwise, thus creating a de facto 'up or out culture', talked about by many firms and written about in the law firm management literature.

Some respondents perceive that the success of up or out work systems are under threat. The following two respondents, one from a PBS firm and the other from an LSE firm, share the same view:

> *I don't think there's any doubt about that. I think we're already seeing it as evidence by my earlier remarks about some people who go, "Well, thanks for lifting the hood and giving me a good look at the engine. I'm not sure that that's for me". And I've got a real concern about that. I've got no doubt that the incidence of people opting out of the tournament will become greater. (Managing Partner, performance-based sharing firm)*

> *I think, increasingly, people will opt out, there are people who are coming to a conclusion that they don't want to turn out like their good partners. They don't want to pay the price – they are making assessments around what they're paid and what the effort is. I think there's an increasing number of people like that. (Managing Partner, lock step firm)*

Some perceive the tournament to be under threat but remain sanguine about the future. These are typically the participants from the firms that describe themselves as 'top tier'. Their perceptions are best represented by the following:

> *I think that the tournament is not such an attractive tournament for many people and that's sensible because the race can't accommodate a large field, in any event. A lot of people, these days, don't want to work that kind of lifestyle, they don't want the pressure, the pressure is constant, it's daily, particularly in a high-performance environment like this. (Managing Partner, performance-based sharing firm)*

Others do not perceive any change occurring:

> *Are we seeing more people saying they don't want partnership, well people like to say yes, but no. (CEO, performance-based sharing firm)*

The data indicate that any concern about lawyers not wanting to strive for partnership is proportionate to perceived brand equity. In other words, the bigger the firm and the 'better' the brand, the less likely Managing Partners are to perceive any strategic risk from employed lawyers opting out of the tournament to partnership by deciding not to pursue partnership. For two of the established top-tier firms:

> *I think we'll end up with enough opting in because the growth rate in the Australian legal market is single digits. The number of really talented, committed people, this elite candidature – it is not a bigger number as a per cent of kids coming out of law school. So I don't feel any threat running a large firm that we're somehow going to run out of talented recruits. I think we have the enviable luxury being able to keep the bar high.*
>
> *We have 680 applications, you then weed that down to about 160 and then you, sort of, go on from there. So if you're going from 680 down to 25, it's not bad given they all already have gotten into law school and they've hung in for at least three years and they're anticipating finishing. So if we were getting 100 applicants for 25 places you might be thinking we've got some sort of a problem. We've got so much headroom in that talent market, it's not a problem for us. (CEO, performance-based sharing firm)*

Certainly this goes to the Gen X – we've never seen any shortage of people who are, as in my case or people in the generation before were, willing to kill themselves on the altar of becoming a partner, or whatever it takes. There's no shortage of those people. No shortage, there's no shortage in people wanting to be put up. Quite a number will leave but part of our model, well all the models, are built on some level of departure because you are expecting to win and win up all the talent to end up by the time you appoint partners that you've got the best of the best. And you want people like that because they know what the life's going to be about. What I say to people is "Well, this isn't for everyone". (Managing Partner, lock step firm)

At the time these interviews were conducted, the Australian economy had entered the downturn that quickly became known as the GFC. Some participants perceived that the GFC would alter behaviours causing lawyers to stay in firms seeking security rather that leaving to seek opportunities elsewhere. This participant explains:

I think, yes, there will continue to be enough people who want in. I think maybe a year ago everybody was starting to say maybe not in the sense of that there were other things to go and do and there were lots of pretty attractive offers of very high salaries and equity options depending on where this all goes at the moment, may even become even more so that people will spin back to what looks like something of a secure alternative. I don't see any less a number of kids that want to become partners here. (Managing Partner, lock step firm)

Some firms are significantly more flexible than their competitor colleagues. They perceive that intense competition for talent brings with it opportunities to maintain their proportion of professional staff leverage without offering, or indeed mandating, a lawyer's progression through to the partnership.

This participant perceives that providing an alternative career structure to up or out is good for his firm:

One of our senior associates stayed around a long, long time. We've had a whole bunch have been here over 10 years. These are not people who are hopeless. It makes sense to find a home for them. (Chairman of Partners, lock step firm)

These two participants perceive that wider social change must have consequences for their firms:

> *Well, I think it may well change because people's attitude to the time they spend at work has changed considerably. But at this stage, I think we're still seeing enough people opting into the tournament. I think also we probably have to look at, perhaps, changing our criteria for making it to equity partnership. We probably have to put it down to take into account family commitments and all those sorts of issues. I can also see us changing the way we reward and promote people. (Managing Partner, lock step firm)*

> *It's not the model we have now, that's the famous McKenzie's (sic) (Cravath) model, isn't it, up or out? No, I think we've got to be realistic about this in a situation where you've got more than two-thirds of your graduates female, where we've now got to have every sort of flexible work arrangement known to the world. Some people are simply not going to want to be partners or certainly not do what's required to be senior equity partners. A senior equity partner in this place has big responsibility. (Managing Partner, performance-based sharing firm)*

The significance of continuing to introduce partners to equity and the opportunities that exist for leading firms is implicit in the comment of a Managing Partner from one large firm, who said with exasperation:

> *There's a huge generational shift going on in the Australian legal market at the moment. All the firms that have got partners with the big reputations are all in their early 50s, they are people who were young partners in the early 90s when all the national firms started becoming national firms. They've all been around for 15 years and they're all pretty tired and nothing's changing and a lot of them are going to retire. (Managing Partner, lock step firm)*

All of the participants were aware of the implications of an ageing partner base. Many are using 'equity management', that is, restricting entry to the partnership and enforcing retirement to continue equity partner profits in a market where there is little growth and continued price pressure. As partners retire, they are not replaced, reducing the size of

the partnership and subsequently increasing the profit returns per equity unit. This strategy is perceived by most top-tier firms as a necessary measure to ensure that partner incomes remain competitive, relative to comparable industry salaries. This is having the effect of intensifying the tournament as employed lawyers compete for fewer partner positions that carry a greater prize.

Summary

In many large Australian law firms, tournaments to partnership are perceived to have been a successful means of growing profits and growing firms. Success tournaments are growth strategies (Galanter and Palay, 1990). Partnerships must expand to accommodate entrants and more employed solicitors must be engaged to maintain leverage structures that are critical for maintaining profit (Galanter and Palay, 1990).

The growth model inherent in the tournament appears to be changing to a market-driven model where firms will grow and contract to fit market demand and seek to maintain or grow relative share:

> *I think the law firms grew as big as they could be for the market and, if anything, the market is going to be less. (Managing Partner, lock step firm)*

This has implications for the way partnerships manage success tournaments however the options appear to be limited. Partnerships can continue to expand relative to demand for services, reducing average profit per partner alternatively partnerships may remain the same size they are now and ensure senior partners retire relatively early to create room for aspiring partners finally partnerships may shrink by raising entry requirements and by exiting senior partners earlier than they otherwise would, thus increasing the value of the tournament prize. In fact, the interview data show that all of these three changes are currently occurring.

For firms that do not enjoy market leading 'brand equity', different motivation strategies may be called upon to replace the tournament; should this occur it will represent a major institutional change. This may also mitigate against the impact of employed lawyers opting out of the tournament, thereby allaying the stated concerns of many participants. These firms see themselves as being controlled by changing circumstances and having to react accordingly.

It is likely that success tournaments will continue in firms that perceive themselves to be elite, requiring only a small number of highly talented, ambitious lawyers relative to the number of available graduates. Such firms perceive that a sufficient number of employed solicitors will always aspire to partnership and that this is sufficient to

guarantee the perpetuation of the utility of tournament-like dynamics in leading elite firms.

5.5 What we already know about changes taking place from comparative financial analysis

To add to our understanding of how large Australian law firms have changed and to enable a fuller comparison between PBS firms and LSE firms, it is useful to consider trend information over a 10-year period for some of the firms in the sample.

I do not come to this project or these firms as an independent academic. FMRC has been measuring financial performance parameters in all of the participating firms for several years in many of the sample since 1985. FMRC has consulted with many and we are currently consulting with some; FMRC continues to provide comparative financial performance data and comparative market share data to all.

Tables 3 and 4 report measured change in participating firms across several performance parameters that occurred between 1999 and 2009. The international practice management consultant David Maister (2003) suggests that law firm profitability per partner is a function of professional leverage, price, lawyer productivity and profit margin; the greater these measures, the more profitable a firm will be. I have been measuring these parameters in large Australian firms for more than 20 years, and tables 3 and 4 use these data. The tables do not report ‘raw data’; instead the tables report the changes that have occurred in each of the performance parameters in each firm over a 10-year period, to illustrate the extent to which change is occurring in many aspects of law firm management and highlight both the inconsistency (with some firms experiencing an increase in partner profit and some firms experiencing a decrease in partner profit) and the magnitude of the changes that are occurring.

Although there are several permutations of both LSE and PBS systems, I have segmented the sample into the two primary systems. Tables 3 and 4 report data from 16 of the participating firms. The remaining three firms have not participated in comparative financial analysis for a sufficiently long period to enable these calculations.

5.5.1 Relative performance parameters used

Tables 3 and 4 use a number of parameters to measure financial performance in law firms. The performance parameters used are taken from the large law firm comparative survey conducted annually by FMRC. Following on from Maister's (2003) observations I have reported profit, leverage, price and lawyer productivity. Diverting from Maister to better address the phenomena under investigation, I include salary margin (the proportion of total firm income paid to employed fee earners) and changing partnership structures (the change in numbers of salaried partners employed).

Change in profit per profit-sharing partner 1999–2009

Profit per profit-sharing partner is a useful measure of relative organisational performance for both PBS firms and firms that share profits through an LSE system. This measure averages the partner earnings for the entire equity partnership by taking the total distributable profit and dividing it by the number of equity partners. With a myriad of sharing methods currently being used by firms, this measure provides a comparative assessment of financial performance that may be disguised in measures such as returns to the highest-paid partners. This measure reports the overall accumulated increase or decrease in a firm's profit per equity partner for the period 1999 to 2009. For example, in the case of the first of the LSE firms, average profit per equity partner increased between 1999 and 2009 by 75%.

Although some firms have experienced declining profit per profit sharing partner and others have experienced modest growth, by and large the firms in the sample are more profitable than they were a decade ago. The overall growth in the business services sector in the Australian economy has translated into success for the majority of LSE and PBS firms in equal measure.

Change in price 1999–2009

Price, measured here by a 'blended hourly rate', measures what a firm charges for an average hour sold, regardless of who does the work. Hourly rates vary significantly from senior partners to graduate solicitors. The blended rate is essentially a weighted

average across a firm. This rate enables a meaningful comparison between highly leveraged firms and those who engage fewer employed lawyers per equity partner. This measure indicates the change in price for the period 1999 to 2009. For example, the first of the PBS firms has increased their blended billing rate by 35% from 1999 to 2009.

The dramatic rise in the price of legal services has been one of the key drivers of profit growth during this decade. The compounding effect of annual fee increases has effectively doubled what many firms get paid for providing the same service.

Change in salary margin 1999–2009

Salary margin measures the proportion of total fee income spent on employee salaries. This measure indicates salary growth, proportional to total income.

Despite the significant increase in price in most firms, reflective of the market price of legal labour, the proportion of gross fees paid to non-partner lawyers has decreased significantly in many firms.

Change in partnership structure 1999–2009

This measure reports both equity and non-equity partner changes as at June 2009, as a percentage of their respective 1999 full-time equivalents.

Five of the LSE firms have increased their salaried partner numbers by more than 100%. One of the LSE firms (068) has abolished the role. Salaried partner numbers in PBS firms have also changed. Two of these firms have abolished the role, two others have had modest growth and two more, significant growth. This suggests that the LSE firms are making greater use of salaried partners. This may be occurring, in part, as a result of the lack of flexibility in LSE relative to PBS. By requiring a partner aspirant to become a salaried partner prior to possible promotion to equity, LSE firms may have the opportunity to ‘test’ an aspirant’s capacity to contribute equally. PBS firms may have greater flexibility in sharing arrangements, giving them the opportunity to appoint partners who may not contribute ‘equally’ but may still be considered worthy of equity.

There has been significant change in the way firms utilise salaried partners. Some firms have discontinued the practice of appointing salaried partners, while others have doubled their number among their ranks. This is symptomatic of the lengthening of the progression from admission as a solicitor to the attainment of equity partnership (particularly in LSE firms), an example of the existence of closure mechanisms (Ackroyd and Muzio, 2007).

Change in professional leverage 1999–2009

Leverage is a measure of employed fee earners relative to equity partners. Sherer (1995) reports a positive linear relationship between leverage and profit. This measure expresses change in leverage at 2009 as a percentage of its 1999 level.

The use of leverage is a given in all large firms. These data, however, illustrate that some are better at increasing leverage than others. The data don't enable conclusions to be drawn about LSE relative to PBS firms. Some firms, in both samples, have increased leverage significantly, and others have decreased leverage significantly.

Change in volume of work done per lawyer, per annum 1999–2009

This measure reports total hours worked on matters per year per lawyer. It is an average of all lawyers in each firm. Volume is an indication of lawyer productivity. These results indicate how productivity has changed during the period 1999 to 2009.

Australian firms have become increasingly performance-focussed, with many adopting performance-based sharing for partners during this period. All lawyers, in all of the firms represented in the data set, have performance budgets, and all review employed lawyer productivity and set salaries with reference to the review process. Despite these measures, productivity, measured here in hours worked on matters each year, has remained static, at best. One firm has improved by 6% (074, a PBS firm), two remain unchanged (one a PBS firm and one an LSE firm) and, in the rest of the firms in the sample, hours worked on matters per annum in 2009 was actually less than they were in 1999.

Table 3

Comparative performance data from LSE firms from 1999 to 2009

Firm	*% Change in profit per PSP*	*% Change in price*	*% Change in salary margin*	*% Change in number of fixed draw partners*	*% Change in number of equity partners*	*% Change in leverage*	*%Change in hours worked on matters pa*
1	+ 75	+52	unchanged	+>100	-7.5	unchanged	-8
2	+107	+70	+7	unchanged	-35	+27	unchanged
3	+97	+92	-10.8	-100	+12	+38	-16
4	-50	+69	-3	+80	-28	-57	-9.5
5	+112	+84	+13	+>100	+32	+26	-7
6	+13	+94	-28	+12.5	+77	+90	-18
7	-6	+50	+23	+>100	+31	-24	unchanged
8	+18	+44	+31	+>100	+>100	-54	-28
9	+61	+78	+20	+>100	+>100	-54	-14

Table 4

Comparative performance data from PBS firms from 1999 to 2009

Firm	*Change in profit per PSP*	*Change in price*	*Change in salary margin*	*Change in number of fixed draw partners*	*Change in number of equity partners*	*Change in leverage*	*%Change in hours worked on matters pa*
10	+69	+35	-25	unchanged	-17	+70	-10.5
11	+101	+89	-16	+10	+5	+3	-11
12	+60	+23	-25	+11.5	-14	+42	-5.5
13	+108	+89	+6	+80	+39	+8	-10
14	+4.5	+25	-21	-100	+30	unchanged	-3
15	+23	+38	+3	-100	+22	-5	+6
16	-8	+59	-20	+60	+>100	-14.5	-22

5.5.2 Summary

As can be seen from tables 3 and 4, many large law firms have enjoyed significant growth and success, some have not. Furthermore, the growth in the success of profitable firms appears not to have occurred through productivity growth, in all but one firm, productivity has remained the same or declined. The tables illustrate the influence that price has had to a firm's overall success, measured by profit per profit sharing principal. There have been significant price increases in all firms. Increases in leverage and productivity have been less consistently achieved among this sample. Significantly, there is no apparent relationship between firm performance and sharing methodology in

any of the performance parameters reported in the tables. Nor is a direct relationship perceived to exist, as these representative respondents explain:

> *You know better than most what drives profit in a law firm, Neil. It's all about price and utilisation [the proportion of chargeable time performed by a solicitor relative to total available time]. It really doesn't matter how you cut the cake, that happens as a result of profit it's not a driver of it, not in any immediate sense. (Managing Partner, lock step firm)*

> *If all of my partners achieved their six [chargeable] hours a day and all of the lawyers billed their budgets, we'd make more money than we'd probably be comfortable with, although we'd learn to live with it [laughs]. Our REM [partner remuneration] model hasn't contributed greatly to an increase in profit, nor do I think it will. It does provide greater flexibility to manage performance at either end though (referring to under- and over-achievers), that's really why we shifted to it. (Managing Partner, PBS firm)*

> *All compensation models work and they all don't work. We know some firms have changed to a merit model, hoping it will increase profit but it doesn't seem to have done that; better returns to those at the top, perhaps, but certainly not the average partner. (Managing Partner, lock step firm)*

The data do not support Pederast's (1990, p.7) proposition that incentives are the "essence of economics" in a generalisable way. Nor do they support the assertions of Baker et al. (1998) and Lawler (1996) that individuals will respond to incentives. If these propositions were accepted in the context of Australian large law firm partnerships, the performance data should show PBS firms outperforming LSE firms, but they do not appear to do so at the moment.

Changing from LSE to PBS would not appear to improve firm performance directly. The flexibility that is said to accompany PBS may offer benefits perceived to be considerable, such as assistance in retaining high-performing partners and ensuring that those partners receive big incomes, but its potential to increase the profit performance of the entire partnership as a whole is questionable.

5.6 Chapter summary

In this chapter, the data have been reported and analysed. Discussions arising from the data and the implications for policy and practice are yet to be presented. Chapter 6 relates the findings here to the findings from the review of the law firm management literature, detailed in Chapter 3, to enable the research questions to be answered.

Chapter 6 Discussion

6.1 Introduction

In the previous chapter, interview data and comparative financial analysis data were presented and analysed. This chapter discusses those findings drawing on phenomenology to specifically explore the 'worlds that open and close' to individuals and firms as a result of adopting the assumptions inherent in PBS or LSE profit-sharing systems. This chapter commences with a discussion of lived realities and likely experiences of participants in particular profit-sharing systems. It then discusses the propositions raised in the literature review. An analysis of the literature produced by those researching the legal profession in foreign jurisdictions, typically in the USA, Canada and the UK (detailed in Chapter 3), is a significant component of this thesis and the learning process inherent in phenomenology. Accordingly, the discussion also involves key concepts of the theory and how they relate to the data.

6.2 The opening and closing of worlds

Integral components of any hermeneutic phenomenological study include the preconceptions and biases that a researcher brings to the study (Giorgi, 1989). The assumptions I held prior to commencing the study (after 23 years advising on legal practice management) were as follows:

- Most firms have a profit-sharing system that has been developed over a relatively long time. A firm's sharing system is often tinkered with from time to time to achieve pragmatic outcomes, such as catering to the requirements of noisy over-achievers, simplifying merger negotiations and attracting lateral higher partners.
- The decision to modify a firm's profit-sharing methodology is usually influenced by what other firms are doing at the time.
- There is no one best way to share profits.
- Profit-sharing models contain strengths and weaknesses; in different law firms any one particular system can be perceived to work or to fail.

- Money motivates some lawyers; however, it is not the primary reason that many lawyers choose to become lawyers and remain lawyers.
- A minority of lawyers respond to financial incentive by significantly improving their performance and behaviour.
- A law firm with a collegiate partnership culture will usually outperform a law firm with an internally competitive partnership culture.
- Profit-sharing methodology can influence the financial performance of a firm. The way sharing influences profit manifests differently in different firms.

The following discussion is not limited by these general pre-conceptions, nor does it set them aside, by 'bracketing' them. This is consistent with the data analysis process as described in Chapter 4.

This discussion involves a search for and an understanding of paradigms, defined as a "typical example, pattern or model of something" (Oxford Dictionary, 2007, p.743). I consider both PBS and LSE to be distinct paradigms in the context of this study. Each paradigm contains assumptions about the world in which it operates; these assumptions may or may not be true. In effect, a paradigm is a set of rules and regulations through which one views and interprets the world, filtering or blocking information that does not fit one's paradigm. I consider that worlds (experiences) become open to firms as a result of their chosen profit-sharing paradigm. Similarly by choosing a particular profit-sharing paradigm, worlds (experiences) are closed to the firm.

Initially, I have limited observations of worlds that open and close to those that are definitive, not those that may or may not occur depending on how a profit-sharing system is implemented and administered. Having analysed the data, it seems that law firms can manage challenges around their profit-sharing system or with their profit-sharing system; because of this, worlds that open and close to firms, mutually exclusively as a result of their chosen sharing methodology, are in fact few.

6.2.1 Worlds that open to LSE firms

An important initial observation here is that no firm in the study has changed from a PBS system to an LSE system. LSE is a sharing methodology that firms have either decided to retain or to change.

Partnerships that remain faithful to the paradigm underpinning LSE do so by assuming that equal sharing produces a team-like dynamic, a sense that ‘we’re all in it together’, striving to achieve a desirable collective goal. LSE systems are embraced or retained with the assumption that all participating partners are capable of contributing at the agreed performance levels. LSE also involves the assumption that collegiality will produce a more favourable outcome than individual incentive and individual reward. Managing partners of LSE firms generally assume that equal sharing is fairer than performance-based pay.

By accepting these assumptions and adopting the paradigm of LSE, partners are likely to experience greater collegiality and a greater willingness to share clients and jobs within practice groups and among practice groups. In some of these firms, average-performing partners and high-performing partners experience greater independence from management that is, they are left alone; it is a high trust working environment.

In firms with an LSE system, profit sharing is likely to be peripheral to organisational performance and individual performance, not a determinant of these two phenomena. That is not to say that performance doesn’t matter to LSE partners. On the contrary, in LSE partnerships continued performance is critical to individuals who wish to remain in the partnership. The analogy of team-like behaviour explains the behaviour of LSE partnerships. Like any ‘elite’ team, underperformers are identified and encouraged to ‘lift their game’; sub par performance is tolerated up to the point where it becomes apparent to the majority that they are incapable of improving. At this stage, they are dropped from the team. LSE partners are likely to experience strong peer pressure to perform at agreed acceptable levels. If they fail to achieve these expectations they are likely to experience ‘social pressures’ such as isolation (partners will not refer work to them), management intervention and, ultimately, they may be encouraged to leave the partnership – in extreme cases they may be expelled.

The high levels of collegiality evident in LSE firms can manifest in higher levels of homogeneity within a partnership. Partners are more likely to be 'home grown' and are more likely to have adopted the same values over their practising careers as adopted by their fellow partners. Some may be seen as a 'boys' club' by external or internal observers. In other words, LSE partnerships may be seen to be closed to those aspiring partners who, for whatever reason, perceive that they do not 'fit the mould'.

In summary the worlds that open to LSE firms are collegiate, where partners share demand risk collectively and profits equally. The worlds that open to LSE firms are worlds where social controls drive performance and cultural fit is seen as an essential partnership pre requisite.

6.2.2 Worlds that close to LSE firms

LSE profit-sharing systems and the partnership cultures that often accompany them do not readily accommodate part-time partnership, the lateral recruitment of equity partners, merger with another firm or the management of partners that are underperforming through reasons beyond their control, although firms have achieved all of these things within an LSE paradigm.

Part-time partnership is often considered to be a gender-specific issue in LSE firms and it tends to be managed by rare exception. It is considered a privilege to be earned and a necessary, pragmatic mechanism for retaining women in the partnership, not an entitlement for all partners. As such, part-time partnership is inconsistent with the paradigm of equality; however, society and pragmatic concerns such as changing practice demographics have required some LSE partnerships to tolerate part-time partners, although few, if any, would encourage part-time partnership. Those firms that have struggled to move beyond tolerance are likely to close down opportunities to include more female equity partners, who are likely to experience negative social pressures within the partnership.

Partnerships with an LSE sharing system are often closed to lateral partner recruitment and are therefore limited in their capacity to expand. Potential recruits are unlikely to

join an LSE system if an equal share in the proposed firm is significantly less than their current income. It follows that LSE may close down some recruitment and growth opportunities. As a consequence LSE firms may be closed to the worlds of fresh ideas and perspectives that may accompany lateral recruitment.

LSE may also close down benefits that arise from the provision of financial incentives and rewards. These benefits may include the retention of high-performing junior partners who may become disenchanted with time-based sharing.

A pure LSE system assumes equal reward for equal achievement, not equal effort. This is an important distinction because LSE does not accommodate partners who may be applying equal effort but, for whatever reason, are unable to achieve at the same level as other partners. As such, LSE, while potentially collegiate, may also be quite brutal by failing to accommodate those partners who are good, but not good enough. In effect the rigidity of pure LSE provides for no second prize, opening up a world with a high performance culture where partners perform to agreed levels or leave.

In practice, the majority of LSE firms have modified their lock steps to accommodate partners who are capable of achieving performance levels that are less than those achieved by full-parity partners. This strategy has enabled them to retain partners who may be in the latter stages of their careers, partners who wish to reduce their input and part-time partners. In most firms, however, tolerance of ‘doing less’ has its limits, and agreed lesser rates of performance are treated as a rare exception and are usually ‘earned’ through previously demonstrated high performance.

6.2.3 Worlds that open to PBS firms

Partnerships that have embraced a PBS do so by accepting the assumptions that individual partners respond positively to performance incentives and that the provision of incentive and reward will produce more favourable outcomes than the alternative system of equal sharing found in LSE firms. PBS partnerships assume that partner performance can be measured and compared. PBS partnerships assume that the flexibility offered by PBS will provide a competitive advantage, particularly in

recruitment of partners and other firm growth options. PBS firms assume that performance-based pay is fairer than equal sharing.

The assumption that individual partners are likely to perform at different levels opens a world that is more tolerant of diverse contributions, beyond minimum acceptable contribution. This in turn opens up greater recruitment opportunities and firm growth strategies. More internal partner aspirants are likely to become eligible for partnership, and partnerships become open to the flexibility to lower partner admission requirements without impacting individual partner shares. PBS opens up a more inclusive and flexible world. Partner aspirants are able to be assessed on their individual merits without the performance expectations placed on aspirants in successful LSE firms.

PBS opens up a world involving measurement and assessment, regardless of an individual's current performance or experience level. The process of measurement and assessment opens up a value set consistent with those of managerialism (similar to the MPB observed by Cooper et al., 1996).

6.2.4 Worlds that close to PBS firms

PBS closes down a world in which natural collegiality and mutual support among partners are central values. The term 'natural' is used here intentionally to contrast the engineered collegiality and partner support that can be created by making these phenomena assessable partner performance criteria.

PBS closes down a world where relative partner profit shares are incidental to day-to-day practice. Partners attracted to PBS systems are likely to be attracted to measurement and comparison; partner profit shares may become a league table whose very existence increases competition. In this environment profit sharing will be an integral part of day-to-day practice, not peripheral to it.

Having discussed worlds that may open and close to firms, on a mutually exclusive basis, as a consequence of profit-sharing methodologies, the discussion now turns to worlds that are opening and closing to all firms in the study. This is done by addressing the propositions raised in Chapter 3 and by linking the data to the literature.

6.3 Propositions supported or rejected by data analysis

As a consequence of reviewing the law firm management literature and using it to inform my experience in the field, I advanced four propositions. Following the analysis of the data, each of these propositions can be addressed in turn.

> Proposition 1 *Despite a changing demographic among employees and potentially partners, large Australian law firms maintain traditional beliefs about the utility of success tournaments.*

Interview respondents were found to have different perceptions to the likely continuance of success tournaments. The respondents from the largest firms in the sample perceive no changes occurring and none that are likely to occur; they remain confident that there will always be adequate numbers of graduates eager to participate in their employment model and compete for the prize of partnership. Accordingly, many firms see no need to change the way they select and groom partners.

Most of the respondents from smaller firms within the sample expressed concern about changes that may occur as the result of changing demographics and the potentially different needs of future generations of partners. The majority of these firms did not, however, perceive that these changes are occurring when the interviews where being conducted. While the smaller firm respondents foresaw likely change, none are changing their partner profit-sharing arrangements specifically to accommodate them.

Both PBS firms and LSE firms were found to utilise success tournaments however those firms that did not utilise success tournaments were all PBS firms. Such firms perceive themselves as offering greater flexibility and see this as creating a strategic advantage in a competitive talent market.

All firms in the sample were found to offer a variety of flexible working arrangements for employees, but few have extended those arrangements to equity partners. Where firms have extended flexible arrangements to equity partners, it is seen to be the exception rather than the rule. These observations support the proposition that success

tournaments will continue, although there will be some firms that rely on alternative performance management strategies and incentive systems.

> Proposition 2 *Because of the impact of coercive normative and mimetic dynamics in the institutional field of law, a high degree of homogeneity exists in the way large Australian law firms share profits among partners.*

Participants' comments show a high level of interest and a perceived understanding of what goes on in other firms in other words they are monitoring one another's practices regularly. Responses to interview questions concerning critical strategic challenges showed no significant difference in the perception of participants from LSE or PBS firms, lending weight to the adoption of the proposition.

Salaried partners are a common feature of Australian law firm partnerships and, in many firms integral to profit sharing methodology. The perceptions of respondents on the merits of the position of salaried partner were polarised. Four participants were strong advocates of the position, while all other participants were quick to point to the weaknesses associated with two-tiered partnerships often created by the introduction of salaried partners. The majority of respondents, however, while acknowledging the inherent problems associated with the position, plan to continue employing salaried partners. Although there is some consistency in the dissatisfaction participants expressed with the position of salaried partner, there are sufficient inconsistencies to accept the proposition in so far as salaried partners are concerned.

With the exception of two participants (both from LSE firms), who both saw strategic advantage in catering to the needs of female partners (particularly those choosing to work part-time), all participants bundle the issues of women partners and part-time partners together. The perceptions of the majority were found to show a high degree of homogeneity and trended toward those that may be expected of a traditional, male dominant partnership. Despite the apparent flexibility offered by PBS firms, perceptions of participants from those firms were consistent with those from the traditional LSE firms. This supports the proposition that law firm partners view their worlds through very similar frames of reference.

Although the profit-sharing methodologies adopted by firms in the study all involve some level of partner performance management, and they can be broadly described by the two primary models of LSE and PBS, they are all slightly different. Be that as it may, time in the partnership is still regarded as a valuable contribution by most firms with individual partner performance highly valued by all.

Although similarities exist among firms in the sample in the way they organise, structure and manage, and in their perceptions of many of the strategic phenomena under consideration, homogeneity in relation to these phenomena does not exist subtle differences and in some cases significant differences remain. On balance, the proposition as it is stated can be rejected. Had the study examined 'similarity' instead of 'homogeneity' as the subject of this proposition it would have been accepted.

> Proposition 3 *Profit-sharing systems have little impact on the relative financial success of Australian law firms.*

The comparative analysis data indicate that the significant growth in law firm profit that occurred between 1999 and 2009 in both LSE and PBS firms was, by and large as a result of price. While most firms have increased professional leverage individual lawyer chargeable hours have declined.

The comparative analysis data presented in Chapter 5 demonstrate that both high-profit and lower-profit firms can share profits with either LSE or PBS. These observations support the adoption of the proposition.

> Proposition 4 *Profit-sharing systems are not perceived to influence partner attrition, partner retention and greater gender equity in Australian law firm partnerships.*

There is no doubt that changes are perceived to be occurring in the Australian legal services market. Both the service market and the labour market are seen by most firms to be more competitive, in terms of both attracting and retaining clients and attracting and retaining lawyers. Firms all acknowledge the importance of maintaining partner

performance and minimising voluntary partner attrition. Despite this, only two firms in the sample have changed their profit-sharing system specifically to align sharing arrangements with strategic objectives and desired outcomes. Other firms in the sample have adopted PBS systems or retained LSE systems without any linkage to strategic objectives beyond profit maintenance. In the case of the latter sample sub-set, the PBS firms perceive that their sharing system makes the management of challenges occurring from the changing market easier, due in part to the perceived flexibility of PBS. The firms that remain committed to LSE are managing changes in the marketplace around their profit-sharing system, not specifically with their sharing system as a management tool.

Several firms in the sample have changed to a PBS in large part because it is perceived to assist in the management of partner retention. Ironically, in recent years PBS firms have experienced greater attrition than did traditional LSE firms (FMRC, 2009). Participants value the flexibility offered by PBS and its ability to deal with individual high performers, as required from time to time; however, attrition was seen more as a consequence of profit quantum and cultural factors than as a consequence of dissatisfaction with a particular model.

Despite the apparent flexibility offered by PBS systems, female equity partners are not represented in the partnerships of these firms in significantly greater proportion than in LSE firms (FMRC, 2009). Females form a distinct minority in all equity partnerships in the sample. All of the firms in the sample said that they would like to have a greater proportion of female partners, many firms perceive that they are actively managing their firms to achieve this ideal however it is apparent that they are not managing their partnerships to achieve a greater inclusion of and retention of female equity partners, regardless of their profit sharing system. Women are now in the majority in every employed lawyer category in every firm in the sample. Logically, this should be reflected in equity partner numbers. The fact that it is consistently not, appears to be a systemic failing. Firms acknowledge that some women do not want to be equity partners but appear to be doing little to determine why. The inclusion of women in equity partnerships remains a significant strategic challenge for the majority of firms.

Firms in the sample are managing the phenomena under examination around their chosen sharing model, not with their sharing model. They do not, in the main see

sharing methodology playing a significant role in the management of these challenges These observations support the adoption of the proposition.

6.4 Linking the data to the literature

Much of the law firm management literature comes from outside Australia. In this section, linkages are identified between established management theories from the literature and practice in Australian law firms, observed from the interview data to add to our understanding of how worlds may be opening up to or closing down to large Australian law firms.

6.4.1 Archetype theory

The debate around archetype theory was discussed in the literature review (Chapter 3). Making a definitive determination on the state of and the future direction of Australian firms' organising modalities is not central to this thesis; however, there are several interesting overlaps between elements of archetypal change, on one hand, and the reconstructed professional firm on the other. For the Archetype change theorists (Greenwood et al., 1990; Greenwood and Hinings, 1993; Cooper et al., 1996; Brock, 1999), changes in the organisation of professional service firms can be attributed to the adoption of an increased managerial pattern of practice and management. They connect developments in structures, systems and managerial values to the emergence of a new archetype, the managed professional business (MPB). There is little doubt that these changes have occurred and continue to occur in the large Australian law firms that participated in this study.

There is also evidence in the Australian profession that supports the observations of those advocating the reconstructed professional firm (Ackroyd and Muzio, 2007) as an alternative explanation to a more fundamental change of the magnitude that MPB infers. Closure mechanisms such as declining equity partner numbers (relative to total lawyers in a firm) earning larger, per-partner incomes and the lengthening of career progression by using salaried or non-equity partners are common among participating firms. At the

same time, firms have continued to grow in total lawyer numbers and in profitability per partner.

All of the participating top-tier firms have embraced centralised management for many years. The participants' approach to strategic management differs; however, they all measure firm and partner performance in a sophisticated, systemised way, embracing the use of business intelligence software and established key performance measures. All have a formal, structured approach to human resource management, marketing, knowledge management and financial management, so in a structural sense their practices reflect the managed professional businesses archetype. In a cultural sense, however, they see themselves as partners and owners; in other words, firms have moved to an MPB archetype but management remains subordinate to the partnership and most of the firms in the sample are managed by a partner, not an employed manager. In these firms, management is a tool of the partnership, subject to the direction and desired approach of the majority. Management implements the initiatives of the partnership; management does not usually drive initiative. This is evident in the interview data and in the very structure of participating firms.

Observations can be made of many of the firms in the sample that are consistent with those of Pinnington and Morris (2003) in their analysis of archetype change in large British law firms., While there is evidence of more business-like ways of operating, strategic management and decision making occur through the partnership and the scope of delegation to management is low, with many decisions requiring partnership ratification (Pinnington and Morris, 2003).

An interesting, anecdotal observation of many large Australian law firms on the progression towards an MPB comes from the phenomena around profit sharing. Among the sample of firms interviewed, only two of the participating PBS firms remunerate their management partners at a rate higher than the remuneration earned by the average equity partner. This would indicate that management is not valued as highly as individual professional contribution in such firms.

Most partnerships still value individual professional independence over a centralised managed and directed approach to the delivery of their services. The culture of the

partnership is seen by participants as the most significant strategic and managerial tool. In the Australian context any shift towards archetypal change is consistent with that observed in England by Morris and Pinnington (2003).

6.4.2 Professional closure and the reconstructed professional firm

Some researchers dispute the claim that a new archetype, the MPB has emerged Ackroyd and Muzio (2008) claim to have found only limited evidence of increased managerialism in the English profession. They propose instead that changes are, in fact, a "redrawing of the contours of professional closure" (Ackroyd and Muzio, 2008, p.151), concluding that increased managerialism is simply an expedient and rhetorical tool, utilised to protect the incomes of the professional elite, in the case of law firms, the equity partners. A study of the English profession noted changes to solicitor admission requirements, employment conditions and a declining reliance on non-lawyer support staff. Although their observations may be reflected in Australian firms, the data from Australian firms do not enable definitive conclusions to be drawn as to why these changes are occurring.

Much has changed in the Australian profession in recent years. Indeed, many of the strategies observed by Ackroyd and Muzio (2008) can be attributed to law firms reacting to prevailing market conditions. As the Australian economy has grown, many firms and partnerships have also flourished. During the mid-1990s and the early 2000s, law firms were capacity constrained, salaries increased significantly and the competition for talent became intense, even at entry level. As has been demonstrated, much of the growth in fees billed and partner profit was due to price increases, not increases in efficiency or more effective managerial approaches. Such has been the increase in price that, despite the increasingly competitive talent market and associated salary increases, salary margins (the proportion of total fees paid in salaries) have in fact declined in many firms.

The interviews do, however, indicate that some professional closure may be occurring among Australian law firm partnerships. The widespread adoption of the position of salaried partner that has occurred in Australia, despite the acknowledged weaknesses of the position evident in the data, may lend weight to the existence of mechanics that

could be interpreted as closure mechanisms. The data do not, however, show that salaried partner is being used intentionally as a closure mechanism. Far from preserving their 'elite' positions (as described by Ackroyd and Muzio, 2008), equity partners are under constant performance pressure. The data show that all firms, regardless of sharing methodology, rigorously maintain partner performance, and no partners enjoy continuing an unmanaged tenure without some form of performance management. Furthermore, many firms told me that they now expect partners to retire from the partnership in their early to mid-50s.

Ackroyd and Muzio (2008) provide evidence of closure by observing that law firms have increased professional leverage and decreased their reliance on non-lawyer support staff. The FMRC comparative financial analysis data used in this thesis does show significant increases to professional leverage between 1999 and 2009. A decreased reliance on non-lawyer support staff is, however, unclear, although it is reasonable to conclude that such a reduction would be a likely accompaniment to technological advances in the way lawyers do their work and the likely increase in the outsourcing of administrative functions to low cost jurisdictions.

The data do not enable a determination to be made in the structuring and organising debate in the Australian context, but they do clearly indicate that law firms have evolved to become economic opportunists. They are principally demand driven, expanding and contracting with economic cycles, taking advantage of contemporary technology to deliver their services as efficiently as they are able.

6.4.3 Agency theory

Much of the literature explains patterns in profit sharing in professional partnerships with agency theory, which "focuses on how organisations maximise the gains from cooperation, by adopting structures which reduce the potential for participants to pursue their individual rather than their collective self-interest" (Gilson and Mnookin, 1984, p.313).

Agency theory has emerged as one of the most important business management theories used to explain problems endemic to a wide range of business relationships. Law firm

partnerships contain a number of complex agency relationships where partners are both owners and workers, simultaneously principal and agent.

Firms are managed by the partnership to ensure the best outcome for the collective, regardless of sharing methodology. Those firms that share on the basis of performance do so with the belief that such a strategy will enable the lateral recruitment of successful partners and help to guard against agency-related problems, specifically shirking or free riding (doing less than your agreed share).

Those that share equally, after lock step progression, apply a range of social controls to ensure that underperformance is managed. LSE firms may employ coaching and counseling assistance to assist partners to improve their performance. LSE firms may sanction underperforming partners, by halting their progression through the lock step or by reversing their progression, as a temporary disciplinary measure. LSE firms may even expel a partner. The data show that these measures are not often used. These measures are usually only triggered by sustained underperformance, when the underperformance has occurred over some years.

The relatively infrequent use of sanctions indicates that agency-related problems in equal sharing firms are behaviours that occur as an exception rather than as the rule. Firms rely on the long-established culture of the partnership and rigorous selection processes to ensure that such behaviours are minimised.

The analysis illustrates the importance of partnership culture as a vehicle for performance management. This is underscored by the Managing Partners' unanimous observation that most partners are not driven by financial reward. An individual partner's profit share is seen as consequence of performance and ultimately success, rather than as a driver of performance. Managing Partners perceive that most of their partners will not change day-to-day behaviour or long-established professional behaviour to affect higher personal returns, indicating that compensation offers limited utility in the management of performance in law firm partnerships.

To the extent that compensation is used as a performance management tool, it is more likely to be employed as a punishment or as an attraction/retention tactic. Where PBS is

employed as a tool in the management of retention and the attraction of lateral partners to a firm it can be described as a strategic enabler. However, there is no evidence to suggest that PBS enables a firm to perform at higher levels than it otherwise would, under a more traditional profit-sharing system. PBS firms do not out-perform LSE firms in Australia.

At the time of writing many major Australian firms, including several in the study sample are merging with and seeking to merge with international firms. LSE represents a major barrier to these merger negotiations. Accordingly PBS may be an inevitable accompaniment to internationalisation.

The data show that PBS firms are no more successful at minimising agency problems than their LSE firm contemporaries. This suggests that performance, in most firms, is driven by cultural factors, not financial reward or punishment. In all participating firms, social controls and partnership culture are more integral to success than are sharing mechanisms. It follows that those firms with long-established cultures are more likely to succeed as equal sharers than recently established firms, often the product of merging two or more firms to form one large partnership with greater partnership cultural diversity.

6.4.4 Tournament theory

Tournament theory (Galanter and Palay, 1990; Greenwood and Empson, 2003) explains how large firms have grown and succeeded, in large part, due to the creation of a competitive tournament-like behaviour among employed lawyers who aspire to partnership. Such a tournament, it is suggested, creates an environment where participating employees are likely to work harder and contribute more than they otherwise would in the absence of tournament-like conditions. Galanter and Palay (1990) propose that expanding partnerships are an inevitable accompaniment to such a tournament.

The research shows that tournament-like processes are commonplace in most large Australian law firms. Australian firms, however, have grown and are now contracting in step with patterns in the wider economy. In the main, partner profits are being

maintained. Subsequent to gathering the interview data, many of the firms in the sample have downsized partnerships, in some cases to accommodate new partners while preserving average partner income, and in other cases to reduce total partner numbers, effectively buying back equity units to concentrate ownership and preserve the incomes of remaining partners. Success tournaments have hitherto been considered to be growth strategies, and have been used to explain the growth in large law firms (Galanter and Palay, 1990). The continuing utility of success tournaments in contracting law firms, where fewer partner aspirants are likely to achieve partnership than in a growing firm, remains unknown.

Many of the firms represented in the data enjoy 'institutional status' and many can trace their roots to firms over a century old. However, in their current form, large Australian law firms have partnerships that are only one or two generations old. The partners who built these firms into their current form (predominantly post-war baby boomers) have recently or are currently reaching retirement age. The departure of these partners from the partnership (along with the economic climate of the time) is generally causing partnerships to contract, while simultaneously providing a concentration of equity in the hands of the remaining incumbents and opportunities for associates to ascend to the partnership, albeit in lower numbers than previously experienced. The research shows firms perceive that these circumstances are likely to enable a distillation or concentration of quality. Such firms intend to admit fewer, better candidates, thus increasing the relative returns of the average partner. In all probability, this will cause a continuation of the tournament-like behaviour observed by Galanter and Palay (1990) as employed lawyers compete for fewer but larger prizes.

In a small number of firms, Managing Partners perceive that some associates are voluntarily opting out of the tournament. In these firms, it is perceived that the flexibility demanded by recent generations of lawyers leads them to conclude that the prize is not worth the sacrifice to lifestyle required to attain it. Typically such firms have moved to accommodate lawyers who do not aspire to partnership by creating the promotional position of 'special counsel'. Although many firms are no longer rigidly up or out, tournament like dynamics may be found in all large law firms and all remain hierarchical. The respondents from very large firms perceive that there will always be the required number of elite candidates willing to perform at acceptable levels to enable

them to maintain the size of partnership required of the times. Australian firms have evolved with economic times and with the changing labour market, and no participating firm remains rigidly ‘up or out’.

6.4.5 Portfolio theory

Portfolio theory (best summarised by Gilson and Mnookin, 1984) has been used to explain risk management through diversification in large partnerships. Large law firm partnerships offer opportunities for specialisation; however, specialisation is inherently risky. It is likely that demand for a specific specialised service may vary over time; some may cycle with the economy and others may be countercyclical. It is suggested that by practising in large partnerships, demand risk can be minimised.

Researchers (Gilson and Mnookin, 1984; Huddart and Liang, 2005 and others) have suggested that lawyers are, by their very nature, risk-averse individuals, practising in partnership to minimise demand risk. The data indicate that the risk burden associated with fluctuating demand is shifting from the firm to the individual, particularly among PBS firms. Historically, fluctuating demand was seen as a firm risk and provided the primary incentive to share profits equally. As some firms are changing to PBS, individual partners experiencing a decline in demand for their specialised services are likely to receive less than those partners who are experiencing high demand for their services, thereby individualising a risk that was traditionally borne collectively.

The question of whether or not law firm partnerships are individualising demand risk presents an opportunity for further research, as such a shift calls into question the very existence of large partnerships as a means of delivering professional services. If individual partners shoulder the risk of a decline in demand for their specialty, and such a decline in demand is entirely beyond their control, why continue in a structure that increases the cost of delivery, is by its nature more political than a small firm and is, in the main, perceived to require greater conformity to management systems and hence less professional independence?

The data show that both brand equity and national practice are perceived to be more significant motivators for large firm practice than risk minimisation. There is no

observable difference in these perceptions between PBS firms and LSE firms. The data from all firms indicate that benefits perceived to flow from phenomena such as brand equity and geographic reach may contribute to our understanding of 'the form of the firm' and provide greater utility as an explanation for the existence of large firms than traditional portfolio theory and its assumption of risk minimisation.

6.4.6 Gender studies

In recent times, researchers (Bolton and Muzio, 2009; Philips, 2005; Noonan, Corcoran and Courant, 2007 and others) have explored what some term 'the plight of female lawyers'. An increasing number of employed lawyers in large law firms are female yet these changing demographic trends are not reflected in the gender makeup of law firm partnerships, particularly equity partnerships.

Profit-sharing systems were not found to influence greater gender equity in partnerships. The data are consistent with research focusing on the plight of female lawyers. The majority of Managing Partners in the sample perceive that employed female lawyers are not intentionally excluded from joining the partnership. Instead, many female lawyers are perceived to 'opt out' of tournaments to partnership, preferring other roles or other employment offering greater flexibility. Participating Managing Partners from both PBS and LSE firms (with some exceptions) perceive that true equality involves applying the exact standards for progression to female and male lawyers alike, making no allowances for the specific needs of either gender.

Part-time arrangements are perceived by both PBS and LSE firms, in the main, to be gender specific and relate, by and large, to women having and raising families. All firms in the sample appear to tolerate the concept of part-time partnership (although many do not have part-time partners) as an exception to, rather than part of, their profit-sharing systems. Part-time equity partners are in stark minority in all participating firms, both PBS and LSE. Part-time equity partnership is tolerated by many and perceived as a necessary evil by all.

There are, however, some firms in the sample that perceive themselves to be more 'female friendly' than many of their contemporaries. Somewhat ironically, these firms

are traditional LSE firms and their perceptions are yet to be reflected in the makeup of their equity partnerships. There is no evidence to suggest that PBS firms are utilising the flexibility inherent in their sharing arrangements to accommodate a greater proportion of female equity partners, nor is there any evidence to suggest that these accommodations will not occur in coming years. The data do not show that women are intentionally excluded; on the contrary, most participants stated that they would like to have more female equity partners. However, the data do not indicate the adoption of strategies and approaches aimed at achieving this.

6.5 Chapter summary

This chapter has addressed the propositions advanced in the literature review. Three of these propositions were supported by the data and one was rejected. The chapter also provided linkages between the international literature and the data from Australian law firms.

The following chapter presents the conclusions and the answers to the research questions. It also provides recommendations for policy and practice and suggestions for further research.

Chapter 7 Conclusions

7.1 Introduction

This research examined changes occurring in large Australian law firms, focussing on profit-sharing systems and the phenomena that surround them. This chapter presents the conclusions drawn to answer the research question and sub questions. It summarises and highlights the results of the study and its contribution to management practice, and makes recommendations for further research.

7.2 The research questions answered

This thesis has used hermeneutic phenomenology to increase our understanding of Australian law firms. The research question at the centre of the thesis is:

> What are the likely experiences that open up or close down to law firms as a result of their chosen profit-sharing methodology?

To answer the central research question, I asked secondary questions around the perceived consequences of the two dominant approaches to profit sharing in large law firms:

- How are partnerships changing the way they share profits?
- Why are partnerships changing the way they share profits?
- What do leaders of firms perceive are the human and cultural consequences of change for the phenomena surrounding sharing?
- What is the impact of change on organisational performance?

7.3 Profit-sharing methodologies: How and why are firms changing?

According to the international law firm management consultant and author David Maister (1993, p.255) “profit sharing arrangements between partners are among the most difficult set of issues in professional service firm management”. The way partners share profit goes right to the heart of a firm, what it values, the behaviours it seeks to

foster and reward, the way it defines and recognises contribution and the people it chooses to promote. There is no doubt about the difficulty of these issues, nor about their importance.

Australian firms are changing their profit-sharing arrangements to affect a greater focus on individual performance, replacing a traditional focus on collective performance. There has been a demonstrable shift in all large law firms towards more active formalised, institutionalised management of *financial* performance. In many firms, this shift also encompasses the management of non-financial performance criteria. All of the firms that participated in this exercise are acutely aware of individual and collective partner performance; no firm considered partnership to be a long-term tenured appointment, such as that enjoyed by the owners of other businesses. Although some reflected a greater tolerance for underperformance than others, continuing as an equity partner appears to be conditional on the maintenance of agreed or at least tacitly understood performance parameters, in particular, financial performance parameters.

Regardless of the sharing methodology employed, the performance of individual partners is monitored and often controlled. Monitoring methods vary among firms – some are formal and some informal – but the performance of individual partners is central to all. In addition to individual monitoring, partners are accountable for the performance of their direct reports and the economic contribution of their work group.

Where performance criteria are clearly defined, they seldom attract equal weighting. Despite the potential for strategic enablers such as staff management and development skills, contributions to management and process development and contribution to culture, these skills are usually subordinate to financial performance and client attraction in the majority of peer-to-peer assessments at partner level.

Few firms remain rigidly lock step. Those that do are intolerant of underperformance. Partner selection is perceived to be more rigorous by the firms themselves and focuses on cultural fit above all other selection criteria, thereby advancing the prospect of traditional methodologies being retained.

The majority of firms that describe themselves as lock step to equality are, in fact, modified lock step firms. These firms no longer progress all entrants in equal lock step to equality. They have modified their traditional lock steps to include one or more performance gates, allowing lock stepping partners to progress only if they meet agreed performance standards as they progress to full equity. Such a partner may have their progression halted temporarily until performance concerns are addressed or their progression may be halted permanently if, for example, their area of specialisation will never enable them to attain agreed performance standards. This is an example of firms individualising a demand risk that has historically been shared by the entire partnership.

In addition to modifying lock step progression, the maintenance of equality at the completion of the lock step has been relaxed. Partners can be stepped down as a sanction or they may step down voluntarily as they approach retirement. The firms that have modified their lock steps to incorporate performance flexibility see the exercise of such flexibility as a rare exception, not the rule, which explains their perception of the maintenance of lock step to equality. This is perceived to be extremely important to their partnership culture, albeit implemented with tolerance for flexibility. They further perceive that tolerance of flexibility within the lock step is more likely to enable this sharing methodology to continue longer than it otherwise would under a pure lock step, explaining why some firms are changing aspects of their LSE model but are not changing from LSE to PBS.

This study shows that, among this sample, lock step to equality is a more effective strategic enabler than performance-based sharing and is used by its proponents to great effect. The perceived importance of a homogeneous, well-understood partnership culture that fosters client sharing and mutual support to both profitability per partner and the maintenance of brand equity is an unequivocal finding of this research. LSE firms have been able to advance their strategic endeavours through the maintenance of such a culture. Few PBS firms have achieved similar outcomes.

PBS firms seldom link their sharing methodology to strategy, although there are exceptions. In the main, however, performance sharing is often adopted in the belief that financial incentives will increase individual partner performance or that the profit outcomes of the collective can only be maximised if there is a mechanism to punish

those who contribute less than their agreed share. This research calls into question the accuracy of these axioms.

Although some firms are using performance sharing as a strategic enabler (by using their agreed strategy to formulate partner performance criteria and subsequently profit sharing), most do not. In the majority of PBS firms, partnership culture develops autonomously from management and may also occur differently in departments or local offices. The propensity of these firms to merge with other firms, acquire firms and recruit lateral partners as a part of their growth strategy often, though not always, limits the use of partnership culture as strategic tool. As a consequence, these firms appear to have little strategic focus beyond growth and short-term profit maximisation (they generally perceive growth and profit maximisation to be a function of one another).

Despite this, there is a discernible shift away from lock step to equality and towards performance-based sharing. This change may be occurring for a number of reasons: 'noisy' high-performing partners (who may be dissatisfied with the apparent inequity of equality) may be retained; lateral hire partners may be attracted and guaranteed an income often significantly higher than that earned by an average partner; part-time partners and lesser-performing partners can be dealt with and management consultants to the profession may promote the change because of the methodologies' apparent axiomatic relationship to performance; or firms may be changing simply because others are doing it. All these factors have contributed to and continue to contribute to this shift towards PBS. In other words, firms are changing for some or all of these reasons.

It can be reasonably concluded from the research that in many firms the change towards performance-based sharing is symptomatic of a greater focus on individual interest and a lesser focus on collective interest. In these firms it is likely that demand risk, historically borne by the entire partnership, will be increasingly borne by individual partners, making some areas of specialisation less attractive than others and the early decision to specialise (a decision made in the first few years of practice) critical to a lawyer's career success. Such a change is likely to cause further specialisation within firms as lawyers shun less remunerative services, preferring to specialise in growing practice areas where there is little demand risk. This may, in time threaten the existence of large 'full service' law firms.

No one sharing methodology is, in and of itself, superior to any other. All profit-sharing systems contain inherent strengths and weaknesses. As several of the participants in the research observed, any system can be made to succeed, relative to its objectives. This study has shown that there are highly successful firms utilising a variety of methodologies. The capacity to draw definitive conclusions about the superior nature of one methodology over any other is, in large part, frustrated by the as yet unexplained phenomenon of 'partnership culture'. It can, however, be said that partnership culture is simultaneously a creation of, and in large part is created by, successful sharing methodologies. An exploration of the phenomena around partnership culture is an opportunity for further research.

The axiomatic assumption that the prospect of greater reward will improve the performance of individual partners by providing a link between incentive, performance and reward – and ultimately the increased success of the firm – is not supported by this research. Similarly, the belief that equality will inevitably lead to agency-related problems of shirking, grabbing and leaving and ultimately reduce firm performance is not supported.

7.4 The human and cultural consequences of change

Table 5 summarises the impact of the two main sharing methodologies studied on strategic phenomena occurring around them.

Table 5

The impact of sharing models

	Lock step to equality	Performance sharers
Relative success	Not more or less profitable	Not more or less profitable
Partner attrition	Attrition relatively low Low levels of lateral recruitment Stable partnership culture through internal promotion to partnership	Attrition relatively high High levels of lateral recruitment Partnership culture less clearly defined, may vary among practice groups and between offices particularly in recently merged firms

(continued overleaf)

Table 5 (continued)

	Lock step to equality	Performance sharers
The use of salaried partners	Few use SPs SP considered temporary as a part of progression SPs usually paid on performance despite observed benefits of equality at equity level Some have recently changed back or are currently changing back to single tier Lock steps are lengthening as an alternative to SPs	All use SPs Many identify weaknesses in two-tiered partnership but persevere with it SP used to manage flexibility requirements, particularly for female lawyers SP used as a 'try before you buy' test SP used to effectively lower the bar to partnership as a retention strategy
Partner performance management	Both formal and informal monitoring Both formal and informal control Strong use of social control Low tolerance of perceived underperformance Perceived high performance pressure	Formal monitoring Formal control Greater flexibility in allowing partners to play to their strengths Higher tolerance of underperformance through ability to punish High reward for few and lowering of the performance expectations on some Lowering the bar to improve attraction and retention
Changing practice demographics	Little change occurring in the proportionate numbers of female equity partners Female partners perceived as capable as existing male equity partners make it Low representation of females in equity partnership Tolerance of flexibility for women Low tolerance of flexibility for men Traditional male-dominated orientation	Little change occurring in the relative number of female equity partners Large representation of women in salaried partnership Low representation of women in equity partnership Flexible arrangements offered as an exception Flexibility seen as gender specific
Success tournaments	High confidence in tournament continuing, unabated High confidence that there will always be sufficient quality graduates opting in to the tournament	Many see people opting out of tournament or the potential for it Some lowering of the entry bar to partnership as a retention strategy Some don't use a tournament, instead allowing lawyers to work at agreed levels and to have long-term salaried careers
Use as strategic enabler	Maintenance of traditional, collegiate, high-performance cultures.	Usually not used as a strategic enabler Used to aid management of attraction and retention Used to provide flexibility to tolerate different performance levels Profit sharing overtakes strategy requiring annual attention and review

Returning to the central research question – 'What are the likely experiences that open up or close down to law firms as a result of their chosen profit-sharing system?' The following conclusions can be drawn. LSE firms are more likely to experience a collegiate high-performance culture. LSE firms are more likely to remain 'full service' firms than their PBS contemporaries, as PBS firms continue to individualise demand risk. As a consequence of entrenched traditional orientations, LSE partnerships are likely to remain male-dominant for the foreseeable future. It is also likely that LSE firms will maintain a high-performance culture, admitting only new equity partners considered capable of achieving 'acceptable' performance.

It is likely that PBS firms will become increasingly specialised, be that around industries or areas of practice. PBS firms are likely to be more attractive to lawyers seeking flexibility in their working arrangements and those seeking recognition and reward for higher than average performance. In a 'tight talent market' this is likely to create a competitive advantage for PBS firms.

The flexibility inherent in PBS is likely to provide a strategic advantage to firms seeking merger partners in Australia and abroad. Flexibility in PBS is also more likely to appeal to new, female-dominant generations of Australian lawyers.

The worlds that definitively close to a firm as a result of profit-sharing systems are scant. This research has shown that any system can be made to work, and therefore it is problematic to draw conclusions as to the superior system. It is, however, a salient point that no firm in the study has moved from PBS to LSE. Where changes are occurring they are all towards PBS or greater performance management within an LSE.

7.5 The phenomena around profit sharing

Several specific challenges, germane to all law firms in Australia, emerge from the phenomena around profit-sharing arrangements. It is not the intention of this thesis to provide proven solutions to any of these phenomena but to shed light on them, allowing better clarification of both cause and effect, possibly encouraging further research.

7.5.1 Partner attrition

At the time of data collection, partners were more mobile than ever before. Traditionally, partnership was considered to be a long-term, indeed permanent, appointment. Partners occasionally left a firm to pursue a career outside the private law firm profession, as a corporate senior counsel, for example, but moving from one firm to another seldom ever occurred. This has been observed historically in both UK (Pinnington and Morris, 2003) and US (Gilson and Mnookin, 1985) law firms.

There are many possible explanations for the apparent increase in partner mobility. This thesis has concerned itself with one: the impact of chosen profit-sharing methodology on partner attrition and partner retention.

No participant perceives a causal link between sharing methodology and partner attrition; most cite relative quantum of individual partner income as the primary driver of partner attrition. Nonetheless, voluntary partner attrition is perceived to be highest among performance-based sharers.

It is likely that increased partner mobility is a by-product of the profession's ever-increasing focus on performance management, exemplified by pure performance-based sharing. There are several reasons for this observation. Employed lawyers have been in a 'performance incubator' for many years. Budgets are set, performance is constantly monitored, performance and career progression are regularly and formally reviewed relative to a firm's performance expectations and salaries are negotiated accordingly. If the reviewed lawyer becomes dissatisfied with the outcome of this process they are likely to leave, seeking employment at another firm where they perceive more likely prospects of success.

When partner mobility was low, so was employed lawyer attrition. During this time there was little performance pressure; progression in many firms was more a matter of fit than form (fitting into the partnership culture rather that producing outstanding individual financial performance). Firms saw themselves as members of a collegiate fraternity, not competitors, and the great majority of firms shared profits equally. It is

likely that partners employed during these years developed greater cultural attachment to their organisations and that this attachment was reflected in low attrition.

It is also likely that lawyers who have spent their entire career in a formal performance-management process may exhibit less organisational attachment and place a higher priority on individual achievement than on collective achievement.

Additionally, the data show a trend away from the collective sharing of demand risk towards an individual risk burden, particularly among performance-based sharers. This apparent trend may be accompanied by a shift away from collective aspiration to individual aspiration as a priority for many law firm partners, particularly younger partners conditioned to the management of individual performance.

The fact that the widespread adoption of performance-based sharing coincided with the arrival and acceleration of partner mobility may, in fact, not be coincidental at all. The data do not show any causal relationship between PBS and attrition; however, this is an interesting supposition worthy of further research. It may be the case that law firms adopting performance-based sharing in part due to its apparent utility as a retention management tool are, somewhat ironically, managing attrition with the very tool that creates or perhaps exacerbates it.

Nonetheless, partner performance management is perceived necessary by PBS firms and LSE firms alike, and this is dealt with more fully below. Many participants attribute their evident success directly to partner performance management. Interestingly, though, this increase in performance focus has had little impact on the quantity of work done by each individual lawyer; two of the firms in the dataset have lawyers that do no more chargeable activity than they did 10 years ago. The remainder of the sample have lawyers that do less chargeable activity than they did 10 years ago, as indicated by comparative utilisation rates across the 10 years 1999 to 2009. There is no observable difference between the utilisation rates of lawyers in PBS firms relative to LSE firms. Success can, by and large, be attributed to price increases rather than profit-sharing systems.

Firms that have retained an LSE system are less likely to recruit lateral partners and more likely to promote internal candidates who have been employed by the firm for many years. In such firms, it is more likely that partners feel a greater attachment to the culture of the partnership and place a higher priority on collective success than their contemporaries in performance-sharing firms.

7.5.2 Partner performance management

Sharing methodology has little impact on partner performance. Among the ranks of high-performing firms are both performance sharers and lock step firms. More often than not performance sharing is used as a tool to manage perceptions of inequity in an environment characterised by differentials in partner performance, not to create performance through an agency-based incentive – performance – reward process.

The social pressure that accompanies equal sharing does not, in and of itself, increase performance. In either model and in the variants of either model, performance is perceived to be a function of the culture of the partnership and the effectiveness of both monitoring and control.

Not surprisingly, LSE firms are perceived to be ‘harder’ on acknowledged underperformers than performance-sharing firms, by those outside them. The data do not, however, support this perception. PBS firms were found to be no less tolerant of underperforming partners than their LSE contemporaries. Sanction often occurs quickly in a PBS firm, it occurs relatively slowly in an LSE firm, often requiring several years of acknowledged underperformance before partners are sanctioned or expelled from the partnership.

If firms have changed or are changing to performance-based compensation with a view to increasing partner productivity, the strategy is not working; lawyers do no more chargeable hours on matters now than they did 10 years ago, and many firms have lawyers that do considerably less. It would appear that firms have changed and are changing to enable them to reward those that do the most and punish those that do the least, not to improve the average partner contribution. There is no indication that changing to a PBS sharing system improves law firm profitability per partner.

7.5.3 Changing practice demographics

The data do not lead to a conclusion that law firms have made significant steps toward 'gender equity'. In the main, firms are yet to define it. Some perceive themselves to be champions of their interpretation of equality; others don't see the need to adequately define 'gender equality' at partnership level, let alone manage it.

In all firms represented in this study, relative numbers of female lawyers entering firms as junior lawyers stand in stark contrast to the number of women that become and remain equity partners. The reasons for this are a matter for further research.

The impact of chosen sharing methodology on the promotion of greater gender equality is not made clear by this study. The study does, however, show that it is particularly difficult for female lawyers to become successful equity partners in LSE firms. Furthermore, it is extremely unlikely if they choose to work part-time; it can and does happen but it remains a proportionally rare exception.

The internally homogeneous cultures that have been integral to the sustained success of LSE firms provide a barrier to any lawyer that is not perceived to fit in. Consequently, female lawyers that become successful partners have achieved by exhibiting the behavioural characteristics considered desirable by their predominantly male partners: equal reward for equal effort.

To the extent that conclusions can be drawn, PBS firms appear more likely to accommodate the needs of female partners and those of their male counterparts seeking greater career flexibility, although there is no evidence from the data that these accommodations are currently occurring at equity partner level.

7.5.4 Changing partnership structures (the use of salaried partners)

In 1999, the majority of the firms represented in this study had equity partnerships. When the data were gathered, all but two had moved to two-tiered partnerships, with both equity and non-equity partners. At the time of writing, four of the firms represented in the dataset have moved back to single-tier partnerships.

The data show mixed perceptions about the success of two-tiered partnerships. Some participants champion the position, citing benefits such as greater flexibility to retain partners perceived incapable of contribution levels expected of equity partners but good enough to retain, the usefulness of a trial period to assist in the management of a risky promotion decision or to trial laterally recruited partners and, for a minority of firms, to enable them to pay laterally recruited partners more than their equity partners earn. Other participants have retained the position but perceive inherent weaknesses in so doing, citing the inevitability of a two-tiered culture accompanying their two-tiered partnership.

The data show that non-equity partnership is utilised to maximise professional leverage by extending the time interval between admission as a solicitor and promotion to equity partner. In this way the returns enjoyed by the incumbent equity partners are maximised, perhaps lending weight to the creation of professional closure regimes proposed by Ackroyd and Muzio (2007). There is, however, no evidence from the data to suggest that closure is a specific driver. It is more likely that retention and flexibility are driving the continued use of salaried partners.

Non-equity partnership is more likely to be perceived as a successful construct where it is a temporary promotional position, a stepping stone to equity partnership, and it is accompanied by cultural inclusion in the wider partnership. Where apparent hierarchies exist between non-equity and equity partners, it is less likely to be perceived to be successful. PBS firms have the greatest potential to operate single-tier partnerships, paying the equivalent of non-equity partners what they would otherwise earn as actual non-equity partners but including them in the equity partner fold. The data show, however, that performance sharers are more likely to retain the position than abandon it. Three of the four firms that have shifted away from a two-tiered structure in recent years are LSE firms.

The data show that the perceived importance of maintaining one partnership culture to success is such that LSE firms are less likely to have non-equity partners, despite the apparent utility of an alternative to equal reward for equal contribution. As a consequence, non-salaried partnership is, counter intuitively, more likely to be perceived successful in performance-based sharing firms.

7.5.5 The ongoing use of competitive success tournaments

The literature discusses the role of success tournaments in the creation of the modern, large law firms in Canada (Galanter and Palay, 1990). This study has confirmed this in Australian law firms. What remains undiscussed is the impact that various sharing methodologies have on the perpetuation of these tournaments.

Partnership tournaments exist in both PBS firms and those with LSE. While there is a concern among some of the participants that these tournaments may be under threat from good employed lawyers 'opting out', there is no evidence (beyond isolated, anecdotal examples from experience in the field) of this happening. The fear that 'people don't want to be partners any more' is exactly that, a fear not a fact. The data show that, despite some fear of employees potentially opting out of tournaments among participants, many employed lawyers still aspire to partnership in all of the firms represented.

It is highly unlikely that any of the participating firms will ultimately fail due to a lack of partnership candidates. It is true that it now takes the average lawyer longer to attain partnership, and fewer will get there. Those that do become equity partners will, however, quite likely earn more than their predecessors as partnerships shrink and individual partner incomes rise. It is also likely that they will be partners for a shorter period of time than their predecessors, as firms enforce retirements through their partnership cultures. This may have the effect of intensifying the tournament, forcing aspiring employees to work harder to achieve a shrinking number of available partnership positions, each carrying a greater prize.

Even though success tournaments are likely to continue, firms have created alternative career paths for those senior employed lawyers perceived sufficiently capable to keep, if not promote. No firm in the data set remains rigidly up or out. The desire to maintain leverage structures, in a competitive talent market, has driven this change and is likely to maintain it.

7.6 The impact of change on organisational performance

Historically, some firms have placed much trust in the apparently logical axiomatic relationship between incentive, productivity and reward. They were not alone; indeed it appears to have been a widespread perception within the population of large Australian law firms and their management advisors. This widely held perception explains, in part, why many firms have changed their sharing methodology from LSE to PBS, doing so with the belief that productivity gains are certain to follow. What has become clear from this study is that productivity gains may not necessarily follow a change to PBS.

It is beyond the scope of this thesis to detail specific advice, nor is such advice sufficiently general to enable the documentation of a standard approach. What is possible is an articulation of the fundamental observations that should now influence industry practice among large law firms. This advice is best summarised by cautioning firms against thoughtless tinkering, such as changing their profit-sharing arrangements as a result of observed changes in competitor firms or as a result of a belief in management axioms around incentive, reward and performance. These guiding observations are;

- Lock step to equality is not an outdated anachronism. It can produce and maintain a highly productive culture if managed well.
- Prior to moving away from lock step to equality, firms should examine the culture of their partnership to determine the value placed on collegiality, the pursuit of collective success, and its impact as a performance driver and capacity to manage performance outliers, both over and under.
- Changing from lock step to performance-based sharing is likely to decrease collegiality by individualising demand risk.
- Changing from lock step to performance-based sharing is unlikely to increase total firm profit.
- Changing from lock step to performance-based sharing will not necessarily provide greater diversity in the partnership.
- Performance-based sharing offers little utility as a performance management tool.

- Performance-based sharing offers little utility as a strategic enabler.
- Performance-based sharing provides greater flexibility to manage tactical challenges, but this flexibility may come with the cost of an uncertain partnership culture.
- Performance-based sharing can, and does, change perceptions of inequity among partners but offers little as a means of increasing average partner income.
- Any change should occur in full light of the relative strengths and weaknesses inherent in all models considered.

7.7 Contributions to management practice

This research concludes with the following recommendations for management practice within Australian law firms and for the wider legal industry within Australia.

7.7.1 On sharing methodology

The findings of this thesis have implications for the legal industry in Australia. Lawyers are often accused of being slow to change. In some respects, the pace of change may have a deleterious effect on law firm performance, in others respects it has contributed to the ongoing success of some firms. The consequences of change or lack of change are outlined here.

An increasing focus on the management of lawyer and law firm performance has characterised the last 20 years of legal practice in Australia. In other jurisdictions, researchers (Greenwood and Hinings, 1993 and others) have observed a movement in organisational archetype, towards that of a managed professional business with strategy focused on firm performance and an increasing managerial or businesslike approach to practice. There is little doubt about the impact that this change has had on the culture of law firms and the practice of law within the private profession, but what of the impact on firm performance? The data in this study support the observation that large Australian firms have become increasingly managerial in their focus. This change has not been accompanied by significant industry gains in lawyer productivity. Controlling for price increases, lawyers are, in fact, no more productive than they were 10 years

ago. Firms may be better placed to deal with increased competition, deregulation and the commoditisation of their services but at an individual level an increasing managerial focus has had little impact on lawyer performance, if any.

It could be argued that an increased performance focus has enabled firms to maintain performance in the face of a rapidly changing practising environment characterised by increasing competition and commoditisation. It could also be argued that, although the quantum of work done by lawyers, per lawyer, has not changed, the amount of activity performed within each hour of lawyer time has increased and is reflected in price, that is, the relative value of each hour. Were they to be made, both of these claims remain untested, are unexplored by this study and are an interesting area for further research.

The change that has occurred in many firms, away from LSE towards models that involve greater scrutiny of and reward for individual performance, has had little measurable impact on firm performance. Although there is some evidence of an axiomatic belief that performance-based compensation will increase law firm performance, there is no evidence of performance increases as a result of a change to PBS occurring in the data. Performance-based sharers are no more or less likely to succeed than their contemporaries as a direct result of chosen sharing methodology.

This study concludes that PBS offers little utility as a strategic enabler. Where it is used successfully it is used as a pragmatic tool to manage retention, career flexibility, lateral partner attraction and the placation of ‘noisy’ high achievers. Although PBS may provide incentives for individuals to perform at higher levels than they otherwise would, there is no evidence of this actually happening, to the ultimate benefit of increasing law firm profitability per partner.

Law firm mergers are an important exception to the above observation. Although some large international firms have negotiated successful mergers and retained their LSE sharing systems it is doubtlessly easier to merge firms from different countries in a PBS environment. Differing price (English and US law firms have historically charge significantly more for partner time than their Australian contemporaries) and fluctuating exchange rates are likely to make LSE inoperable. At the time of writing international partnerships are being formed and the Australian dollar is trading at 108 US cents.

Should the exchange rate return to its long term average of 72 US cents it will effectively produce a 33% decline in the financial contribution of an Australian partner. This is unlikely to be tolerated in an equal sharing environment.

Ultimately success appears to be a function of partnership culture or 'ethos', as described by Empson (2007), working in conjunction with price increases. It would seem that all and any sharing systems can be made to work, subject to the retention of a collegiate partnership culture in which collective interest is not subordinate to individual self-interest.

Accordingly, firms seeking to improve financial performance should focus on partnership culture before they seek to change traditional sharing methodologies. They should examine the likely impact that any proposed change may have on the culture of their partnership and the delicate balance of collective relative to self-interest. Ultimately, they will need to decide their future sharing arrangements, examining the high cost of monitoring relative to any perceived benefit that may eventuate from change.

7.7.2 On partnership structures

Although some firms have stepped away from two-tiered partnership, it is likely to continue as a position, despite widely acknowledged weaknesses.

The ultimate impact on firm success of two-tiered partnership remains largely untested. Where it is perceived to be successful there is a commitment to one internally homogenous partnership culture. This is achieved through total inclusion and the absence of hierarchical structures within the partnership. Few firms achieve this state, choosing to tolerate a less than ideal structure to achieve the pragmatic ends of retention, attraction and a lengthening of the progression from solicitor to equity partner.

I would recommend that firms considering introducing the position of non-equity partner should be guided by the observations of those firms that have them already, and

explore alternatives such as lengthening their lock steps or accommodating lesser or greater performers within their PBS systems as a superior strategy.

7.7.3 On partner performance

Partner performance does not appear to alter as a direct consequence of sharing methodology. The conclusion that individuals respond to contracts that reward individual performance (Prendergast, 1999), appears to have limited utility in the management of law firm equity partners.

Equity partners are more likely to correct poor performance or maintain high performance as a result of social control mechanisms than financial incentive.

7.7.4 On promotion-to-partner tournaments

Although some law firm leaders are concerned about large numbers of lawyers opting out of success tournaments seeking instead non partner careers, there is no evidence of this occurring in such numbers as to render it significant, certainly among large law firms.

There has been an enduring perceived correlation within and among many outside the legal profession between ‘career success’ and partnership. This perception appears to continue. It is, however, likely that fewer lawyers will progress to partnership, as a proportion of willing candidates, if partnerships continue to shrink. At the moment, firms have stopped growing and partnerships are shrinking. The ongoing management of those who aspire to partnership but are unsuccessful in fulfilling their aspirations is an area for further research and ultimately recommendations for practice. Tournaments, by their very nature, produce winners and losers. The successful management of a growing number of losers may have a greater impact on the standing of the profession and an individual firm’s employment brand than the ever-increasing success of the winners.

7.7.5 On changing demographics and greater inclusion of women in equity partnerships

The data and their interpretation show no direct gender discrimination. Partnership candidates are assessed in all participating firms on their relative strengths and weaknesses, regardless of gender. Among performance-based sharers there is no apparent gender discrimination at equity partner level. Despite this, the reality of the gender imbalance in the partnerships of all participating firms cannot be ignored.

Female lawyers have formed the majority of graduating classes in Australia for more than 20 years. Female lawyers currently form the majority of all employed lawyers in the participating firms yet their numbers are in the significant minority in the equity partnerships of these firms.

Modern society accepts the inherent equity in gender equality and has done so in many countries for many years, but this ideal is far from the reality of the modern law firm partnership. It is reasonable to conclude that current strategies aimed at retaining and promoting female lawyers are failing.

Whether or not excessive performance expectations, long-established male dominated cultures, perceived client preference for male partners, or the frustration of balancing the roles of primary carer role and law firm partner contribute to the apparent imbalance remains, by and large, unanswered and is beyond the scope of this thesis. It is, however, unlikely that so many female lawyers are voluntarily opting out of partnership, en masse, as some law firm leaders perceive. The imbalance between female equity partner numbers and female employed lawyers is such that there must be a systemic explanation for it. I would suggest that the maintenance of success tournaments and ultimately ongoing success in an environment of changing gender demographics depend on successful exploration and investigation of this important phenomenon.

7.8 Further research

Current experience in the field indicates that the magnitude of these continuing challenges is likely to increase, not abate, with the passage of time. With the post-GFC economic climate upon us, many firms have changed from being price setters to being price takers, with clients now dictating legal fees and demonstrating a willingness to move from one firm to another, seeking lower prices for their legal services. Hourly rate has ceased its annual growth for the first time in 15 years. Similarly, firm growth strategies are being re-thought. In this climate, observation, discussions and recommendations from the data become even more pertinent.

The phenomena explored in this thesis are not straightforward. As such their investigation prompts more questions, all worthy of further investigation. Suggestions are presented here in no order of merit or priority.

Partner attrition continues to be a feature of some law firms and an irrelevance for others. While this thesis examines the relationship between sharing methodology and attrition, a wider examination of this phenomenon is justified.

It is easy to observe managerial change in Australian law firms. Firms have grown in size and geographic reach. They employ a cadre of management personnel specialising in finance, human resource management, marketing, information technology, knowledge sharing and general management. As a profession, lawyers have seen the rise of organisations, associations and publications pertaining directly to law firm management. In several Australian jurisdictions, management training is mandatory. While this increased managerial focus has produced a variety of important changes, increased lawyer productivity does not appear to be among them.

Australian firms are consistently outperformed in this regard by their international contemporaries. The apparent rigidity of lawyer utilisation in Australia relative to the performance of firms in other countries and relative to a significant investment in managerialism is worthy of further investigation.

The historical significance of price to profit, and its capacity to endure as the legal profession in Australia becomes increasingly competitive and commoditised, should prompt further research. Are price increases reflective of relative value (amount achieved within an hour of time for instance) or are they reflective of monopolistic market control or other prevailing phenomena? Whatever the answer, it has significant consequences for the continued success of this important sector of the Australian economy.

Noting the contribution of Empson (2007) on partner ethos, more research is required to fully understand the nature of partnership culture. The genesis of, contribution to and utilisation of partnership culture is worthy of further examination. The evident importance of what participants describe as partnership culture and its relationship to Empson's partner ethos is worthy of some investigation. Are these synonymous terms or is one a subset of the other? If ethos is a subset of culture, what are the component parts and how may they be managed to best effect?

Finally, the poor representation of females among equity partner numbers should be examined. The data show that this is occurring as a result of uncertain phenomena. Greater certainty around gender equity at equity partner level would be a valuable contribution to the sustained success of law firms.

7.9 Limitations

This is an applied research project utilising action research to answer a specific question for a specific client. Nonetheless, generalisability of the conclusions and industry policy recommendations remain valid for large firms in the Australian legal profession, particularly mid-tier firms, an expanding segment of the market currently experiencing great change.

Generalisability into other professional service industries and non-Australian jurisdictions is limited. This study required finite sampling; the size of the Australian legal market is very small when compared with that of the UK or the USA. Although the sample was a large proportion of eligible firms, it would be considered small in

other jurisdictions; this may impact on the weight of the findings were they to be transposed onto other international markets.

This study concerns itself with the perceptions of law firm leaders. Managing Partners, Chairs of partnership and CEOs usually have a prescribed term of office – they come and go. At the time of writing, two of the Managing Partners that participated have subsequently retired. It is likely that leader perceptions will change with successive generations of Managing Partners, limiting the validity of the conclusions into the future.

All of the participants in this study are male and they were all in the firm's most senior management position when the data were gathered. This is a limitation. Non management partners both senior and junior, women and men could have added to the study, as could the inclusion of non equity partners and senior employees.

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Appendix

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Dear Mr Oakes

FINAL APPROVAL

Title of project: "Factors influencing the adoption, rejection or modification of partner compensation models at leading Australian law firms and the impact of the models on partner performance and retention"

Thank you for your recent correspondence. Your response has addressed the issues raised by the Committee and you may now proceed with your research.

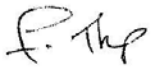
Please note the following standard requirements of approval:

1. Approval will be for a period of twelve (12) months. At the end of this period, if the project has been completed, abandoned, discontinued or not commenced for any reason, you are required to submit a Final Report on the project. If you complete the work earlier than you had planned you must submit a Final Report as soon as the work is completed. The Final Report is available at: http://www.research.mq.edu.au/researchers/ethics/human_ethics/forms
2. However, at the end of the 12 month period if the project is still current you should instead submit an application for renewal of the approval if the project has run for less than five (5) years. This form is available at http://www.research.mq.edu.au/researchers/ethics/human_ethics/forms If the project has run for more than five (5) years you cannot renew approval for the project. You will need to complete and submit a Final Report (see Point 1 above) and submit a new application for the project. (The five year limit on renewal of approvals allows the Committee to fully re-review research in an environment where legislation, guidelines and requirements are continually changing, for example, new child protection and privacy laws).
3. Please remember the Committee must be notified of any alteration to the project.
4. You must notify the Committee immediately in the event of any adverse effects on participants or of any unforeseen events that might affect continued ethical acceptability of the project.
5. At all times you are responsible for the ethical conduct of your research in accordance with the guidelines established by the University http://www.research.mq.edu.au/researchers/ethics/human_ethics/policy

If you will be applying for or have applied for internal or external funding for the above project **it is your responsibility** to provide Macquarie University's Research Grants Officer with a copy of this letter as soon as possible. The Research Grants Officer will not inform external funding agencies that you have final approval for your project and funds will not be released until the Research Grants Officer has received a copy of this final approval letter.

ETHICS REVIEW COMMITTEE (HUMAN RESEARCH)
LEVEL 3, RESEARCH HUB, BUILDING C5C
MACQUARIE UNIVERSITY
NSW, 2109 AUSTRALIA
Ethics Secretariat: Ph: (02) 9850 6848 Fax: (02) 9850 4465 E-mail: ethics.secretariat@vc.mq.edu.au
http://www.research.mq.edu.au/researchers/ethics/human_ethics

Yours sincerely



P.P

Dr Margaret Stuart
Director of Research Ethics
Chair, Ethics Review Committee (Human Research)

Cc: Dr Steven Segal, Macquarie Graduate School of Management

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