

PARTNER'S REPORT

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Why You Should Change Partner Compensation

How to compensate partners is one of the most important decisions facing any CPA firm. It is also the decision that is most fraught with potential issues that could trip up a firm and blow up in its face.

Nevertheless, as CPA firms emerge from the recession and deal with a changing marketplace, many of these firms are turning a critical eye toward partner productivity and how partners get paid. Are underperforming partners benefiting too much from current compensation systems? Are they being held accountable? Is there a way to put more partner pay at risk not only to reward the success in business development that firms need but also to reward partners who make a broader contribution to the firm?

"If you're paying out the bulk of earnings to partners throughout the year, what incentive is there for them to bring in more business and be the best that they can possibly be?" asks Phil Whitman, president of Whitman Business Advisors in New York. Given the relatively high pay levels of partners in middle-market firms—the mid-to-high six figures—firms face an even more difficult task in finding ways to motivate this group or get them to accept changes to their pay.

More incentives?

Like many organizations, a number CPA firms are turning to incentives to spur partners to new behaviors and ways of doing business. "Under the

old model, firms would pay out 70 to 90 percent of their estimated earnings for the year in bimonthly or monthly checks," says Robert Fligel, a consultant with RF Resources LLC in New York. Now, "firms are moving anywhere from 20 percent to 50 percent of partner compensation to incentives."

For example, one mid-size firm distributes 60 percent to 65 percent of earnings as partner compensation, with the balance as variable pay. The variable pay component is based on three categories of metrics related to (1) every-day client work, (2) business origination and business development, and (3) other variables outside of business development, such as client handholding and training/development. The system is designed to reward overall contribution to the firm rather than just revenue generated.

As firms go through the process of changing partner compensation, here are some key elements that can help the compensation plan succeed.

Develop a strong foundation. Effective incentives include compensation that:

- (1) is tied to overall business goals and objectives,
- (2) offers a potential payout that is large enough to motivate desired performance,
- (3) shows a clear link between individual efforts and payouts,
- (4) are clearly understood by partners, and

(5) are reviewed and updated regularly to ensure that they remain strongly linked to the needs of the firm.

Back it up. Just because a firm creates an incentive that rewards business development or other metrics doesn't mean the partners in that firm will be able to achieve the stated goals right away. For one thing, all of the partners may not have the skills necessary to meet their new objectives and may need time to develop or update those skills. For another, the way the firm operates may not support the achievement of those goals.

That is why it is so important to change business practices in parallel to changing compensation design. For example, if the firm wants to put more emphasis on cross-selling and changes incentive metrics and goals accordingly, the firm culture and structure should support partners' efforts to achieve those goals. Otherwise, "you may be asking people to suddenly do things they are not comfortable with," says Fligel.

Be patient. Even with supporting changes, it could still take time for the change to take hold. How long depends on the extent of the change. For example, if a firm has always been focused on aggressive client acquisitions and wants to shift to a more collaborative business development model, simply rewarding partners for crossselling and activities in support of business development won't make the necessary changes happen overnight or automatically.

Support partners through the transition. There is no question that changing partner compensation is a major challenge. Partners themselves may also hold things up by resisting the changes. "The ones who are on the way up or the ones who are concerned about their ability to earn and contribute under a different approach" are more likely to resist changes, says Fligel.

To help overcome resistance, it is important to make sure partners understand why the system is changing. "They need to believe that the pie is going to get bigger so that most people win rather than having it be a win/lose scenario," says David Rhoads, managing partner of ThreePoint Consulting in Chicago. "If they don't like it, that can create a real danger of a partner backlash and morale problems."

Consider a closed compensation system. One way to deal with opposition and avoid controversy is to move to a closed partner compensation system, in which only the individual partner and those involved in the pay decision know how much each partner is paid. A closed system can help firms avoid lengthy and time-consuming discussions among partners about whether their or their peers' compensation is too high or too low.

Given that at least some pay decisions will be based on subjective decisions and metrics, it is important to provide some recourse for partners unhappy with their payouts. A closed compensation system can include some sort of procedure that allows partners to appeal decisions about their own pay if they feel that they were not treated fairly. This review can include a discussion of exactly how and why the pay decision was made.

Periodically review the program. It is a good idea to have a set schedule for reviewing the compensation program at least every three or four years. By having these reviews occur on a consistent schedule, "it can take some sting out of the review process because it can be quite emotional and contentious," says Rhoads. "If one group of partners thinks everything is fine and likes the way they are getting paid and the other half of the partners don't, an ongoing process of review prevents whoever is screaming the loudest to get a review started." □