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Boutique Firms and the Problem with the Partnership Equity Model©

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Lawyers, doctors, accountants, engineers, and others aspire to "make partner" in their firm. But this aspiration may not be possible in a small firm. The reason is not the lack of suitable candidates or firm politics – although these also could be a problem. The problem is one of organizational structure; that is, "Too many chiefs and not enough Indians" or more accurately "not enough Indians to have more chiefs."

Non-Equity Partnership

To understand this we can take a quick look at the "partnership track."[1] Generally, for those "best and brightest" associates who do not wash out or leave during the, say, six to eight years it takes to make partner, the next step is to be a non-equity partner. True to its name a non-equity partner does not share in firm profits and may not have access to the firm books and records. The non-equity partner does not vote and does not necessarily get a raise or otherwise make more money.

The obvious question then is "What does the non-equity partner get?" The answer is the private and public increase in status and the recognition of excellence. To say one is a "partner" is to say "I've made it" (or close to it) to yourself and the world.

Equity Partnership

The next step is equity partnership. Equity partnership is what most of us think of when we say "partner." And, it fits the legal definition of "partner;" that is, one who shares in the firm profits and looks to those profits for compensation. In this case the partner may receive an advance or draw against his or her profit share. But ultimately, the equity partners get paid if and when the company makes sufficient profits to pay them.

There's the rub, which takes us back to the "not enough Indians" problem. The equity partnership model assumes and is based on the fact that there are lower level associates who generate profits in excess of their cost. For example, a firm client has more than 50 physicians who generate virtually all of the firm's profits which exceed $1.5 million. The five doctor-partners can distribute these profits among themselves.

In contrast in a small firm the doctor may "eat what he or she kills;" that is, what the doctor bills covers the doctor's salary and overhead and not much else. Regardless of the equity partner's billing rate most of the partner's billings will be used to pay the partner. As there is no pool of profits to distribute beyond one's own, there is no equity in profits. Worse, with no retained earnings from profits the partner's equity in (the value of) the firm or net worth will be relatively

[1] You may have surmised that "partner" is a term of art. It applies whether one works for and owns a corporation or limited liability company (LLC).

small. For reasons of organizational structure and economics the equity partner model of firm ownership has relatively little to offer. This result can be even worse where the new equity partner buys his or her interest in the firm and signs a personal guarantee of its debt.

Name Partner

We come to the question: "What, if anything, does a boutique firm of lawyers or other professionals have to offer those on a career track?"

There are a few, important things:

One, being a partner has prestige. Being voted in and recognized as a "partner" is important to the partner, friends, family, and the firm.

Two, the boutique firm may be just what the "major player" wants. The larger firm, multi-partner model contemplates that departments may have good years and bad, and that regardless, the net profits can be shared. Under this model each department, in theory, serves as a safety net for the others. This is good for a sense of security. But if each year the "star players" turnover some of their revenues to weaker departments, the "stars" may leave. It is not uncommon for high-billing attorneys to leave the larger firm because in the larger firm the earnings are spread over "lesser lights" and other departments.

Three, becoming a "name partner." In this case the partner's name is added to the firm name. Instead of "Jones and Davis PLLC" the firm becomes "Jones, Davis, *and Johnson*," as Johnson's name is added to the firm name.