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Implementing Performance-Linked Pay System

Defining Vision for Firm and Goals of Individual Partners Is Important Starting Point

BY J. MARK SANTIAGO

PAY FOR PERFORMANCE is not a new concept in this country. The ideas and concepts underlying a graduated pay scale based on contribution and merit are deeply ingrained in our society and date back at least to Adam Smith. And despite some recent, spectacular aberrations at the top of some of America's most despised corporations, pay for performance in the corporate setting has served this country well.

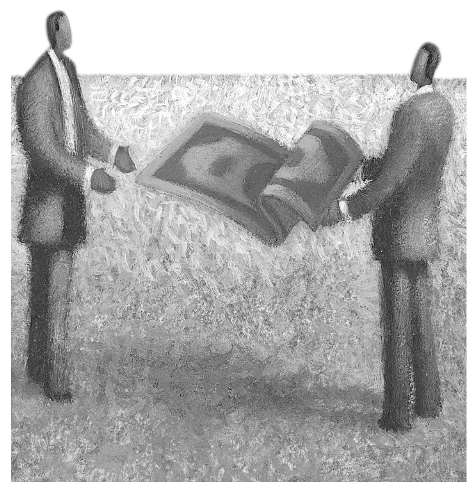
Professional firms in general and law firms in particular were slower to adopt pay for performance systems. There were many reasons for this. First and foremost, the law was thought of as "a profession," not a job, and partner compensation reflected not only the work that one did but a return on invested capital and time in the service of the firm. It was not unusual for old law firm lock step pay systems to increase compensation as a partner aged (and presumably had additional financial responsibilities brought on by a family) peak when the partner reached his or her mid-50s and then decline (as the financial obligations of colleges and marriages decreased) through the partner's 60s.

Those lock step systems gradually gave way to the "Scorecard" pay systems that predominate in law firms to this day. In these systems, objectives were set for each partner in a number of quantifiable areas such as originations, recorded billable hours and billed fees. These systems, which may have served law firms in the past, do not provide a law firm's management with the proper tools to motivate partner behavior into those activities that will help a firm achieve its strategic objectives. Indeed, some of these systems are so heavily weighted to the wrong compensable factors that they actually hinder a firm's ability to succeed.

What law firms need now, and this article will describe, is an approach to partner compensation that closely links partners' pay to their ability to contribute to the achievement of the firm's strategic objectives and that provides firm management with the tools it needs to not only achieve current strategic objectives but to build those skills and attributes within the firm, enabling it to meet future objectives and challenges.

Vision and Strategy

There are four key requirements to implementing a performance-linked partner pay system. They include:



- Clearly defined and broadly supported firm vision and a strategy for achieving that vision.
- Differentiated contribution roles for partners within the partnership with explicit expectations and a clear definition of success in each role.
- Structured goal-setting and evaluation processes that provide partners with actionable feedback.
- Availability of substantive data that will allow partners to personally validate compensation decisions using available guidelines and criteria.

Within each of these requirements there are a number of tasks and activities that must be undertaken to ensure their successful completion.

Vision and strategy are the logical starting points for a law firm's partner compensation program. After all, if

J. Mark Santiago *is a managing director in the New York office of Huron Consulting Group and leads the office's team of consultants who specialize in serving the legal community.*

a firm does not know where it is going, how can it direct and reward those actions that will get it there. Although strategy development can be (and has been) a long and arduous process it need not be. A law firm can develop strategy by answering a series of questions, including the following.

- In what practices does the firm enjoy competitive advantages?
- How much capital (human and monetary) can the firm invest in building those competitive advantages?
- Where does the firm wish to invest its capital?
- What is the firm's culture?
- What aspects of that culture is the firm unwilling to change?
- Are there some aspects of its culture that the firm wants to change?
- What types of partner behavior does the firm want or need to change?
- Who "owns" the firm's clients?
- What behavior does the firm need or want to reward?

This list is by no means exhaustive, but it demonstrates the breadth of issues that a strategy and its supporting compensation system must address. A firm's responses to these questions also help to define partner contribution roles — that is to say, how each individual partner will make his or her maximum contribution to the achievement of the firm's strategic objectives utilizing their individual strengths. In turn, these roles provide a framework within which expectations can be set and performance evaluated. The importance of a firm's strategic vision cannot be overemphasized. The recent failure of several firms around the country can, I believe, be traced in part to their lack of a clear strategic vision and a mechanism to direct partner efforts toward the achievement of that vision.

Contribution Roles

No one expects every member of an athletic team to perform the same tasks equally well. There are different positions in each sport, and each position contributes to the success of the team in a different way. If we expect different contributions from a quarterback and a linebacker, why then do we expect every partner in a law firm to contribute in the same way and at the same level to a law firm's success?

Contribution roles recognize these differences, identify key performance measures within each role by which success can be measured and provide a logical progression from role to role.

Typically there are four to five different contribution roles within a law firm. These roles might be identified as: Individual Contributor, Subject Matter Contributor, Responsible Contributor, Client Contributor and Administrative Contributor.

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Expectations and performance metrics are defined by a firm for each role, and while (at a high level) they are broadly similar they are specific to each firm that defines them.

As an example, a firm might see the Responsible Contributor role as filled by partners who are charged with managing individual matters within their field of expertise. The partners would be responsible for selecting and managing the other partners and associates who perform the work, identifying the issues involved in the matter, coordinating the development and execution of the approach to resolving the client's matter, and communicating on a daily basis with clients. In short, the Responsible Contributor would be responsible for the overall successful completion of individual client matters.

Metrics to measure a Responsible Contributor might include: fee realization percent on matters, net fees per hour on all matters managed, imputed interest on accounts receivable, etc.

In addition to specific quantitative metrics for each contribution role, other qualitative metrics would also be applied. These might include quality of work performed, associate mentoring, public service, firm committee work and support of firm administrative policies.

Individual Partner Goal Setting

This phase has two distinct steps. First, each partner develops an individual "contract," outlining how he or she will contribute to the firm's overall success. These contracts are developed late in the year in connection with the firm's business planning cycle for the coming year. The contracts are based on the previously developed contribution roles noted above. For example, partners Smith and Jones are in the same law school class. Partner Jones is a truly great litigator who attracts, and usually wins, significant cases. On the other hand, Partner Smith is a brilliant technician with the ability to manage and remember hundreds of individual facts and circumstances.

The best use of these individuals is quite different. Partner Jones' role in the firm would be that of an Individual Contributor while Partner Smith might be called upon to be a Responsible Contributor. Each partner's plan would recognize their areas of expertise and, in light of their different roles, establish different objectives and evaluative criteria. Partner Jones, as an Individual

Contributor, might be evaluated on the quality of his work, the complexity of the litigation he handles, and his responsiveness to clients. As a Responsible Contributor, Partner Smith is evaluated on the selection and management of the attorneys performing the assignment, identification of additional services the firm might provide to the client, and, of course, the quality of the work performed.

Assessment Process

The second step of this phase requires each partner to submit to the firm's management a written self-assessment of his or her performance against the contract each developed at the beginning of the year. This assessment compares the year's goals contained in the contract with the partner's actual achievements. The assessment also enables the partner to notify management of other noteworthy accomplishments for the year that were not in the original contract.

Near the end of the year, the assessment process begins. Individual partners meet with their evaluator — department head, office manager, compensation committee member, or managing partner — to review their prior year's achievements. This conversation is based on the individual partner's contract and the year's actual results. Individual partner performance data — "the numbers" — are still a major topic of discussion, but performance in more subjective areas, such as attorney development, practice enhancement and firm management are also included.

When the individual meetings conclude, the evaluators get together and, based upon the firm's overall strategy and needs, evaluate the partners relative to each other. This process groups partners into various hierarchical levels and allows for a firmwide "equity" evaluation.

It is important that individual partners be able to independently confirm their performance evaluation on a periodic basis and, at the end of the year, validate the firm's pay decisions. Therefore, whatever criteria a firm uses to evaluate its partners — client development, management, billing, collections — the firm's management information system must provide a ready means for individual partners to assess their performance. If partners are measured on something, appropriate information should be available so they can "keep score."

Communicating Pay Decisions

The final phase of any compensation program — and the one most frequently overlooked — is communicating final results to the individual partners. Firms that downplay the importance of effective communication squander one of their best opportunities to direct partner behavior and improve firm performance.

An appropriate member of the firm — department head, office manager, executive committee member — and the individual partner should discuss the individual's pay and bonus decisions. These discussions should clearly and directly link the pay and bonus decisions to the partner's actual performance, compared with the goals set in their individual contracts and previously defined role within the firm. This is an opportunity to explain "why you got what you got," and to discuss how individual partners' strengths can be leveraged and what weaknesses need to be addressed. It may also be an appropriate time to discuss partners' long-term career goals and opportunities at the firm and their role in the firm.

This annual review is also the starting point for the following year's compensation cycle when partners begin to prepare their new individual contracts for the coming year based on these discussions.

Closing the Loop

By closing the compensation "loop," the compensation system becomes an effective mechanism for directing partner behavior and achieving the firm's strategy. As firms recognize and adapt to succeed in their changing environment, the compensation system can help individual partners appreciate the integral part they play in their firm's long-term success. As in all change, the most difficult step is the first. Before embarking on a major overhaul of its compensation system, a firm needs the following components:

- A clear, broadly shared, articulated vision of where the firm is going.
- A management group that is committed to undertake the substantial changes required to achieve the firm's vision.
- A managing partner with both the patience and the drive to take day-to-day responsibility for implementing and managing the necessary changes.
- A partnership that understands and supports the firm's vision and strategy, as well as the behavioral changes required to achieve its goals.

Revising a compensation system in a partnership is a long and arduous process. It strikes at the foundations of the firm, and any revision has as much potential for ill as it does good effects on a firm. Change should be undertaken neither lightly nor with the expectation that any fix to the compensation system is permanent. Compensation systems need annual reviews and periodic adjustments to ensure that they correctly reflect the firm's current thinking about its strategy and how best to achieve success.

J. Mark Santiago

Managing Director

P 646-277-2298
F212-785-1313
msantiago@huronconsultinggroup.com

1301 Avenue of the Americas, 6th Floor
New York, NY 10019

Mark is a Managing Director located in the New York Office of Huron Consulting Group. He leads the New York Office team of consultants who specialize in serving the legal community.

Mark has consulted to Managing Partners and Corporate General Counsels for approximately 25 years in the areas of administrative process improvement, financial management, partner compensation, organizational development, Shared Service feasibility studies, Mergers & Acquisitions due diligence and integration planning and implementation and the introduction of technology into the legal environment.

Professional experience

Conducted due diligence studies on some of the largest law firm mergers in 2002/03 and identified significant issues for the acquiring firm to consider in the merger value proposition.

Assisted in the relocation of a major US law firm's administrative back office functions to a low cost geographic location.

Managed the design and redesign of clerical departments to maximize the advantages achieved from the introduction of new accounting systems and development of policies and procedures manuals.

Developed the Business Case to out-source the administrative functions of a major international law firm.

Managed the design and implementation of pay for performance Partner compensation systems featuring 360 degree performance feedback.

Education & certification

- Master of Business Administration, Fordham University
- Certified Management Consultant (CMC)
- Member of the Institute of Certified Management Consultants (IMC)
- Member of the American Institute of Certified Public Accountants (AICPA)

Published several articles on the links between compensation and strategy

Articles and publications

- January 1999 issue of the ABA's Law Practice Management Journal
- June 2000 issue of Australian Lawyer
- April 2003 New York Law Journal)
- ABA Law Practice Management Journal, June 2001 (Due diligence in law firm mergers)

Speaking engagements

- Frequent speaker on operational, financial and compensation issues in the legal community
  concerning law firms and corporate counsels.
- 2002 and 2003 LMA Annual Conventions
- 2001, 2002 and 2003 ALA Annual Conventions
- Numerous ALA Regional conferences
- NorthStar (Fulcrum) Law Firm Management Conference Series including Chairing all seven of their Annual CFO and three M&A conferences.