

Pay to Win—How to Make Your Law Firm's Compensation System an Asset

Nothing can create more tension and controversy in a law firm than partner compensation. At their best, compensation systems leave some partners feeling short-changed. At their worst, they misallocate financial resources, cause severe infighting, and set the stage for destabilizing defections. Although consultants admonish firms to use their compensation systems to further their strategic ends, only a few firms have clearly managed to do so. But given the current degree of upheaval in the legal profession, no firm can afford not to link compensation closely with strategy. The challenge is determining how best to accomplish that goal.

Most firms use one of three types of compensation systems--and usually, none of them fits the bill. Traditional lockstep compensation works well under very limited circumstances and fails dramatically the rest of the time. To make such a system work as a strategic tool, firms need institutional clients and practices, a lucrative market, agreed-upon cultural expectations, and the departures of those who are unprepared to meet those expectations. The firm also should be relatively insulated from lateral comings and goings. As the legal market becomes more tumultuous, it will be the rare firm that will be able to meet these conditions.

See also:

How to Make a Lot of Money Practicing Law

The second generic approach is a formula system. This uses statistics to set compensation and generally focuses on personal productivity, such as hours billed or dollars collected, and business origination. These systems are often considered to be fair, but they are never strategic. They reward a limited number of factors in a rigid fashion. There is no room for management-driven rewards, flexibility, or strategic investment.

Most large U.S. firms use a compensation system in which partners are awarded points or placed in tiers according to various criteria. That approach is far more robust than a formula system. It allows management to focus compensation on those whose efforts, broadly defined, are most important to the future of the organization. Unfortunately, these systems often fail to achieve their potential because partners do not know exactly what is being valued. Even worse, there is a perception in many firms that compensation decisions are arbitrary because the "rules" change from year to year or from person to person. And critical measures, particularly origination or business generation contributions, are suspect because the data are weak. As a result, subjective systems--while on the right track--frequently fail to advance the firm's strategic objectives or even achieve the perception of fairness.

Obviously, it is time for a new approach.

Enter the dynamic subjective system. This system is subjective because it calls for judgment on the part of firm management in setting compensation. However, it is dynamic because it robustly interprets difficult firm data and can evolve over time to meet changing firm needs.

The goal of a dynamic subjective compensation system is to allow management to allocate partner compensation in a manner that is universally perceived as fair, advances both the strategic and short-term interests of the firm, can be adapted to accommodate advances in the firm's performance, and addresses the weaknesses of subjective compensation systems. Such a system must be tailored to the individual needs of the firm. However, as a general proposition, it will have at least three compensation components--a share of base income against which the firm will pay a regular draw, a personal bonus that allows the firm to reward the extraordinary performance of an individual partner, and a "team award" bonus that focuses on the contributions made by teams of lawyers, such as practice groups.

Just as in current compensation systems, a large share of firm income under a dynamic subjective system continues to be allocated based on the individual's contribution to the firm's economic performance. The firm selects criteria, such as time billed or business development, as the key elements of its compensation system. However, the dynamic system uses these criteria far more rigorously than a typical subjective system does. For example, when evaluating contributions to business development, the firm's management may begin with "originating attorney" or "billing attorney" computer data. Based on careful review of the individual lawyer's performance through interviews, discussions with the practice group leaders, and other approaches, management will rank the lawyer's performance on business generation on a specific step scale similar to "Business Generation Levels" [see below]. These levels would, of course, be adjusted to reflect the practice of the specific firm.

Business General Levels

Tier Description Approximate Value (Example Only)

Level 1 No or minimal business generation \$0 to \$250,000

Level 2 Keeps self 50 percent busy \$250,000 to \$350,000

Level 3 Keeps self busy \$350,000 to \$750,000

Level 4 Keeps another lawyer busy \$750,000 to \$1.0 million

Level 5 Keeps two lawyers busy \$1.0 million to \$1.4 million

Level 6 Rainmaker Over \$1.4 million

The purpose of such a schedule is not to pinpoint precisely the contribution of each lawyer, but instead, to group lawyers into comparable contribution brackets. This is done by assigning credit for their contributions based on a subjective evaluation, rather than relying solely on accounting records.

This process is then applied to other chosen criteria, such as personal productivity, internal management, and leadership contribution. Depending on the criteria, different weights might be assigned to subjective and objective evaluations. The end result, however, is the construction of a grid of scores on key compensation factors. The grid might have three or four columns corresponding to the major categories of compensation criteria, each of which might have three to six performance levels.

The performance categories can be weighted to suit the firm's needs. However, the performance necessary to achieve a particular level must be clearly stated--even though it will be subjectively evaluated. The reasons that individual lawyers are slotted in particular tiers of compensation are linked directly and clearly to their performance in meeting the criteria. As a result, criteria can evolve over time without creating the sense that the system is arbitrary and subject to changing rules. Most important, the system gives management the framework to assure fair evaluation of the efforts of all lawyers without obsessing over awarding credit. The system is used prospectively to set compensation tiers similar to those utilized in most current subjective systems.

To reward individual lawyers for behavior that is above and beyond expectations, the dynamic subjective compensation system uses a retrospective bonus pool similar to that used in current systems. But it differs from current systems in that it creates a clearly defined framework against which such performance can be evaluated. As a result, it imposes a greater degree of discipline upon management in awarding bonuses. Lawyers receive bonuses only when something that they did clearly puts them in a different performance level on key criteria. The size of the bonus is determined by the degree of divergence. Typically, relatively few lawyers would receive bonuses, and the bonuses that are awarded would be substantial.

The third element of the dynamic subjective system rewards teamwork and is most often built around the firm's practice group structure. Management uses this element to establish team objectives for each practice group. Depending on the circumstances, management establishes three to seven criteria (more becomes too confusing!) with specific objectives. These can vary from year to year and potentially, from group to group, to

emphasize areas where improvement is necessary. For example, specific group objectives could be set for criteria such as hours (both average and minimum), improving the rate at which clients pay their bills, cross-selling, and introducing new clients as shown in "Team Goals" [see next below].

Team Goals

Criteria Measurement Value Per Partner

Hours Average 1,800/Minimum 1,700 100 Points

Realization Improvement 95% of 3% percent increase 50 Points

Cross-Selling \$2 million of work 200 Points

New Clients Ten greater than \$50,000 150 Points

Total 500 Points

The goal is to get all members of the team to work together to achieve the targets. By establishing both a minimum hours level and a target for average hours, for instance, members of the team are encouraged to help lawyers who are not sufficiently busy find work. The goal cannot be achieved by just letting busy lawyers offset less busy ones.

As groups achieve their expected performance levels in certain areas, goals are adjusted to assure ongoing improvements in performance. Criteria should be clearly measurable, but need not be purely economic. In one case, a firm established as a criterion that each practice group schedule and hold a monthly meeting. Similar goals may be valuable for firms that are trying to jump-start a practice group structure.

Criteria and goals are set prospectively, but compensation is usually awarded at year-end. The team performance pool--generally a minimum of 10 percent of available firm income--is divided among the groups in proportion to the share of points achieved by each group. The award must be big enough to ensure that strong teamwork has a serious impact on compensation.

Making the dynamic subjective compensation approach work requires that a number of conditions be met. Among the most important:

Management must actively put significant time and energy into setting compensation and matching the system's criteria with their firm's strategic needs.

Lawyers must be willing to trust and support other lawyers in their practice groups and tell management of their contributions.

Partners must be willing and able to defer a significant portion of their income to year-end. Between the personal bonus pool and the team performance pool, about 15 percent of total annual compensation will not be allocated until then.

The firm must have strong practice group leaders or others who are willing to lead groups to success.

Obviously, a dynamic subjective system is not for everyone. But for those firms that can support the system requirements, this approach may be the way to use a compensation system as a strategic tool--at last.

Interested in Learning More About Legal Hiring? Read the Definitive Guide:

[*How to Hire a Legal Recruiter for Your Law Firm: How Law Firms Recruit Attorneys Using Legal Recruiters*](#)