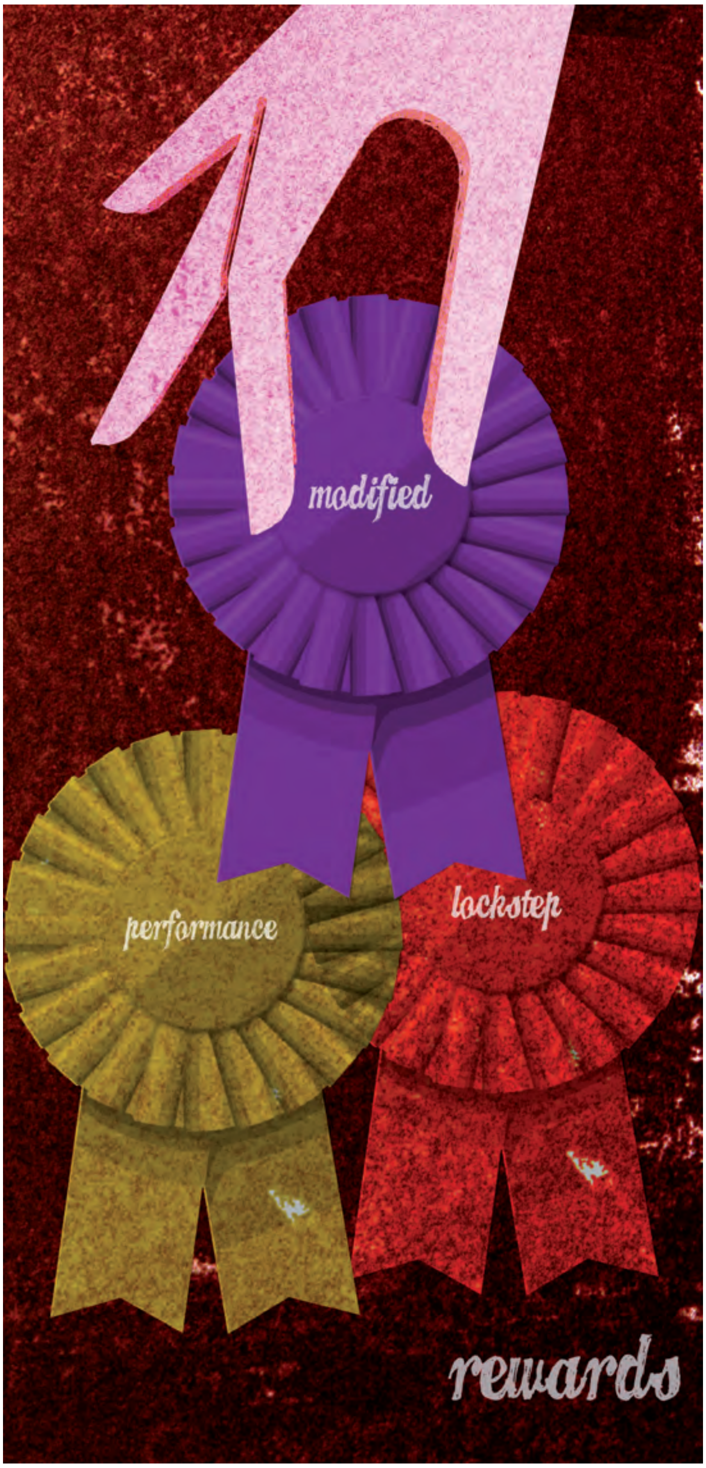
Eyes on the prize

Outstanding partner performance is now more important than ever to keep your practice ahead of the competition. So how can you use your reward systems to achieve this goal? **Peter Scott** explains

In tomorrow's challenging legal environment, building competitive advantage over rivals will rely on law firms being able to attract, retain and develop key people who are outstanding performers – and to avoid losing them to their competitors. Equally, if firms really prioritise client satisfaction, that should determine what 'outstanding performance' means, and what skills and experience it takes to succeed.

All this means that firms need to question whether their partner-reward systems are actively helping them to achieve their strategic objectives and build their competitive edge, or are actually holding them back. This article considers the concept of reward in the context of law firms, the different types of partner reward systems, and the main issues to address if you are considering implementing a performance-based system.



WHAT MAKES UP A PARTNER'S VIEW OF REWARDS?

Each individual will have a different view of which rewards are competitive for them. Money will certainly be part of that: if a partner says "I am not being paid what I am worth," then that should sound the alarm bells that the firm might need to review its reward strategy.

The concept of 'relative worth' also needs to be considered – partners may compare their rewards against not only those of their peers in competitor firms, but also of their colleagues. This is the root of such comments as "I am worth more than he is".

A partner's view of what constitutes competitive rewards will usually also be influenced by a number of other factors that law firms can focus on in their drive to recruit and retain the best talent. These factors include:

- the firm's reputation and profile;
- the quality of work available;
- the firm's 'culture' (the way people in the firm behave);
- the firm having a defined 'vision' and strategy, and being seen to be progressing and becoming increasingly successful; and
- a perception that the contributions of all partners, not just top-line billings, are valued and will be fairly rewarded.

Any or all of these factors may be at work to varying degrees when a partner is considering whether to stay or to go. Firms need to work very hard at all of them because they are, to some degree, interdependent.

WHAT CAN A PARTNER REWARD SYSTEM ACHIEVE?

I would suggest that a competitive reward strategy should:

- actively assist a firm to achieve its goal of gaining competitive advantage over its rivals;
- help to create a 'culture of high performance' and be used as

part of the process of driving up performance levels that a firm is seeking to build;

- provide sufficiently large differentials in terms of financial rewards to recognise each partner's relative worth in the firm; and
- positively encourage the development of new skills, as well as help to nurture acceptable partner attitudes and behaviours, which can lead to the creation of an environment that encourages both higher performance and agreed behavioural norms.

Achieving any of these objectives will not be easy or quick, as it is likely to involve the challenge of overcoming serious internal obstacles to change. To deal with this successfully will require leadership, vision and courage on the part of those driving the process of change.

It is important, however, to always be aware that no partner reward system can make up for a lack of profits. If average equity partner profits in a firm are below the competitive level in the market, then that firm will be at risk, because it will not be possible to reward the highest performers competitively without depressing the earnings of others to below an acceptable level. Accordingly, changing a partner reward system to meet the demands of the highest performers will not be the answer, unless the underlying profitability of the firm also improves. The first and foremost requirement for many firms, therefore, should be to build a 'larger cake' to provide a sufficiently large profit pool to satisfy everyone.

WHAT TYPES OF PARTNER REWARD SYSTEM ARE THERE?

There are three basic choices:

- lockstep systems;
- performance-based systems; and
- a mixture of both (known as 'modified lockstep').

Lockstep has traditionally been the reward system in law firms and there are probably as many variants of lockstep as there are firms. In its simplest form, each partner, on the basis of seniority, reaches a 'plateau' where there is equality. This form of partner reward has worked well in the past for many firms, but firms are increasingly moving away from the model, because it is perceived to be no longer 'fit for purpose'.

Having said that, this model can work well in some firms, particularly if:

- every partner is pulling their weight and contributing (in the broad sense) equally, so no one partner should feel they are 'worth' more than any other partner; and
- the profitability of the firm is sufficiently high to enable it to reward every partner competitively.

However, the model assumes that partners make equal contributions, and that is not usually the case: some partners, for whatever reason, will contribute (or consider they contribute) more than others. When partners feel they are contributing more and not being rewarded for it, they will begin to ask themselves whether an alternative should be found that involves paying greater rewards to some for higher performance.

A lockstep system of this simple kind can also be too rigid in its application – for example, it may provide few ways for a firm to deal with underperforming partners. Issues such as this have persuaded many firms over the years to develop variants of lockstep, often referred to as 'modified lockstep', which involve elements of both seniority and performance. For example, instead of a partner automatically moving up the lockstep each year to reach the plateau, advancement might only take place if certain performance targets are met. Similarly, some modified lockstep systems will provide for partners to move down a lockstep under certain circumstances. The potential variants will depend very much on the culture of a firm and its competitive needs at any given time.

A purely performance-based system has the advantage that it can incorporate reward differentials that are sufficiently large as to make it worthwhile for partners to achieve higher performance. However, implementing such a system is not simple, and any firm wanting to make the change needs to bear a lot of issues in mind.

WHAT MAKES AN EFFECTIVE SYSTEM?

For a performance-based system to work effectively, it needs to be kept simple, manageable and understandable. Performance will need to be actively managed, and partners will need to know the key areas of performance, the performance goals in each area, and how their performance is to be measured and assessed in relation to these goals. It is also critical to ensure clarity and agreement about the minimum acceptable level of performance and the average level of performance. From this, objective decisions can be made around under-performers and high-performers.

If a firm is considering a move to a performance-based system or is thinking of making changes to its existing modified lockstep or performance-based reward mechanism, then it should bear in mind the following points.

- Any change should aim to be consistent with and advance the goals of the firm.
- The relative contribution of each partner with respect to other partners should be recognised, by differentiating rewards for high performers from those of average performers. If problems exist with under-performers, then that will need to be addressed outside the remuneration system.
- The system should strongly emphasise performance and aim to encourage partners to build on their strengths and move away from their weaknesses.
- It should be sustained performance over time that is rewarded.
- There is no such thing as 'the perfect system' – one that works well for one firm may be a disaster for a similar firm. It is about putting in place a system that will work well for the particular firm.
- As already mentioned, a performance-based system cannot make up for a lack of profits.

Clearly, any performance-based reward system will depend for its success on the ability to measure performance in accordance with the criteria and standards built into the system, so that the rewards are fair and satisfy everyone. That, as many firms that have tried this will testify, can be difficult to achieve, which is why developing reward systems requires hard work, and systems need to be aligned with the firm's thinking and objectives.

Performance criteria will first need to be decided and target levels of performance arrived at with partners. This ensures that all partners agree about the behaviour that they value as core to the way in which they wish to build their firm, and which they are therefore prepared to reward people for demonstrating. Partners will then feel that they 'own' the process, making it more likely to be implemented successfully, and providing greater transparency for those aspiring to become partners.

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Such criteria and performance levels will often focus on broad objectives such as:

- developing people;
- developing client service;
- managing and enhancing the firm's reputation;
- developing market share; and
- developing profitability, cash generation, and other financial performance.

Under these will sit more specific objectives, such as:

- building client relationships;
- technical ability;
- commercial and financial awareness;
- business development skills;
- management skills;
- managing relationships with colleagues; and
- personal attributes.

A new performance-based reward system should be kept as simple as possible, and explained in a straightforward way. I recently heard of one firm with a new, fairly simple to understand, performance-based profit-sharing scheme that released a paper to explain the scheme that was so complicated that very few of the partners could understand it – clearly not the right approach.

Above all, those driving the changes should communicate clearly to the firm's partners what it will take to succeed at the firm in the future, and how the new system will work for them. This has led some firms to have a 'dry run' for a year before introducing a new system – this enables the partners to see how it will work in practice and to become comfortable with it and its impact.

HOW IS PERFORMANCE ASSESSED?

In order to manage a performance-based reward system, a firm will also need to develop an effective and trusted process for assessing performance against the agreed criteria.

Performance development reviews (sometimes known as appraisals) need to be part of an ongoing performance management process, and should aim to provide each partner with an agreed and actionable performance-development plan that can, in due course, form the basis for performance-based reward.

But this begs the question of who should appraise the partners – often a highly sensitive issue. If feedback and assessment are provided only by those to whom the individual reports, as with the traditional 'downward'-only appraisal, the result can not only be ineffective but also counter-productive if not handled well.

Arguably, a more effective method is some form of 360-degree appraisal that provides an all-round perspective of a partner's performance. Feedback could be solicited from:

- those to whom the partner reports;
- the partner's peer group (for example, fellow partners); and
- staff who report to the partner.

This form of appraisal, if managed well, can be more constructive, better received and more effective at enhancing performance and changing behaviour than the downward-only feedback of the traditional appraisal. Who better to provide feedback on partners' performance than their peers and the people they manage?

Obtaining feedback from colleagues in this way can, as well as forming the basis for reward, encourage partners to build on their strengths, reinforce what they are already doing well, and identify what they could do better.

However, any kind of 360-degree feedback process must be something to which partners are willing to commit – a firm should not seek to impose it upon partners. This commitment is essential if the partners are to take the feedback to heart and change behaviour or performance as a result. Above all, the process must not be seen as threatening.

Accordingly, any firm thinking of developing a 360-degree appraisal system as part of a process to manage performance and reward should involve partners from the outset in the development of the process. In particular, the firm should explain to partners the purpose of the process, its benefits, how it will work in practice, and its impact on them. It should also be highly tailored to the firm and its needs, as there is no single 'right' way to do this.

WHO SHOULD HAVE THE FINAL SAY?

Metrics are critical to a performance-based reward mechanism, but no method of performance measurement using a number of criteria is likely to produce a score that is accurate enough to truly reflect actual performance; instead, common-sense judgment by those managing the system, applied to broad criteria, will often result in the most fair awards.

> Implementing a successful system will require leadership, vision and courage on the part of those driving the process of change

Crucial to the process of assessing performance against criteria, therefore, will be the need for trust and confidence among those who assess performance and the rest of the partnership. Achieving this will require careful thought. For example, those involved in management should clearly have a significant representation and influence, given their day-to-day knowledge of the business. In addition, if possible, trusted and respected partners not involved in management should be involved in the process to provide checks and balances.

MAKING IT HAPPEN

If there is to be a transition in a law firm from any one system to another – such as a traditional lockstep based on seniority to a more performance-based method – then a firm will need to tread very carefully. The move can be difficult, and will require a great deal of communication and much gentle leading of partners by the hand until all are comfortable with the new regime. Such decisions and their implementation should not be rushed – in particular, it can be a good idea to minimise changes during the first year and go slowly, taking the partners along with the changes. Above all, communication is key to making the change a reality and making sure everyone buys into and supports it. ■

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