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Developing a partner reward strategy – to build competitive advantage

Putting partner reward into context

Competitive advantage is said to be *'an advantage that a firm has over its competitors, allowing it to generate greater sales or margin and / or retain more clients than its competitors'* (see definition at www.investopedia.com/terms/c/competitive_advantage.) Competitive advantage matters because it is what places a firm ahead of its competition and means that it will have to do things differently and keep innovating to stay ahead.

If a law firm is to gain a competitive advantage over its rivals then it will need to consistently deliver ***what its clients require*** – and do this better than other firms in its market. A law firm that wants to be successful in today's competitive markets when faced with difficult economic times must ensure that it has access to highly trained, skilled and motivated people who are high achievers. And a firm's people will need to know in which key areas their performance will be measured, their performance goals and how their performance rates against these goals. Actively managing performance in this way will be a critical objective if a firm is to outperform its rivals.

Performance management has for long been recognised as a key component to gain competitive advantage, and two of the most common purposes for which performance is measured are reward and progression within a firm. Given the paramount importance of building high performance, in this Briefing Note we focus on performance – based reward structures which are increasingly gaining favour in place of the traditional 'pure' lockstep model which involves reward and progression being by reference to seniority.

How can a law firm attract and retain key partners who are outstanding performers and who will be instrumental in building a firm's future success?

What will a firm need to do to deliver ***what those partners require***?

If a firm is unable to offer competitive rewards in its market, then it will risk losing its best people and be unable to recruit the best. Competitive rewards can however be very personal to individuals and are not always limited to financial reward. For example, some of the factors in the following list may persuade a high achieving lawyer to move from their current firm to join a competitor. Identifying these matters can help firms to develop people retention and recruitment strategies to satisfy their lawyers' aspirations for interesting and rewarding careers -

- The reputation of a firm and its profile in the market

- The firm having a clearly defined vision and strategy

- The extent to which a firm is seen to be dealing with underperforming partners who are unable or unwilling to consistently provide the high quality advice and service now demanded by clients and which, if not dealt with, can be damaging to internal morale and lead to the loss of good partners

- The quality of work and clients

- The ‘culture’ of a firm, which will need to be focused on creating an environment where the needs, ambitions and aspirations of its people are viewed as important as those of the clients

- The extent to which a firm is prepared to invest in its people, training and technology to develop a high performance culture.

Having listed above some reasons why partners are prepared to leave their firms for competitors, direct financial reward is on the other hand equally important.

In particular, law firms should never underestimate the damage that can be caused if partners perceive that their contribution is not being valued and fairly rewarded. *Relative reward* between partners can be a driver of unhappiness if one partner thinks he or she is worth more than another partner but this not being reflected in terms of their relative rewards.

On the other hand, absolute reward is also important to many partners and in every legal market there is a threshold level of average partner profitability which will need to be achieved or exceeded if the best partners are to be recruited and retained by a firm. A firm which is below that level risks losing its best people to more profitable firms and will be unable to offer competitive financial rewards to recruit the best in the market.

Profitability is key

It will be difficult to reward high performers competitively without depressing the remuneration of other partners to an unacceptable level if average profitability is not at or above the threshold level in the market. Hence changing the reward structure of a firm to meet the needs of high performers is not an answer unless the underlying profitability of the firm is also improving. If a firm is below that threshold level of average partner profitability then taking steps to improve profitability to threshold levels in the market will need to be undertaken at the same time as making changes to a partner reward structure.

Objectives of a performance – based reward structure

If a firm is considering a move to a performance - based reward structure or is thinking of changing its current performance - based reward structure, then the objectives of doing so will need to be carefully thought through. Ideally such changes should -

- Have a strong emphasis on areas of performance which are consistent with and advance the strategic goals of the firm

- Help to maintain the firm's competitive positioning in the partner recruitment market

- Determine the relative contribution of each partner with respect to other partners, by differentiating rewards for high performers from those of average performers. If problems exist with underperformers, then that problem should be addressed outside the reward structure.

- Establish individual partner goals and aim to move partners towards their strengths and away from their weaknesses

- Reward sustained performance

The success of a performance - based reward structure will depend on a number of key components being incorporated -

1. Performance criteria

Performance criteria are fundamental to developing a reward strategy and a firm should consider what its people should be doing differently / better / more of / less of, to drive innovation and client satisfaction and to advance a firm's competitive goals, by helping to develop higher levels of achievement in relation to, for example -

- Client service
- Skills and expertise
- A culture of sharing
- Enhanced financial performance (not just individual billings)
- Enhancement of a firm's reputation and profile
- Market share

When a firm agrees criteria by which performance is to be measured, this is usually the result of the partners having identified behaviours which they value as core to the way in which they wish to build their firm and its competitive positioning. Because they value such behaviour, then they are prepared to reward that behaviour. Accordingly it is vital that partners are closely involved in establishing the criteria to define 'high performance', rather than having the criteria by which their performance will be measured, forced on them. If this is done then partners will feel that they own the process and will work to make it a success. Further, a 'transparent' reward structure will not only help to build partner confidence in the reward process, but also clearly show future partners what will be required of them.

Performance criteria should ideally cover both activities that are an investment in longer term competitiveness and short term profitability, and can relate to individual performance as well as group performance, depending upon a firm's objectives. And, depending on priorities from time to time, 'weighting' can be introduced within each set of performance criteria to provide for greater reward to be given to performance achieving certain criteria which are priority objectives.

Typical examples of performance criteria are likely to include some of the following –

- Developing and maintaining valued client relationships
- More effective business development
- Developing and enhancing technical ability
- Building teams and maintaining excellent relationships with colleagues
- Sharing, delegating and supervising work
- Financial management (covering not just personal billings but a range of financial disciplines including building profitability and cash management)
- Risk and compliance management
- Developing and enhancing certain personal attributes for the benefit of the firm

It is also critical to ensure there is clarity and agreement about what is the minimum acceptable level of performance and what is the average level of performance. From this, objective decisions can then be made around underperformers and high performers.

2. Assessing performance against criteria

Linking performance management to a reward structure requires that the process is (and is seen by partners to be) fair and equitable and rewards those that contribute most to a firm's success. The performance review process therefore becomes critical if a performance related reward structure is to be successful and achieve its objectives.

What is the best way to assess performance for the purposes of reward?

There is no 'best way' although many firms are increasingly using techniques such as 'all round feedback' (360 degree feedback) whereby the process of appraisal is carried out by gathering feedback from peers as well as from more senior and more junior colleagues, or various combinations of these. This is because it is increasingly recognised that it is the people that partners work with and manage who are often the best people to provide feedback on partner performance.

It was mentioned earlier in relation to agreeing performance criteria that it is sensible to involve partners in the process. When it comes to agreeing a method of appraisal it is equally important to involve partners in a constructive way, in order to obtain their full commitment to the process.

Performance reviews should provide, among other things –

- A means by which individual partners can establish and agree goals for the coming year

- A process by which a partner can ask for help and / or resources to achieve the next year's goals

- A means by which partners are able to understand how their 'rating' in terms of profit sharing has been arrived at and a forum in which this can be constructively discussed

Crucial to this process is the requirement for ***trust and confidence*** between those who assess performance and determine rewards and the rest of the partnership.

This is particularly important where, instead of using a formulaic performance measurement system where data is entered and reward is automatically calculated, a more subjective approach is used, as where a remuneration committee determines the compensation due to a partner based on their knowledge and judgment of that partner's contribution to the firm.

Whilst metrics are critical to the success of a reward structure, it is unlikely that a method of performance measurement using a number of subjective criteria is likely to produce a numeric points score of sufficient accuracy and for that reason common sense judgments by those managing the process, applied to broad criteria, will often result in fair awards.

Usually a remuneration committee should include at least one person from management, because they will have first - hand knowledge of partners' performance throughout the year and are also likely to have been involved in performance reviews, which are often sensibly made a central part of such a performance based system.

Making the transition from one reward structure to another

There is often misunderstanding and mistrust by partners when 'management' proposes a new reward structure. This is why it can be so important to involve partners in the design of a new reward structure so they buy – in to it from the beginning. It should not be imposed on partners otherwise it is likely to seem threatening to some. It is also vital that those who are proposing the new reward structure make clear to everyone the purpose behind the changes, the benefits to the firm and to partners and how it will work in practice. Effective communication is essential to build that trust and confidence which is central to the success of any such performance - based reward structure.

In this Briefing Note we have not described particular models of performance based profit sharing as it is often said that there are as many different models as there are law firms. A reward structure which works well in one firm may be a disaster when implemented in another firm. Accordingly a firm will need to carefully tailor its reward structure to its specific needs and should go slowly when implementing the changes.

Set out below are some matters to be considered when reviewing any proposed reward structure –

The elements of reward

What is a partner's reward intended to cover and what should be the emphasis? For example -

- A 'salary' element?
- Seniority (for example, years on a 'lockstep')?
- 'Interest' on capital invested?
- An element based around performance against agreed criteria and targets?

Differentials between performance bands

If a partner's reward is to be partly linked to the achievement of certain performance levels and a banding system is to be introduced to try to fairly reward different levels of performance, then the differentials between the top and bottom bandings will probably need to be large enough to make it worthwhile for partners to seek to get into the higher / highest bandings, and to reflect the difference between average performance and outstanding performance.

It can also be sensible not to have too many bandings, so matters are kept relatively straightforward and clear cut, to enable partners to be clear what they need to do to go from one band to a higher one.

Keep changes to a minimum

Simplicity and being easy to understand are important factors for partners when considering changes to the way in which they are rewarded, and so whilst some 'tinkering' may be required from time to time to emphasise different performance priorities, changes should not be too frequent and whatever changes are proposed they should always be communicated in the clearest manner to partners.

Some firms will even have a 'dry run' when changes are to be made. For example, if moving from a pure lockstep to a performance – based system, a firm may continue in the first year to allocate profit on the existing basis but use that year to illustrate to partners what they would have earned if the new reward structure had been operational. This can help to iron out any issues which may arise and is likely to build essential trust and confidence in the new reward structure.

In conclusion, if a firm is considering changing its reward structure, then it should at the outset ask itself at least the following two questions –

- Is our existing profit sharing system helping us to achieve our objectives?

- Is our current reward system fairly rewarding each partner's contribution to the firm?

If a strong positive answer cannot be given to both of those questions, it is likely that a firm will need to at least review what alternative reward options may be available to it to improve its competitive advantage over rivals and to retain its best partners.