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Compensation for Leadership

Firms have worked hard in recent years to fine tune their partner compensation systems, clarifying performance expectations for partners and improving the metrics and other types and sources of input considered. Yet compensation for the key leader or leaders (such as a full-time Chairman and/or Managing Partner) remains surprisingly unstructured in many firms, and is almost an afterthought. This has led to consternation on both sides – leaders feeling underappreciated, and partners questioning the value the leaders are delivering to the firm. Because firm leaders are often among the highest contributing and highest paid partners, it is important that firms do their best to get it right.

In our recent work with firms, and based on three recent benchmarking surveys on governance and related compensation issues among leading law firms, we have reached the following conclusions (among others) about compensation for firm leadership:

- Performance expectations for firm leaders are often undefined, and there are rarely agreed upon goals and objectives for the year.
- Performance assessments at year end tend to be superficial even if there is a robust process in place for other partners.
- Firm performance, other than to the extent that it impacts overall profitability and point value, is rarely considered in assessing leader performance.
- Compensation setting is often based on a leader's historic compensation levels as a practicing lawyer rather than their value as a leader of the firm.

Firms typically do a good job in spelling out other aspects of leadership, including the selection/election process, the terms and term limits, the broad scope of authority of the roles, the expected time commitment for those not in a full-time leadership role, and even provisions for compensation protection when a partner leaves the leadership position and returns to practice. But performance management and compensation tends to involve far fewer specifics and more trust in the process. While compensation of partners is often as much art as science, we do think there is room to enhance the process for firm leaders.

Key Areas for Focus

The areas calling for a more robust process fall into four categories: 1) Agreement on goals and objectives, 2) Performance Assessment, 3) Compensation aligned with achievement of goals, and 4) Objectivity of the compensation setting group.

Agreement on Goals and Objectives. While many firms expect partners to prepare annual plans, fewer expect firm leaders to do the same, and fewer still review and agree to those goals. Of course, many leaders do set objectives for themselves as part of their own personal planning process but rarely review those with others. As a result, we sometimes hear partners question what the leaders are doing and whether they are doing the right things, or the most valuable things.

Setting out goals for the year that align with and support the firm's strategy is a critical step all firm leaders should be taking. Those goals should then be reviewed and agreed with the board-level management body. In some firms the agreed goals will be published to the partners so that all have a clear understanding of the priorities for firm leaders for the coming year.

Performance Assessment. The performance assessment of firm leaders needs to be done with the same rigor as that of the rest of the partners. It should start with an assessment of the leader's achievement of the goals set out at the beginning of the year. The assessment should include a self-assessment from the leader, input from the Board/Executive Committee and other key managers in the firm, an assessment of relevant metrics in support of key goals, and possibly feedback from the partners.

The feedback from the Board and partners needs to be weighed appropriately given that being an effective leader of a firm isn't a popularity contest, and the actions a leader must take may necessarily result in some ruffled feathers. In addition, some partners can have unrealistic expectations for the firm's leadership, as well as less than full visibility into all that the leaders do, resulting in feedback that is not fully informed and often overly critical.

Some firms use a scorecard approach to evaluate a leader's contribution, which captures goals and Key Performance Indicators (KPIs) along key dimensions, such as:

	Strategic Direction	Client Management	Talent Management	Financial Performance	Inspiration/ Leadership
Goals					
KPIs					

Compensation Alignment. Once the assessment is complete, the results need to be factored in to a leader's compensation determination. Achievement, or not, of key goals should have some bearing on the outcome. In some firms this might be a part of the bonus determination for the leaders. In other firms, it might influence base compensation or levels placement for the coming year. A few firms have an 'at risk component' of compensation for leaders that is dependent on achieving objectives. This latter approach is most similar to what we see in other businesses, but in practice can be difficult for law firms to implement.

The use of firm performance metrics is always an interesting topic when it comes to leader performance and compensation. Often firms wonder if the firm's profit per equity partner performance should be a key metric in determining compensation. While PPEP is indeed important for many firms, it is important to balance that with other metrics that support the key goals. And firm metrics should inform, but not formulaically determine, leader compensation. The danger of relying too heavily on metrics is that it can incentivize maximizing short term profits which can lead to underinvestment in strategic medium and longer term objectives. Finally, unless a leader has a fixed salary, their compensation ultimately is influenced by firm performance through point or share value, as is the case for all partners.

Compensation Setting Group. There needs to be trust in the process for partners to have confidence in the results. In more than a few firms there can be a perception that the compensation committee, or leadership group, is focusing on their own compensation over the partners. Based on our work with firms, this is in fact rarely true, but it is important that partners believe that it isn't true.

The group responsible for determining leader compensation needs to be seen as being fair and objective in their role. If the firm leaders are members of the compensation committee, as they often are, it generally requires establishing a separate process for the leaders. This can be a subset of an independent Board/EC, or a group of former Board/EC members, or a subset of the Compensation Committee. It could even be a role for an outside director. In some firms, it is important that the group charged with setting leader compensation completes their process after their own compensation is already set, so that they don't fear consequences for making a tough decision if one needs to be made.

Increasing the clarity around the role, performance and compensation of firm leaders will serve both the leaders and the firm better. For the leader, it is an opportunity to confirm his/her priorities and continue to maintain the trust of the partnership. For the firm, it helps to ensure that the firm is getting the best from its leaders, and paying them commensurately.

London

Principal: Giles Rubens
giles.rubens@fairfaxassociates.com
44 (0)20 3633 3943

Washington

Principal: Lisa Smith
lisa.smith@fairfaxassociates.com
202.365.4180

California

Principal: Kristin Stark
kristin.stark@fairfaxassociates.com
415.215.9294