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Partner Compensation: Process Can Be As Important As Results

Compensation takes on an outsized meaning in law firms, in part because it is often the only meaningful feedback that equity partners receive from the firm about their performance and status in the firm. Thus, compensation tends to have implications for not only a partner's material worth but also their self-worth, and as a result, partners tend to scrutinize compensation decisions not just relative to expectations or to last year's results but relative to their fellow partners. Firms with closed compensation, where the results are not shared with the partners, or lockstep or formula firms, where compensation does not involve discretion, won't experience this as acutely as firms with open, merit based systems, but even those firms face some of the same challenges.

Partners typically look at their compensation from two perspectives. First, they look at the fairness of the results (did I get paid fairly) and second, they look at fairness in the process (were the numbers arrived at in a fair and impartial way). Obviously these two are interlinked, but they can also balance each other out.

If we start with fairness of results, it poses a tremendous challenge for law firms because many firms are quite transparent with their partner compensation statistics within the partnership, sharing not only compensation numbers but also detailed performance data. So, the temptation for partners to make comparisons based on reported data is enormous. Yet merit systems are rarely based solely on the quantitative factors. By design they are meant to allow discretion in applying the quantitative factors ('getting behind the numbers') as well as considering qualitative contributions to the firm. That means the 'spreadsheet' distributed to partners only tells a part of the story.

In other words, by relying on results alone, many partners are apt to view compensation as unfair or even biased. This means law firms have no choice but to focus on the fairness of the process. In our experience, if partners trust the process, they are much less likely to feel that the results are unfair, even if there are large disparities in compensation. How can law firms construct and ensure a fair process? We advise a number of mechanisms:

Compensation Committee Composition

Is the Compensation Committee comprised of trusted individuals, viewed as high in integrity and sufficiently in touch with the full breadth of the partnership? Even more importantly, are the members viewed by the partnership as being impartial? Nothing poisons a compensation process like a committee that is viewed as 'taking care of their own.' Thus, firms need to ensure that the selection of the committee members is something that is done carefully and with the input of the partnership as a whole.

In many firms the Management or Executive Committee also serves as the Compensation Committee. While management involvement in compensation is indeed a best practice that we strongly recommend, sometimes we find that firms benefit from including one or more partners not involved in management in order to achieve the trust required in the compensation setting process.

Consistency

Is the process the same each year and is the process treating partners similarly from year to year? While it is understandable and even advisable to make improvements in the compensation process over time, too frequent 'tweaking' or simply inconsistent implementation of an established process year to year can undermine partner certainty about the reliability of the process. Furthermore, mid-year changes to the criteria or process can also feel to partners like changing the rules in the middle of the game.

Clarity of Approach

Do the partners understand the approach the committee takes in making allocations? While part of the benefit of a subjective or merit system is to avoid a set formula, that does not excuse firms from being clear with partners about the specific types of quantitative and qualitative contributions that will be recognized in compensation. This type of clarity typically comes in the form of 1) a written summary of both the compensation process and the criteria, 2) regular (e.g., semi-annual or annual) communications to partners reminding them of the process and reinforcing the criteria, and 3) metrics and other materials (such as self-evaluations) that align with the stated criteria.

Partner Input and Performance Communication

Do the partners have the opportunity to have input into the process? Many firms make an attempt at partner input through an annual memo written by the partner to the Compensation Committee. Unfortunately, partners preparing these memos often either draft a treatise or copy/paste from prior year, reducing the value of this step in the process. To compound the problem, given that the memos are a one-way communication, partners often submit glowing reports of their year, and without any feedback on their memo from a Compensation Committee member, partners operate under a misimpression that their memos will lead to greater compensation. When such expectations aren't met and the individual hasn't received communication explaining the gap between the memo and the outcome, perceptions of unfairness heighten dramatically. A better process includes individual partner conversations about each partner's performance and contributions, which can also serve as a valuable developmental opportunity.

Testing Results

Finally, it is important to test the results. Start by analyzing the statistics of partners at the same or similar compensation levels. Are there any unexplained outliers? Look for any evidence of gender or other bias. Study compensation allocations for members of the Compensation and Management Committees. Are those allocations fair and defensible?

Given the outsized importance of compensation in most law firms, there is a premium on getting it right. And ensuring fairness of the process, both in reality and in perception, is a critical component of this.

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