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INSIGHTS

Measuring the Unmeasurable

Individual partner performance in a law firm tends to be based on measurable factors. Law firms capture and slice lawyer financial contributions in a variety of ways. Some individual performance metrics are fairly black and white, particularly billable hours or working attorney collections, while others, like origination or client management, are somewhat gray. Despite the gray areas, law firms tend to directly correlate dollars (or pounds or euros) with partner contributions, and as a result, compensation approaches tend to be heavily data driven.

Based on our analysis across multiple firms, roughly 70-90% of partner compensation decisions in merit or subjective based systems can be explained by a handful of financial metrics. Qualitative and non-quantifiable contributions tend to receive less focus in compensation, in large part because they are difficult to measure. Firms often find that the 10-30% of compensation which is not based on financial contribution creates disproportionate partner tension, largely due to the challenges in measuring and valuing qualitative inputs.

Qualitative Partner Contributions

Building a successful and sustainable law firm requires creating incentives for partners to engage in all of the behaviors required to grow and build the business. As a result, in addition to valuing financial performance, best practice partner compensation systems also seek to value qualitative contributions, particularly lawyer training and development, firm and practice profile building, client service and management, teamwork and collaboration, management and leadership, contributions to diversity and inclusion, and the list goes on. The definition of which qualitative contributions should be valued and in what order of magnitude varies by firm, depending on the firm’s core values, partnership culture and history, and ideally, the partnership’s strategy and goals for the future.

Historically, firms tended to be less specific in defining which qualitative contributions were recognized in compensation setting, and the measurements of these contributions were often spotty or nonexistent. Some firms sought to measure qualitative contributions primarily through tracking of nonbillable hours. This led to a proliferation of nonbillable categories and hours submitted. Over time, these firms found that the more categories used, the more hours submitted, and in some cases, the more dubious the quality of the hours. In reaction, some firms scaled back the importance of nonbillable hours in compensation setting. Other firms refocused their use of nonbillable hours, creating a smaller number of distinct categories and stressing the need for quality of hours and compensation committee review of hours submissions.

Today’s Approaches

Firms are now far more specific with partners about which qualitative contributions will be rewarded. However, the measurement of these contributions has not necessarily become more scientific. While most firms no longer allow for unfettered use of nonbillable hours categories (or if they do, they generally don’t place any value on nonbillable hours without an accompanying assessment of the effectiveness of those hours), few firms have moved the needle in defining specific measurements for qualitative contributions.

That being said, law firms have found other pathways to be more rigorous in their analysis of these contributions. Today, many firms engage in compensation related processes which better inform the discussion of non-quantifiable contributions. These types of approaches include:

- ***Individual planning and goal setting:*** Well managed firms typically use some type of individual annual planning process for partners. When implemented correctly, these plans call for each partner to define clear and measurable goals for the coming year. These goals typically include a mix of both quantitative and qualitative contributions. Firms can then measure progress towards achieving qualitative contribution goals and focus compensation committee attention on this progress (or the lack thereof).

- ***Practice, office, industry team and firmwide planning and goal setting:*** Increasingly, firms are linking the measurement of leadership and management’s performance to their progress towards achieving defined practice/office/industry/firm goals and strategic plans. A leader’s qualitative contributions are evaluated based on their efforts and efficacy in taking action to implement plans established for their respective area of responsibility.

- ***Gathering and applying broader background on qualitative contributions:*** Many firms also seek to gather information on qualitative contributions through partner self-assessments, pre-compensation interviews and practice group leader input. This background helps inform a qualitative evaluation of the non-quantifiable contributions. In some instances, firms also seek out qualitative background on partner contributions from partners and/or others within the firm, either in the form of partner peer review or a full 360 evaluation. For a variety of reasons, partner peer review and 360 evaluations are not widely adopted today, but numerous firms have attempted them and both methods can offer useful data for evaluating partner contributions in non-quantifiable areas.

Many of these processes have helped firms get a handle on the magnitude and quality of non-quantifiable contributions. We have explored the benefits of these approaches in various Fairfax Insights, from partner goal setting, to leadership compensation, to partner peer review. However, the question remains - is this progress towards measuring the un-measured enough? Or do law firms need to move the needle further and push for more rigorous methods for measuring qualitative contributions?

Future Approaches

The need for more definition, clarity and measurement of qualitative contributions will likely vary by firm. Some partnerships with strong leadership teams, reasonable depth of the compensation committee's understanding of each partner's qualitative contributions, and a high degree of trust may not require additional tools for measuring non-financial contributions. However, partnerships which struggle with the impact of subjective elements of compensation decisions may require more structure. For those firms, it may be the time to explore a more rigorous approach to measuring the less measurable. Below are two interesting examples:

Impact Metrics: Outside the legal industry, businesses have sought to establish new metrics around qualitative contributions through the development and adoption of 'impact metrics.' These metrics seeks to evaluate and measure the actual impact or result of a qualitative contribution, as opposed to measuring the effort involved. These metrics are often linked back to Return on Investment, or ROI. For law firms, developing impact metrics might start with establishing a defined set of specific investments to be evaluated under an ROI methodology, such as associate retention, key client relationship expansion, industry group expansion, etc., and then assigning responsibility for these efforts to the partners leading the implementation of initiatives or programs associated with each investment area. Firms would then need to agree upon the methodology for calculating the project's impact or ROI, which could be some combination of profitability measurement and a valuation of other impacts on firm profile, morale, lawyer retention, client retention, etc., depending on the project's primary objective. These measurements would produce a value for the impact of the investment, which would then be attributed to specific partners assigned responsibility. Measurements revealing a positive ROI would produce greater compensation, while those producing a negative ROI would produce less.

Client Satisfaction Metrics: Law firms have long debated whether or not to solicit client satisfaction feedback in partner compensation setting. However, few firms have actively or rigorously sought out and applied this data in compensation allocations. Measuring client satisfaction in order to assess non-quantifiable aspects of partner contributions offers firms the opportunity to develop a more data driven analysis of qualitative contributions relating to client service, quality control, relationship management, delegation, etc.

Like any type of partner compensation change, the methodology used for either of these two examples would certainly engender debate within many partnerships, and it is easy find reasons why the implementation might be a challenge. However, the aversion to new ways of measuring qualitative contributions has in fact been part of the reason why law firms continue to lean so heavily on financial metrics in setting compensation. In order for partners to understand the true importance and compensation impact of qualitative contributions and to incentivize them to invest in all of the other critical things they must do to grow and build the business, law firms must seek out more rigorous tools to measure and evaluate each partner's qualitative contributions.

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