Making Sense of Staff Compensation

By James D. Cotterman

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It is a fact that many law firms (as well as many other organizations) hire and compensate people as a reaction to the moment rather than with careful thought. This process has remained essentially unchanged for years. In compensation, it is not uncommon to ask potential employees what their current salary is and to bring them in at that level or with a small increase. It is also common to add inflation and possibly merit increases year after year as long as the person remains with the firm.

A few organizations have forged ahead in a different manner. They now understand the market value of positions and the need to pay proportionally to the level of performance. Compensation programs fail when an organization cannot attract the right people to the organization and then keep those people.

Different programs work for different employers and different systems work for different positions. The following principles should guide you as you review your compensation system.

First, a good compensation program must be capable of attracting and retaining the caliber of people needed.

Second, ample rewards should be provided to recognize the various ways individuals and teams contribute to the organization's success. Those rewards should be relative to the contributions being made.

Third, keep the compensation program simple, straightforward and easy to understand. Consistency and predictability are key attributes. People will not understand a program that does not link pay reliably to performance.

Fourth, a law firm should strive to achieve a strong sense of fairness. This is a perception that must be strongly felt by at least 80% of the staff. In other words it must be an overwhelmingly dominant trait.

Fifth, the program should be flexible. Compensation programs may need to change over time to remain consistent with the firm's needs and the market.

Sixth, you should ensure that the compensation program reflects values that are consistent with client needs and that include client input.

Generally, all law firm compensation programs should be internally consistent in two ways. First the programs for partners, associates, paralegals, secretaries, and other staff should all be focused on the same goals. If your firm is having trouble implementing its business plan, look at the means by which people are compensated. If the compensation programs point in a different direction than the plan, then you have a problem. If the various programs in use for different types of contributors (lawyers vs. staff for example) point in different directions, you may also find that the individuals are working at cross purposes.

Second, the programs should pay for performance that recognizes a broad range of contributions, yet fairly evaluates total contribution, giving appropriate weight to each of the elements. Far too often, we observe programs where the difference in pay and the difference in performance among individuals are terribly mismatched. We also observe situations where the program is too granular in the evaluation process and tries to imply a level of precision that just is not possible. Ever have someone ask why they received $1,000 less than a colleague?

Why should staff be paid in a different manner from partners or associates? They should not. The foundation of all reward systems should be to reward both individual and group performance. All too often a law firm

continued on page 4

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Compensation... *continued from page 3*

will invest significant time and money to renovate the owner compensation program, and leave the associates and staff with programs that are terribly mismatched.

There are three action items in current compensation thinking:

1. ***Use the compensation program to recognize excellence and reinforce the behaviors and the changes that you want to drive throughout the organization, not just among firm partners.***

2. ***Focus rewards so that they are consistent with achieving the organization's goals and the client's needs.***

Some law firms have invested in planning and client feedback tools such as client surveys, to align organizational goals with client needs. Clients are also realizing the important role compensation programs play in organizational performance. They have even begun asking law firms about compensation programs to increase the likelihood that proposed relationships will achieve promised results. As a result, some law firms have responded by integrating client feedback into compensation decisions.

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Compensation is still considered by many to be a prime motivational factor. It is an extrinsic motivator, however, and not the best means of building long-term performance excellence or loyalty within an organization. At the same time, poor compensation schemes are quite capable of hindering performance and the retention of good personnel.

We all would like employees to take pride in what they do and do it right because that is what should be done. Your best employees will perform irrespective of compensation. Your worst employees will not likely respond positively to compensation as a performance lever. Compensation decisions that follow the above principles will reinforce excellence with appropriate rewards. Do not rely on them, however, as a substitute for leadership, coaching or other elements. Personnel problems are best handled directly in real time and not indirectly with annual performance reviews or compensation adjustments.

3. ***Place money at risk and use incentives.***

Bonus decisions are difficult in any organization. They can become so routinized that they are perceived as deferred salary. Or, they can be so small that employees are negatively affected by the bonus award — the author was struck by a comment that "I could flip hamburgers for more than my bonus." What follows from such a system is a downward spiral — a disincentive to achieve, which leads to less financial success for the firm and which in turn yields even less money to reward performance. Bonuses can also be so arbitrary that there is general confusion as to why they are given. Incentives should be clear, such that when achieved and recognized in the reward system, it is evident that compensation is a meritocracy. Finally, bonuses can be so uniform that they do not differentiate top performers from the rest of the group.

Individuals must feel that their own performance will drive much of their compensation. They should also rise or fall, however, depending on how well the team performed (the team may be a department, a practice area, an office and certainly the entire organization). If the two are not blended together, an individual will "give up" or defer performance if the team is doing poorly and there is no possibility of recognition for individual performance (the downward spiral strikes again). Alternatively, if team performance is not highly rewarded, there is little likelihood that an individual will invest in the success of others.

Certainly it is easier to place significant amounts of pay at risk when pay is a six-figure income. Asking a person with $200,000 in compensation to live on $180,000 with $20,000 at risk is far easier than asking someone earning $50,000 to give up $5,000 and live on $45,000. (As a practical matter, most people live at and many beyond their compensation, including pay-at-risk.) Therefore, care must be taken when implementing pay-at-risk systems to ensure the adequacy of the underlying salary.

So, how do we make sense of our staff compensation structure?

Step one is to determine where the law firm needs to be positioned in the market. Your competitive position is important. It determines the ease or difficulty the firm will have in attracting and retaining personnel. Market position also determines the quality of personnel the firm will attract. Historically, the better

continued on page 10

Compensation... *continued from page 4*

employers targeted the 60th percentile of the market as their hiring base (the 60th percentile is that point in the market where 60% of the employees are paid below and 40% are paid above). Today, most organizations have moved to the median (50th percentile) of market.

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Some employers take the position that labor costs are an expense, an overhead item that must be reduced to the lowest levels. There is often confusion between labor costs and labor rates. It has been the author's experience that being cheap with personnel is a costly mistake. Paying low in the market costs an employer in lower productivity, less creativity, higher turnover, lower morale and higher operating costs. In most businesses the quality and productivity of employees make a substantial difference between well respected operations and everyone else. Remember that labor costs are the product of labor rates and productivity.

Alternatively, an employer should not significantly overpay for a position. That is why most employers look to find the middle of the market for base compensation strategy. It also lessens the likelihood that the market, and the employers' benchmark, will move. Reasonable competitiveness in salary and benefits coupled with a reward program that differentiates the top performers will contribute to long-term success.

Step two is to define the market geographically, by types of employers, size of employer and credentials for the position (education, experience, certifications, and skills). Remember that different positions have different markets. Consider this simple test. Where do I go to find candidates for this position? To whom do I lose good people in this position? Answering these questions gives you a pretty fair idea of your market.

Step three is to obtain survey data to determine base salary, total cash compensation and benefits provided. There are many private and public surveys available. You need to understand how the surveys are conducted, who the participants are, how the data are organized, what standard definitions are used, and the like. It is important to read the introductions, the questionnaire, all footnotes and appendices. Call the survey provider if you have any questions — and you should have questions.

Develop as many reference points as relevant on what the market is for each position. Make sure that national or regional data are adjusted for local market conditions. There are surveys, like The Geographic Reference Report, that can assist with this task. "Mature" all data to a common date. Most of your reference points will have been determined at different points in time. All of the data must be brought forward to your best estimate of current conditions. You can use an inflation factor obtainable from the Bureau of Labor Statistics for this purpose.

Step four is to establish a broad pay range for each position. Typical pay ranges are a spread of from 50% to 100%. That is, if the market for a position is $30,000, then the minimum for the position may be $22,500 to $37,500 (a $15,000 or 50% spread). Position an individual's base pay on the individual merits of the candidate. Afterwards, long-term performance and market should guide adjustments to base pay.

Superior qualifications and performance over time should place an individual in the top half of the pay range. Adequate qualifications or performance should place an individual in the middle of the pay range. One should not move from minimum to maximum simply because of the passing of time or inflation. Step three will adjust the range for current market conditions which will include supply, demand and inflation.

Once an employee hits the top of the market, they must be held to the range. Therefore, it is important to do two things. First, the employer should reexamine the market at least every other year. Second, the evaluation system should have the ability to identify those individuals who should be considered for advancement to positions where they can contribute more and where the market recognizes such contribution with higher compensation. A cautionary note: good employees will perform this task for you if you do not, usually with adverse consequences to the employer.

Compensation should be an organization-wide effort to develop consistent, uniform policies that recognize individuals who work together towards common objectives, are attuned to the values and needs of the clients and achieve individual excellence. ◆

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