DETERMINING THE "RIGHT" PARTNER COMPENSATION

by James D. Cotterman

If by "right," we mean that there is a correct compensation level for each individual; we can precisely determine what that amount is; and, we can convince each person of the wisdom and fairness of that amount — then the answer is no. But, if we mean that we can construct a compensation philosophy in which individuals strongly agree that those who are contributing the most long-term value to the organization are paid the most — then the answer is yes.

I have stated for years that every compensation system can work and every compensation system can fail. Two research studies on high performing organizations (Practice What You Preach by David Maister and Good to Great by Jim Collins) concluded that the method of compensation, as a causal factor for high and sustained performance, is largely irrelevant.

In Practice What You Preach, author David Maister states: "Notice that this does not suggest what the pay scheme should be. The determining factor is just whether the people think it rewards the right people."[1] In Good to Great, author Jim Collins reports: "We found no systematic pattern linking executive compensation to the process of going from good to great. The evidence simply does not support the idea that the specific structure of executive compensation acts as a key lever in taking a company from good to great."[2] Both studies found that whatever system is in use, it simply must be rational and equitably managed.

Different systems work for different firms. The following principles should guide you as you consider your compensation system.

- Make the best people decisions possible. Getting this element right greatly simplifies all else.

- Reward contributions to the organization's success. Correlate the level of contribution with the level of pay. This gives credibility to the terms "merit" and "pay for performance".

- Strive for a strong sense of fairness. This is a perception that must be strongly felt by at least 80% - 85% of the partners.

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[1] Practice What You Preach, Page 50.
[2] Good To Great, Page 49.

- Focus on outcomes. It's the quality of the decisions that matter. The system's job is to support making good decisions.

- Communicate. Communicate. Communicate. Talk about how the compensation process works. Talk about the firm's financial performance and the challenges ahead in remunerating all members of the firm. Talk about how the decision-makers go about their job. Talk about the "why" of the individual compensation decisions.

All staff should be focused on the same goals. To achieve that, the law firm's various compensation systems should be consistent. If the systems in use for different types of contributors (lawyers vs. staff for example) reward conflicting behaviors, you may have a problem.

There are three areas of contemporary thinking on compensation:

1. Orient the compensation system to influence behavior and promote change throughout the organization, not just among firm partners.

   There are two groups of employees for whom compensation is not an effective management tool. The intrinsically motivated (6% to 16% of partners perhaps) do not need compensation as an incentive. The struggling performers (another 6% to 16%) will not react favorably to a compensation system that rewards positive behavior. However, that leaves a rather large group (68% to 88%) where compensation can be an effective management tool.

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

   Clients have begun to realize the important role compensation systems play in the behavior of personnel in their law firms. They have even begun asking law firms to describe their compensation systems so that proposed relationships will achieve promised results. As a result, some law firms have responded by integrating client feedback into compensation decisions.

3. Place money at risk and use bonuses for extraordinary achievement.

   Bonus decisions are difficult in any organization. They can become so routinized that they are perceived as deferred salary. Thus their provision becomes an expectation and their removal a demoralizing event. They can be so small relative to the effort to earn them that the bonus negatively affects performance. 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. Rewards should be clear, so it is evident that compensation is a meritocracy.

Individuals must feel that their own performance will contribute to their compensation. However, they must also know that their compensation will rise or fall depending on how well the team performed. Both must occur. 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 rewarded, there is little likelihood that an individual will invest in the success of others (it will have little value if not rewarded).

Let's return briefly to the two research studies mentioned earlier. They are both worthy investments of your time. They are relatively easy reading, with the hard data in appendices. They confirm what our experience has taught us, but organize it in a way that enables us to critically examine our own practices and habits.

High sustained performance is largely the result of doing many things well and it all starts with having the right people.

> "The most striking finding is that the most financially successful offices did better at *virtually everything*."[3]

> "Those who build great companies understand that the ultimate throttle on growth for any great company is not markets, or technology, or competition, or products. It is one thing above all others: the ability to get and keep enough of the right people."[4]

> "The purpose of a compensation system should not be to get the right *behaviors* from the wrong people, but to get the *right* people on the bus in the first place, and to keep them there."[5]

Your compensation system should support that effort. Making decisions regarding individual compensation or changes to the system or process are going to be difficult — even in a healthy and profitable environment. But then, who said that management was supposed to be easy?

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[3] Practice What You Preach, Page 28.
[4] Good to Great, Page 54.
[5] Good to Great, Page 50.