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Don't Blame the Compensation Committee: Underperformance and the Peter Principle

By James D. Cotterman

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When Laurence Peter and Raymond Hull wrote *The Peter Principle: Why Things Always Go Wrong*[i] in 1969, they posited that individuals are promoted until they reach their level of incompetency. Underlying this premise is the assertion that individuals are considered for promotion based on their performance in their current position. Thus, they are repeatedly promoted until their performance no longer warrants consideration for advancement. At that point they are held in a position one rung above where they last performed well.

Past performance is necessary to evaluate candidates for promotion, but possibly not sufficient. More important is an honest assessment of the individual's likelihood of success in the new position.

We see this with all too much regularity in law firms, particularly in the ranks of non-equity and equity partners, resulting in cohorts of lawyers who consistently underperform. It complicates compensation programs designed to recognize and pay people for the critical success factors of those new roles – and then not finding the new required level of performance.

This gets to the heart of the law firm business model and what is expected of partners – practicing law and generating business. Those two skills are a full-time job alone, then we add running the business, managing the practice, skill development, CLE, pro bono and other necessary activities. These are the performance contributions partners must become comfortable doing and doing well.

Most lawyers must devote a substantial portion of their careers to high contribution as a practitioner. Exceptions are okay for very brief periods of time, or when a significant leadership role is undertaken, or at the tail-end of a career as one works to transfer work, relationships and contacts to successors. But for the most part, lawyer time is devoted to practice, with fee receipt contributions typically rising across 90% of their careers and making possible ongoing compensation increases.

Studies over the years have shown that a lawyer's average billable hours decline after about 6 or 7 years of practice – or just about when firms are looking for more from an associate than simply billing hours.

Luckily, historic hourly rate adjustments have more than made up for the decrease in hours (the so-called escalator of experience and the elevator of inflation phenomenon). Since the Great Recession, however, billing rate increases have been harder to get and convert into higher fee receipts[ii]. This has and will be a drag on compensation increases as long as the pattern continues.

The second major consumption of time and effort, but arguably the most important skill of a partner, is business generation. One cannot work on a matter until a client is landed at the firm. As a non-equity partner, there is an expectation for a modest yet meaningful contribution to new business development. Granted that may be primarily by providing new services to clients and increasing the volume of current work. There is also an expectation that non-equity partners will manage portfolios of work, lead legal service teams, and serve as primary day-to-day contacts for clients. This frees up the equity partner to focus on strategic issues for the client and to hunt for new clients.

That last aspect – successfully acquiring new clients – is a prime differentiator between non-equity and equity partners. Without equity partners who have a robust ability to land new clients, any law firm is embarking on a long road to oblivion. And it is this skill that is the most often lacking in chronically underperforming equity partners.

Non-equity partnership can be categorized into three cohorts:

1. A holding ground for those too far along to be classified as associates and not sufficiently capable to become equity partners;
2. A temporary status for those rising through the ranks on their way to equity;
3. A temporary status for those former equity partners who are preparing for retirement or semi-active status at career-end.

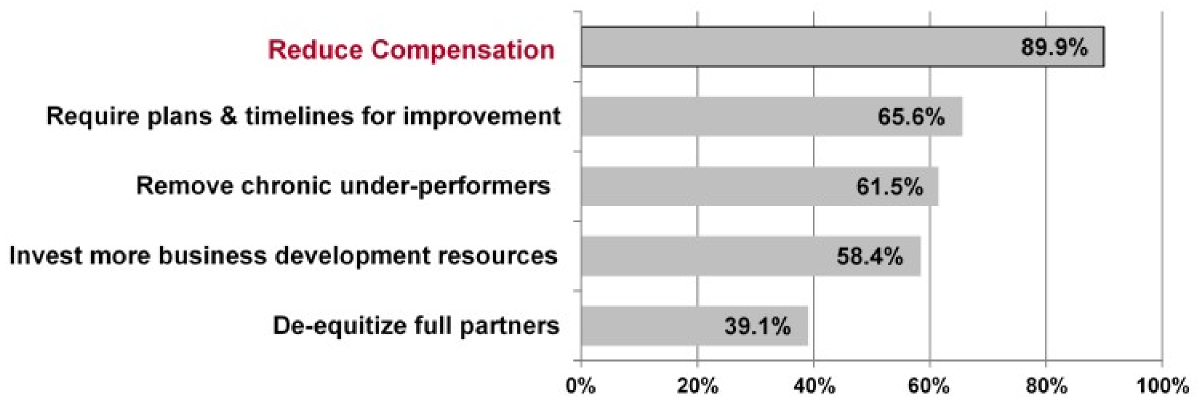
The first cohort is where the trouble lies. There are roles for a *limited* number of senior lawyers who do not meet the business generation skill requirements of equity partners. The emphasis on *'limited'* is critical. Law firms are generally overstaffed across the lawyer ranks, a problem that has evolved profession-wide over many years[iii]. It is quite costly to maintain a significant bench of underutilized talent with insufficient skills in business development.

So here is the *Peter Principle* in action – good lawyers are being elevated beyond roles (senior associate/counsel and non-equity partner) in which they thrived into roles (non-equity partner and equity partner) where they cannot. Law firms are hesitant to aggressively address these promotion failures, believing that this discordance between skills required and skills possessed can be addressed by compensation.

This brings us to a significant challenge facing compensation committees – paying chronically underperforming partners. Note that I do not say 'dealing' with underperforming partners. Generally, the compensation committee's responsibility is to set fair pay, not counsel underperformers out of the firm. And the committee, if given sufficient latitude, will adjust pay downward. According to Altman Weil's *2018*

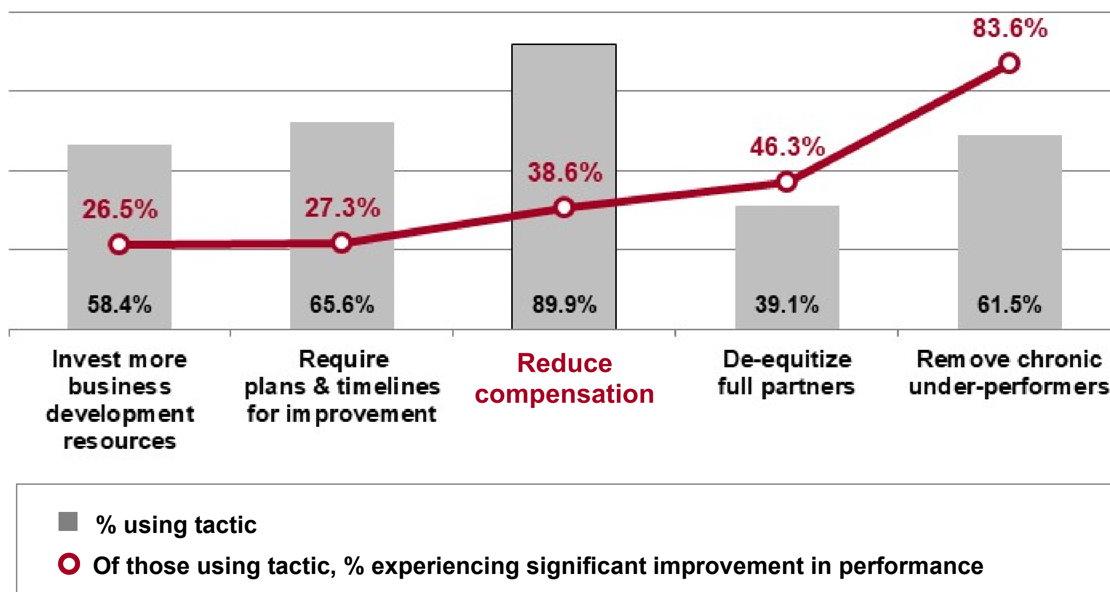
Law Firms in Transition Survey (below) 90% of firms have reduced compensation to address chronic underperformance.

**WHAT HAS YOUR FIRM DONE
TO DEAL WITH CHRONICALLY UNDERPERFORMING LAWYERS?**



However, only 39% of those firms had significant success with reduced compensation addressing the issue (as seen in the second chart). This is because the underperformance rarely improves and often regresses further. The underperformer most likely cannot improve contributions sufficiently to warrant the status and corresponding pay levels. So, expecting the compensation committee to solve the problem is likely going to disappoint the firm. Luckily success in addressing this issue can be found again in *Law Firms in Transition*. Removing chronic underperformers is the best means to deal with the situation.

**HAS EACH TACTIC RESULTED IN
SIGNIFICANT IMPROVEMENT IN FIRM PERFORMANCE?**



Summary

When law firms ask about their compensation programs or about what the compensation committee is doing, it's important to determine if there is a compensation issue or if the real problem lies with promoting someone beyond their capability. The ideal situation (as shown above) is to counsel the chronic underperformer out of the firm. Doing so allows the compensation committee to focus their efforts on recognizing and rewarding performance rather than addressing a lack of capability. It also sends a clear message that contribution standards are real, and individuals will be held accountable if they chronically under-contribute. Finally, it shows that leadership is trustworthy because their words and actions align.

There is support for this approach in other literature. In *Good To Great*, Jim Collins wrote: "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"[iv].

Equitable compensation decisions engender trust and credibility in firm leaders. These decisions are the most tangible expression of what is valued in a law firm. When aligned with leaders' stated priorities, trust and confidence is enhanced. When they are misaligned, trust and confidence wanes. Good compensation decisions are unlikely to drive performance. Inequitable compensation decisions will hurt morale and consequently diminish performance. Mistakes in judgment that result in poor promotion or hiring decisions will have similar consequences as inequitable compensation decisions. A law firm can greatly mitigate these decision errors with a more rigorous review process that incorporates some standardized due diligence (similar to what's done in a transaction).

Don't let the consequences of the *Peter Principle* go unaddressed. A smart compensation committee should make the correct pay decision, but push resolution of the underlying problem back to firm leadership.

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End Notes

[i] *The Peter Principle: Why Things Always Go Wrong*, Lawrence J. Peter & Raymond Hull, Harper Business, 2011.

[ii] The market for billing rate increases is segmented with the very largest and elite firms having more pricing power then much of the remainder of the legal market.

[iii] See Altman Weil Webinar, Too Many Lawyers, Not Enough Work.

[iv] *Good To Great*, Jim Collins, HarperCollins Publishers, 2001, Page 50.