

Part II The Key Components of a Successful Compensation Plan

My last column reviewed the need to periodically assess your firm's compensation system. Here is a link to my previous column <https://attorneyat-lawmagazine.com/is-it-time-review-your-firm-compensation-system>. Here, I will describe the factors to consider when making compensation changes.

TIME FOR A COMPENSATION CHANGE?

An effective compensation system must always be tied into the achievement of business and financial goals and recognize activities which most effectively contribute to attaining those goals. People do what is measured and rewarded, and you can't change behavior unless you can affect compensation.

Compensation systems will not work unless a firm's partners can agree to consider the firm as a business unit, and not just a collection of individual attorneys. In considering change, partners need to think longer term and not focus on how "their" numbers may change next year. Factors such as realization and profitability drive top line growth, aid in recruiting and retaining talent, and help to ensure an enduring legacy.

Although I recommend a firm evaluate its compensation system every 3-5 years, there are events which may accelerate the need for assessment, including (1) inability to attract or retain associates and partners; (2) declining partner profit/distribution; (3) planning for succession/transition of senior partners; (4) lack of partner accountability; (5) decreased realization; and (6) partners expressing increased unhappiness with existing system.

DEVELOPING A COMPENSATION PHILOSOPHY

Changes to compensation structure cannot be made in

the abstract; they must be considered in the context of a law firm's culture, history, values and goals. Partner compensation should reward overall contribution to the firm and be based upon subjective and objective information.

Compensation in a purely objective or formulaic system is calculated strictly based on financial production, giving credit for hours billed and fees received. A formula is predictable and removes uncertainty and "politics" from the mix. Many attorneys like the concept, "If I do X, I will get Y!"

However, there are significant pitfalls to such a system, including manipulation of numbers, unprofitable intake, and little ability to influence behavior. Formulaic systems may unintentionally result in a system that does not recognize, reward or incentivize teamwork, collaboration and "firm first" behaviors. Firms with formulaic systems can also struggle with treating fairly partners who had an unexpected down year.

A subjective system may not be as precise or easy to implement but can effectively incentivize and reward important non-financial contributions that an objective system would not consider. Under a subjective system there tends to be more teamwork. Many firms structure subjective compensation on a points basis or percentage of profit, based on financial and nonfinancial criteria. Thus, a subjective system can smooth out the peaks and valleys of attorneys' performances and income from year to year. The resistance to a subjective system is that it is time consuming to manage, imprecise, and can be perceived to be political.

Some firms use hybrid compensation systems in which a high percentage of a partner's compensation is based on objective financial data, with a separate discretionary bonus pool set aside to reward efforts that may not result in direct financial gain

but are valuable to the firm.

CHARACTERISTICS OF A SUCCESSFUL LAW FIRM COMPENSATION SYSTEM

In speaking with clients who view their compensation plans as effective and successful, I have identified several common elements. The system and process must:

- Recognize and reward contributions toward the firm's goals and objectives.
- Be perceived as fair, consistent and predictable.
- Be fundamentally fair (Do I get paid fairly for what I do?) and relatively fair (Am I paid fairly when compared to other partners?).
- Recognize and reward consistent contributions to the firm's historical success.
- Recognize and reward immediate past year strong performances and the prospects for major contribution in the immediate future.
- Foster an atmosphere of unity, teamwork, collegiality, and harmony within the firm.
- Avoid significant swings in base compensation from year to year.
- Afford a process to allow partners to provide comments and recommendation about themselves and other partners.
- Consider the success of personal goals and objectives.
- Recognize and reward a variety of contributions to the success of the firm by members possessing diverse strengths, skills and interests.

There are almost as many compensation systems as there are law firms. Most lawyers practice because they enjoy what they do, and the profession provides the opportunity to earn a good living. Lawyers, however, look at their value and contribution through different compensation lenses and sometimes, like a successfully negotiated settlement, there needs to be compromise.



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