

Linking Partner Targets to Profit Shares

By Nick Jarrett-Kerr

The issues of partner performance and rewards are rising on law firm agendas, especially with the impact of new age discrimination legislation. Law firm leaders talk a good game about how the firm 'rewards what it values, and values what it rewards' but in reality many firms give scant regard to anything except seniority and billing. What targets should a firm set for its partners if it wants to build for its future and not just recognize past achievements? The success of law firms in the future will depend heavily on the extent to which they can improve and renew their intangible assets and intellectual capital (IC) i.e. the client relations and the human capital of its professionals and their practices. It is the capabilities and competence of a firm which attracts the clients, and such competence increases with use. These notes concentrate on how to get the best out of partners across all areas of the firm by setting the right targets and sharing profits based on the achievement of those targets.

1. Introduction

The success of any law firm which operates with any sense of true partnership is the constant balance of developing the skills and performance of the owners for the better while maintaining the benefits of trust and collaboration amongst the partners.

The success of any law firm which operates with any sense of true partnership is the constant balance of developing the skills and performance of the owners for the better while maintaining the benefits of trust and

collaboration amongst the partners. Performance measures have traditionally been informal or only based on billing, making no attempt to achieve this balance. Partners' targets must be deeply rooted in a firm's values and culture and aligned with strategic goals.

The process of linking targets to profit shares should be based on five key underlying principles:

1. Recognising and understanding that there are a number of internal and external factors which influence and affect the way in which partnership profit shares are divided.
 1. Internally, experiences within the firm coupled with factors such as the firm's size, its culture, values and accepted behaviours have a heavy influence on the reward system and vice versa.
 2. The impact of external influences such as the Legal Services Bill and age discrimination legislation all affect the environment in which firms operate and the structures and disciplines which evolve within the firm as it faces up to its particular demands and challenges.
 2. Breaking down the firm's strategies to all levels of operation through a Balanced Scorecard;
 3. Defining the firm's performance expectations for all of its partners at every level of seniority and development;



4. Regularly reviewing the individual partner's progress and performance against the Firm's expectations; the system should be clear and simple. In the words of Jack Welch in his book *Winning*, "it should be clear and simple, washed clean of time-consuming bureaucratic gobbledy-gook. If your evaluation system involves more than two pages of paperwork per person, something is wrong."

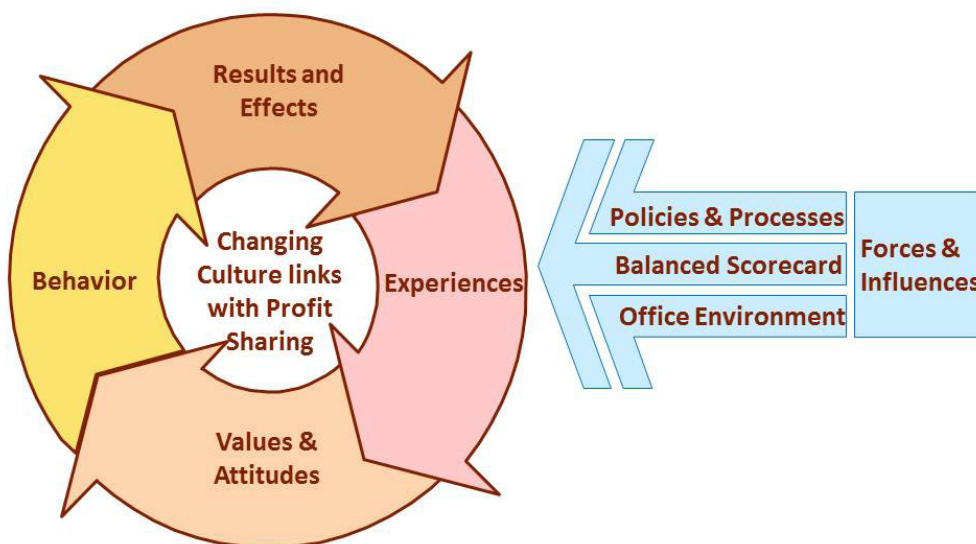
5. Determining the profit allocation should be based on partners' contributions to the progress of the firm and not just the attainment of pre-ordained targets.

2. Values and Rewards: the Perpetual Cycle

Before a firm can link performance to profit it must consider its culture and whether a shift in values is required to adopt a different style of reward system. What do firms value? Most firms lie on a spectrum between the traditional collegiate firm which harnesses performance from its partners through a value system of trust and expectation of future higher rewards further up the lock step and the more entrepreneurial 'eat-what-you-kill' firm which harnesses performance by emphasising internal competition for

rewards based on yesterday's performance. A firm's culture and values will influence its choice of reward system and vice versa. The behaviour of partners is governed by their values and attitudes which in turn are based upon their previous experiences. To bring about changes in the way partners are valued and rewarded, we must create some forces and influences which will gradually affect partners' experiences and then their attitudes and behaviour. For this, we need three things. First, a balanced scorecard approach encourages partners to believe that there are other things which the firm values as well as financial performance. Second, the firm must have in place the policies and procedures which will help to give partners the comfort they need to trust in the new arrangements. Third, the firm must work hard on the firm's climate and environment to ensure that a supportive culture exists.

The Perpetual Cycle



© Copyright 2011 Nick Jarrett-Kerr All rights reserved

116

NJK

NJK

What is important is that a firm recognises that its values and reward system are interdependent and constantly evolving. External

3. Strategy into Practice: the Balanced Scorecard

Adopting a new strategy is one story; actually implementing it is quite a different one. Most enterprises fail to deliver on their strategic objectives as they do not align any of the internal functions and operations to the new strategy. In a law firm where the owners come to work every day, weaving the new strategy into the daily practice is quite challenging. The challenges arise out of:

- the independence of each partner who more or less commands his/her own agenda, and
- the dependence of client relations,

influences will also impact on a firm's choice of reward system. Lock step reward systems can favour or adversely affect older partners and this is potentially age discriminatory falling foul of age discrimination legislation.

A firm will have to justify why it remunerates partners based on length of service. Encouraging loyalty is no justification because there are likely to be younger partners further down the lock step who have been at the firm longer and lateral hires who are brought in part way up the lock step.

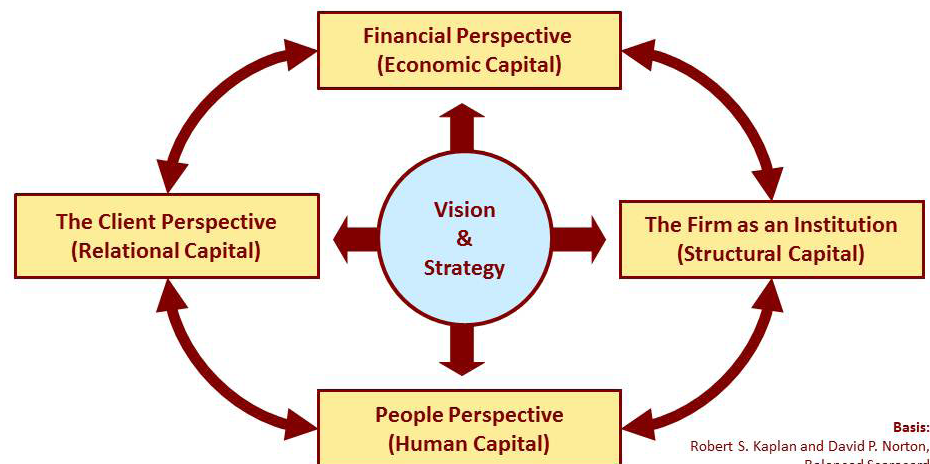
A firm will have to justify why it remunerates partners based on length of service. Encouraging loyalty is no justification because there are likely to be younger partners further down the lock step who have been at the firm longer and lateral hires who are

brought in part way up the lock step.

Firms therefore need to introduce some form of performance management to assist in managing (and at times managing out) the older partners sitting at the top of the lock step. Fixed retirement ages will also be difficult to justify under the age discrimination legislation. Firms will need

to provide real evidence of the business need to retire partners, which could come from a performance management system. Hence, age discrimination legislation could force law firms to adopt some form of performance review whether their value system suits it or not.

The Balanced Scorecard



Basis:
Robert S. Kaplan and David P. Norton,
Balanced Scorecard
And Edvinsson etc, Intellectual Capital

© Copyright 2011 Nick Jarrett-Kerr All rights reserved

25



skills and know-how on individual Partners and other professionals rather than the firm.

The key point to actually putting the firm's strategy into practice is the alignment of



individual contribution to the firm's overall good. The Balanced Scorecard is a state of the art technique for aligning an individual's contribution to overall strategy. The Balanced Scorecard is a management system invented by two Harvard Business School professors Robert Kaplan and David Norton. It is to date probably the most successful business tool to drive strategy through an organisation in the corporate world; it is easy to understand, flexible in design, uses people in the organisation to create it and does not create an administrative burden. In recent studies some 80 – 90% of larger corporations have implemented some form of the Balanced Scorecard (BSC). In the late 1990's the consolidating accounting and auditing firms introduced the BSC to their organisations. Today all four remaining big auditors – together with many law firms - are using the BSC extensively, in some form or other. The Balanced Scorecard is therefore a powerful methodology to align the firm's every day operations to its long-term strategy. Its purpose is to translate vision and strategy into all the actions that the firm undertakes. This is done by looking at desired results from certain perspectives. I have changed the basic Kaplan and Norton model in two ways. First I have aligned the model to reflect the concept that the main constituent assets of law firms are elements of intellectual capital, rather than tangible assets. Second, I have developed the Balanced Scorecard methodology to fit the environment in which lawyers develop their careers by serving their clients, processing their work, and making profits. Hence the perspectives are:

- Relational Capital (Clients): how well



the firm develops its relationships with the outside world

- Human Capital (People): how well the firm develops the capabilities of its lawyers
- Structural Capital (the firm as an ongoing institution): how well the firm develops the 'way things are done round here' - work-flows, processes, and knowledge management
- Economic Capital (Financial Contribution): how well the firm combines its intellectual capital to achieve financial and commercial success.

Strategy can only be implemented by a law firm's partners and its employed lawyers if they perform not only financially but in all four areas. This is best promoted by formulating personal scorecards. - made up of personal targets and initiatives that contribute to the success of the firm and its practice areas.

4. Driving for Excellence: The Firm's Performance Expectations

In our view, every firm should define carefully the objectives which it has for introducing a Performance Management System for partners which can lead to the setting of goals and targets which can then be linked to profit sharing. The table below sets out some of the objectives which we recommend. After all, whether and how fast the Firm succeeds at reaching its strategic objectives is determined by three factors:

- how much the lawyers work (volume);
- how effectively the lawyers work (value);
- how well the lawyers work together (level of collaboration).

The firm needs to help each partner achieve

absolute excellence in terms of their value and level of collaboration; to get there it will always need from every partner a substantial contribution on volume.

While the first criterion is clearly limited by the number of hours in the day, the latter two can be extended almost without limit. The firm needs to help each partner achieve absolute excellence in terms of their value and level of collaboration; to get there it will always need from every partner a substantial contribution on volume. Having said this, no one wants to create “clones” or expects that every Partner is excellent at everything. Instead the Firm helps develop his/her strengths and makes sure that otherwise the Partner is comfortably achieving the minimum requirements.

We have recently been working with a number of firms to define the expectations of their partners on a Balanced Scorecard basis. Our methodology requires in the first place a comprehensive study of the behaviours and accomplishments which are expected and valued of partners at every level in the firm. We have found that this then results in the establishment of criteria which are complementary not only to the firm’s assessment processes for promotion and rewards, but also to the firm’s overall strategy and objectives. The creation of a Partner Development Programme can then normally assist partners to develop across four levels of partnership - new partners, intermediate partners and experienced partners (with a fourth aspirational level to describe the truly exceptional role model).

Twenty Objectives for Partner Performance Management Processes

Strategic

1. Identify the areas where the firm must perform as a whole in order to achieve its strategic and economic objectives which can then be drilled down into ‘Key Areas of Performance’ on a Balanced Scorecard (BSC).
2. Ensure that remuneration levels match contributions to strategic objectives of the Firm as well as the maintenance of cultural values.
3. Recognize/reward long term growth towards strategic objectives rather than just short term results.
4. Encourage partners to support new ventures and develop new services in line with objectives.
5. Encourage, motivate, value and reward high achievers who are critical to the firm’s strategic success and who contribute to an exceptional level.
6. Manage and develop performance in the broadest sense in all areas on the BSC.

Teamwork

7. Sustain concepts of teamwork between partners with greater collective responsibility for the performance of practice areas.
8. Encourage and reward the most capable partners to lead the firm and practice areas as effectively as possible.

Culture, Values, etc.

9. Reflect the values of the partnership and cohesion of the firm.
10. Value performance which contributes to the sustained growth of the firm and one firm approach.
11. Embrace a firm-wide approach to en-



able partners in different practice areas to be rewarded on a consistent basis.

12. Discourage maverick behaviour.

Human Capital Development

13. Clarify the differing roles of partners as working lawyers, producers, managers and owners.

14. Enable the firm to attract and retain partners of the highest calibre and introduce partners from other firms.

15. Be linked to internal training and review processes which support the development of partners' development and improvement in performance.

16. Recognise that partners have different qualities and should be encouraged to focus on areas where they have strengths whilst contributing in all areas.

17. Link with the firm's career development structures for its professionals.

Performance Expectations

18. Achieve clarity in the processes for reviewing/appraising partners and setting objectives

19. Define the requirements and appropriate performance levels for partners at each stage of progression on the firm's lockstep ladder or partner career structure both qualitatively and quantitatively.

20. Identify the data and evidence which will be collected and used to measure performance.

In developing their plans to advance their careers and contribute to the firm, partners would be expected to show two things.



First, they would be expected to show how they have performed and what they have accomplished for their level of seniority. At entry level, for example, the indicators might suggest that a partner should show evidence of training and education both undertaken and planned in order to achieve deeper specialisation and industry knowledge. The second and perhaps more important point to be shown by partners is that they are striving to improve and are working towards higher levels or grades. The levels become more demanding, as partners gain experience and seniority. Ultimately a partner might be expected over the course of time – for example- to be able to show evidence of exceptional fame. This might perhaps be an ambition to be recognised nationally and internationally or named in one or more Directories as a leading expert. This developmental dimension to the scorecard therefore stresses the external elements of the criteria; this should not only be an internal performance assessment methodology but an important tool to help focus partner development and ambition.

The expectations for partner minimum requirements can be subdivided into five categories (or Key Areas of Performance) which are aligned with the BSC. A sample – for an entry level partner – is shown in the Annex at the end of these notes.

1. Financial and Business Performance (Economic Capital)
2. People Management, Leadership and Team/Skills Development (Human Capital)
3. Business Development (Relational Capital 1)
4. Client Relationship Management (Relational Capital 2)
5. Overall Contribution to the Firm as an Institution--Knowledge Management and Solutions (Structural Capital).

Within each of these core areas of performance, care should be taken to define measurable or assessable descriptions of factors that are relevant for judging whether a Partner meets the basic, moderate, high or extreme performance levels. These can be quite simple in some firms (especially where a high level of collegiality and trust exists), but I have found that many firms (where partner trust is low) require a model which is quite complex and prescriptive in order to persuade partners that a large measure of objectivity and 'evidence' will be employed in the assessment process. What is important is that any evaluation system should measure people on relevant and agreed criteria that relate directly to the partner's contribution. The contribution should be both quantitative (based on how people deliver on their measurable objectives and Key they deliver on desired behaviours).

It is clearly performance Indicators) and qualitative (based on how in the firm's interests to see every partner achieving the exceptional performance levels in as many areas as possible. Having said this, it is clearly unrealistic. The firm should aim to encourage its partners to relentlessly work at extending their strengths and making sure that even in their weaker areas they achieve the basic standards.

As a partner grows within the partnership, his/her contribution should increase. This does not relate to the overall hours spent on firm business or the degree of collaboration, but to the value that the partner brings to the firm. It is therefore proposed that partners who have been practising for longer to achieve higher performance results on the grid than less experienced partners. This unfolds as follows:

1. At any stage in the partnership, every partner must be seen to reach the "baseline" performance level in every area on the grid;
2. As every partner progresses in the partnership, higher performance is generally expected
3. Preferably, partners should outperform their expected requirements by a wide margin whatever their level in the partnership. The firm's goal is to help every partner through the grooming process to strive for the "extreme" performance levels which the firm has identified for its star partners.

Reviewing Partner Development

At least every twelve months, every partner should conduct a review of their performance together with either their department head or the managing partner, as appropriate. The primary purpose is to discuss and clarify developments on the development grid. The basis of the discussion will be:

1. a preparatory self-assessment by the partner based on his Personal Contribution Plan;
 2. a summary by the partner of his chargeable work as well as major activities on non-billable work (both pre-agreed and own initiative), including any client or internal leader feedback
 3. if possible, a 360° review with views from fellow partners, associates and staff, and, to the extent available, from clients.
- These types of review have been frequently placed by law firms in the 'too difficult' pile, but we have recently seen (and



helped) a number of firms produce state-of-the-art working 360° models.

The review should lead to determining the areas of focus for improving performance in the next six to 12 months and for identifying the support the partnership can provide; the partner will then integrate this into his/her Personal Contribution Plan that he/she will develop for himself/herself and discuss with his/her department head.

Setting Targets and Objectives

In many years of appraising (and moderating appraisals), I have found that the most difficult and badly done section of the annual appraisals is the setting of objectives. In many years of appraising (and moderating appraisals), I have found that the most difficult and badly done section of the annual appraisals is the setting of objectives. One problem is that this is an area which is normally left until last on the appraisal form and is dealt with when both parties have become tired or when time has run out. There are six typical objective setting problems which need to be avoided:

- The objectives are hurriedly drafted and skimmed – they do not adequately reflect appropriate career development;
- The objectives are too vague and aspirational – they cannot be interpreted, acted on as a series of tasks, or measures;
- The targets are unrealistically high or too low – either will demotivate the partner;
- The process has become bureaucratic – it is seen as a paper chasing exercise;
- The objectives have no meaning and

are left to gather dust – the appraised partner will wonder if the review process has been worthwhile;

- The objectives are simply imposed by the appraising partner and not ‘owned’ by the appraised partner – the appraisee will view their involvement as insignificant.

There are seven rules to setting targets:

1. The most important rule is to ensure that the targets and objectives are linked to the overall strategy of the firm.
2. Where you can, try to focus on outcomes rather than activities. This is much easier said than done. For example, instead of “work to improve cash collection”, one might say “by the end of the next quarter negotiate interim billing arrangements with the following clients”. Instead of “assist with precedent building”, one might say “review and redraft the firm’s standard lease for small offices by October 31st.”
3. Make sure the wording is SMART and carefully worded.
4. Check that the objectives are prioritised (use words like ‘must’, ‘should’ and ‘could’ to give a sense of this).
5. Make sure that it is clear how the targets and objectives are going to be measured. Some metrics are obvious. Others are elusive, particularly when they are less specific and more aspirational. The key to this is to keep asking the question ‘how will we know when we have achieved success?’ The aim is to be able to set some measures based on one of four yardsticks - time/speed, cost, expected quality level, or positive results.
6. Make sure that you agree some mechanism or timetable for regular monitoring.
7. Finally, make sure that the targets and objectives are mutually agreed.

Allocating Profits

Partner Profit Shares in a discretionary sys-



tem comprises two main elements; first, there are incentives designed to motivate partners towards new levels of achievement and second there should be an element or 'bonus' to recognize and reward achievement after the event. However, whether reviewing partner rewards or assessing partner promotions and progressions, the danger is that the process of deciding these elements can be cabalistic, anecdotal, uninformed and inconsistent. Any sophisticated system should attempt to address this by providing a methodology to ensure, as far as possible, that the result will be fair and reasonable and objectively arrived at, whilst ensuring, at the same time, that the process does not become bureaucratic, cumbersome, costly and time-consuming. As firms move towards a system based on performance, it is tempting to consider applying some rating mechanisms to all or any of the following:

- The competency level attained by each partner within the Balanced Scorecard.
- The general development of the partner.
- The success or otherwise of each partner in attaining the objectives agreed with him or her.

There are many difficulties in a rating approach:

1. If lawyers are to be rated, they generally expect to see full details of the evidence presented and assessed – lack of trust usually means that a rating process can be long drawn out and complex if it based on factors other than financial performance.
2. Ratings tend to look at achievement of the measurable objectives or attainment of key performance targets rather than the value added to the firm by the partners contribution.
3. A Rating system assumes that the value of a partner's contribution to the firm's performance increases because of a single

year's short term performance.

4. Even with well defined and agreed objectives, there are many other factors which influence how successful a partner has been. Objectives can become quickly out of date.
 5. The process of setting objectives is usually done very inconsistently, and criticisms of 'soft targets' abound.
 6. Most appraisers are reluctant to score, grade or rate their people. The problem is that if you score low, it can result in an argument; if you mark high, it can make the appraised partner complacent or arrogant. Most appraisers tend to play it safe and mark somewhere in the middle, thus making the entire scoring process rather pointless.
 7. Ratings also work off individual performance, rather than contribution towards team performance.
 8. Ratings tend to be average – and as it has been frequently pointed out 'averages are the enemies of the truth.'
- Many of these issues can be addressed with a more holistic system of overall assessment and judgment, which takes into account all relevant data. For that purpose many firms set up a remuneration committee.

The role of remuneration committee should be fairly and consistently, and without favouritism or prejudice, consider and evaluate the contribution of each partner in accordance and for that purpose should: thoroughly examine all such data and materials supplied to it in relation to the Balanced Scorecard, any key performance indicators, or otherwise, as it thinks proper



and appropriate, and consider any representations made to it whether oral or written, take into proper account any lockstep arrangements, consider each Partners Contribution Plan and appraisal objectives (if any), consider the key areas of performance and take into proper account its assessment of each partner's performance and ability in those areas against the key performance indicators, and take into proper account any guidance and other criteria which the Partnership shall determine from time to time.

Summary--Ten Golden Rules for Assessment and Reward System

All of the outlined issues require a deep-seated and well-considered long-term approach. There are no quick and easy fixes. Here are ten golden rules:

1. Ensure the system is changed as infrequently as possible, and put as much effort as possible into fair and consistent implementation.
2. Introduce a fair and robust Partner Development Programme, which focuses on both financial and non-financial performance/development and which has business and individual career planning at its heart.
3. If you want to reward Partners on a Performance-related basis, develop a fair 'balanced score-card' approach to reflect overall contributions to and roles in the Partnership, before you attempt to intro-



duce any merit based system.

4. Try to encourage a sharing team-based culture, which
 1. emphasises the gains and benefits to be had from diversifying opportunities and spreading risk amongst a group of partners, and
 2. refuses to value aggressive internal competition or anything which promotes an individual 'eat what you kill' mentality.
5. Settle only for the pursuit of excellence, recognising that to be content only with the pursuit of competence will lead to inevitable decline.
6. Understand and manage expectations, avoiding, if you can, any system that requires over-frequent and repetitive subjective assessments with all the anxiety, loss of time and raised temperatures which are inevitably involved.
7. Avoid too rigid or formulaic an approach, although some degree of certainty and pre-determination is vital.
8. Try to achieve some measure of clarity or transparency between the elements of reward which are seniority based and those which are performance based.
9. Do not lose sight of the need for open and honest communication on a constant and consistent basis.
10. Above all, recognise that you are dealing with a set of individuals with a complex combination of confidence, ability, ambition, arrogance, fear, paranoia, resentment and frustration.

Annex

Sample Indicators of Competency Behaviours

for an Entry Level Equity Partner:

Financial Performance (Economic Capital)
Evidences the capability to command a book of client business of at least four times the average profit per equity partner in the firm.

Works at least 50 hours per week.
Plans for and achieves high value matters.
Achieves superior performance against chargeable hours targets.
Maintains good financial disciplines.

Human Capital Management
Has a strategic grasp of manning requirements and plans to ensure appropriate level and mix
Creates a dynamic atmosphere for teamwork
Coaches and delegates responsibly
Displays the ability to motivate and inspire people

Professional Expertise and Technical Skills
Recognised widely as an expert with deep specialised knowledge in chosen area of law
Consistently delivers services to meet client expectations
Seeks and plans for future trends, opportunities and threats, anticipating the need for change
Cascades knowledge throughout the practice area.

Relational Capital Networks
Develops and maintains strong and profitable client/referrer relationships which are critical to the firm's success
Develops networks which are helpful to the Firm for recruitment and the increase of knowledge
Brand
Raises the Firm's profile nationally
Enhances the Firm's reputation in its chosen markets
Assists the Firm's efforts to develop its differentiation
Clients
Has developed a deep expertise in client industry sectors
Shows clear accomplishments in bringing in valuable new work
Achieves role as trusted adviser or business

confidant to major clients
Plans, measures and manages all aspects of Firm's interface with its clients
Plans innovatively for better service delivery.
Contribution to the Firm as an Institution (Structural Capital)
Contributes to the building of the firm's intellectual property including precedents, templates, case management and work-flows.
Assists in the development of leading edge knowledge management and high level technical know-how .
Actively helps builds the firm's processes and systems which contribute to the firm's ability to grow its business including quality control/improvement, governance and management structures
Contributes to the development of a homogeneous culture and esprit de corps.

