

Reward Partner Performance and Contribution

Objective

Agenda:

We'll explore:

- The role of trust in any compensation plan and balancing the inherent self-interest of each partner with what's right and fair for the group
- The potential cause-effect relationship between compensation and your firm's buy/sell and governance models
- Transparency in determining partner compensation and the pros and cons of open and closed compensation systems
- The mechanics for structuring a fair, rewarding and understandable compensation plan
- Don't Start With Compensation
- Too often, partner compensation is the tail that wags the dog
- Partners try to solve behavior problems or poor performance through the compensation system without addressing the matters head on
- Or, compensation is a mysterious "backroom calculation" that partners don't fully trust
- This leads to a feeling of internal competition with each other
- Compensation's Place
- A motivational compensation system can be defined when you have:
 - Developed a clear and unified strategy for the firm so you can drive the right behaviors and outcomes from your people
 - Defined each leader's role and goals so you can determine their target compensation and how they will compare to others in their group
 - Created reporting mechanisms to evaluate performance against expectations so that compensation can be fairly assessed against true performance

The Leadership Development Model

- *The more of these elements you have in place, the more effective and successful your partner compensation system will be.*
- Acknowledge Self-Interest
- Self-honesty is required to acknowledge what's important to you as you establish your compensation system and balance what's "right" for the firm
- Remember, we all have **self-interest!**
 - There are very few Mother Theresa's
- Begin by identifying your self-interest in what you want from your role in your firm
 - Then create an environment where each person can share their self interest -- and start working on your relationships with one another realizing you're each working to protect your self interest
 - But that the needs of the firm as a whole must outweigh the needs of its individual players
- Talking About Money
- One of the issues you face in this discussion is trying to maximize personal wealth, which can be awkward (and even emotional for some)
- Trust Is Key!
- A foundation of trust will help facilitate discussions about compensation
- Balance and acknowledge each individual's self-interest and objectives for your compensation system with the objectives for the firm
 - A bit of faith will be required that when the firm performs, individuals will be rewarded
 - And that adjustments and tweaks will be made to the system as you learn how it works, your business evolves and the market dynamics change
- Partner Compensation
- While no one is really ever completely happy with what they earn, and all of us would be happy making more, you should elicit specific concerns your partner group has with your current comp model
 - Only then can you work to construct a plan that is rewarding and promotes the performance required to meet the firm's goals

- The issues may be different for equity partners and income partners
 - *The Role of Governance and Buy/Sell*
- They're Inseparable
- Compensation And Buy/Sell
- It is difficult to reform your firm's compensation without acknowledging the tie to governance and buy/sell
- Many firms' buy/sell agreements calculate a partner's buyout based upon a formula that uses past compensation as a variable
 - This causes self-interest around compensation to be a "double whammy" – trying to maximize compensation in years that will most impact my buyout formula and maximize my pay out
 - Compensation And Buy/Sell
- And some want to earn big money now and expect a big "payday" at the point of retirement, too
 - The two are not usually compatible with the health of the firm or the unity of your team
- You cannot make shifts to compensation without examining effects to the buy/sell
 - Compensation And Governance
- Your firm's governance or decision making may be tied to shares of stock or ownership in the firm
- Sometimes, big shareholders wield big power in the decisions made around compensation
 - Whether they sit on the Executive Committee or Compensation Committee
 - Often, they are seen as getting it "all ways" – pushing for more compensation themselves and pushing for the big buy down later, too
 - Compensation And Governance
- Further, some firm's compensation systems take into account equity ownership as a calculation element
- This incents people to hold onto shares longer than necessary and appropriate, or to negotiate "backroom deals" to buy back shares from retirees in order to maximize compensation (and power)

- Lastly, your firm's governance agreements may define compensation systems or processes and it is important that you are fully aware of what your agreements call for before making change

- *Compensation Models*

- A Good Comp System Is...
- Motivational and designed to drive the right behaviors to meet goals and contribute to the firm
 - If people are money motivated, will improve firm morale and momentum!
- Understood by all (in writing)
- Simple (or as simple as possible)
- Fair – those who contribute the most get the most and those who contribute the least earn least
- Trusted
- There Is No Silver Bullet
- Every firm handles partner compensation differently
- The typical methods used are:
 - Partners decide
 - Pencil and paper
 - Comp committee
 - MP decides
 - Formula
 - Even split
 - Lock step
 - Pay for performance
 - Variations/combinations of these
 - Compensation Methods
- Rosenberg survey – 8-12 partner firms
 - 69% of firms have an open compensation system

- 49% use a compensation committee with some subjective or non-numeric factors (73% of 13+ partner firms do so)
 - 28% use a formula only (14% of firms with 13+ partners)
- IPA survey of 304 non-national firms
 - 62% have an open compensation system
 - 42% have a compensation committee
 - 24% have a formula-based compensation system
 - 16% have a partner group decides compensation system
- Open Vs. Closed Compensation System
- Open compensation systems:
 - Promotes transparency
 - However, focus is on comparing to others rather than producing
 - May encourage an environment that supports parity
- Closed compensation systems:
 - Can elicit questions about fairness if the system (and partners) are not trusted
 - Require less “politicking” and time by following a well-defined system
- *Performance-Based Compensation System*
- *“Firms are paying an increasing amount of attention to intangible contributions partners make to their firms’ overall success. Examples are nurturing and developing staff, teamwork and firm management. Formulas usually ignore these considerations. Compensation Committees do a much better job of factoring intangible contributions into compensation decisions than formulas do.”*

Marc Rosenberg

- Pay For Performance
- We’re believers in getting as close to a pay-for-performance compensation system as possible
- Making changes in comp systems has to be transitional
- Some foundational tenants include:

- Compensation is separate from net operating income (NOI) or return on owner's equity and/or shares owned
- Some separate NOI and pay whatever is left over after compensation based on shares (others pay owner's return on equity "off the top")
- Comp should be roles-based – those with the perceived most valuable roles make the most
- It includes a combination of base salary (draws) and discretionary or "at risk" compensation
 - A portion of your overall compensation is put "at risk" pending your performance against your one-size-fits-only-you goals
- Pay For Performance
 - Incentive compensation is tied to specific, measurable, one-size-fits-one goals that are established for each partner each year
 - They are documented in writing and are specific
 - Reward current production with clear effect on upside to comp or a take-away if it's not hit
 - And future capacity, such as new business and people development
 - Each goal would have a specific dollar value assigned to it that would be earned when the goal is achieved
 - Sometimes, firms tie the ability to earn discretionary and/or the share of NOI to partner minimums, such as:
 - Total hours, total charge hours, revenue contribution, attending partner meetings, WIP/getting billing done, collections, etc.
- Transitioning Your Plan
- Making changes to your partner compensation system must be transitional
 - Partners need the time and opportunity to adjust to the level of performance required to earn their incentive compensation
 - Or, adjust their lifestyle in accordance with lower anticipated earnings going forward
- Transitioning Your Plan
- The first step would be establishing the total compensation pool

- It could be calculated several different ways
 - If the firm is projected to grow in 2012, you'd want to project how that revenue growth will affect the monies available for partner draws, discretionary pay and NOI
 - A decision to include NOI or not in compensation projections would need to be made
 - NOI could be separated and paid based on the percentage of shares owned
 - Transitioning Your Plan
- Written role descriptions and measurable goals for every partner for the new year would need to be established
- You can then “value” the roles in a number of ways to establish target comp:
 - Based on prior year's draws
 - Distinguishing between income partners and equity partners
 - Paying more “value” for those with “bigger” roles – EC members, Comp Committee, Managing Partners, Service Line Leaders, those with more/additional administrative responsibilities
 - Paying more for partners who are closer to “fantasy performance” than others
- Paying For Performance
- A philosophical discussion to have with your leadership team is how large a ratio can you accept between your highest and lowest paid partners
- According the IPA's 2009 analysis, the higher the spread between highest to lowest paid partner, the higher the total average partner compensation for the firm will be
- To calculate your firm's ratio, take the highest paid partner (\$500,000) divided by the lowest (\$150,000) to come up with your ratio (3.33)
- Measuring Your Group
- Consider an exercise to see how you would rank each of the partners based on their:
 - Role contributions
 - In each of the “fantasy” areas
- Then see how you could establish an earning hierarchy based on these perceived values

- You would then decide how to distribute the base monies across the partners based on their “street” or “role” value to the firm
 - Examine any big disparities in pay and determine if you can still justify them
- Base Versus Discretionary Pay
- Base versus discretionary pay would then need to be established
 - There is no “perfect” split for how much to put at risk or as incentive-based
 - To start, consider establishing the base as 80% and discretionary of 20% of each partner’s target comp
 - Some recommend upwards of 30% for the discretionary portion
 - Specific goals would need to be established and dollar amounts assigned to each that would be earned when they are hit
 - Discretionary Pay Concepts
- Goals have to be indisputable
- You have to decide if discretionary pay is paid on each goal as pass/fail or percentage complete
- Those who don’t meet achieve their goals (all or part) have their monies kept in a pool that can be used for subjective, spot bonuses
 - Model For An Income Partner Plan
- This model could be used for an Income Partner plan, too
 - Roles need to be defined and measured
 - If there are differences in the IP roles where some are more “valued” this would help identify those areas
 - You could then assign “ranges” for total comp targets
 - Total compensation targets need to be established
 - A percentage of the total compensation, using 20% to be consistent, would be “held-back” for discretionary pay
 - Specific goals with assigned dollar amounts would be established and earned as each are hit
- Compensation Is Not The Only Reward!

- Remember, people value and are motivated by different things and compensation is only one of them
- Be sure you are also rewarding your partners through:
 - Acknowledgement and respect
 - Increased responsibility and challenge
 - Personal development
 - Camaraderie and fun
 - Flexibility and time off
- ***Next Steps***
- Reward Performance
- Partner compensation is both the “driver” and “end result” of an effective partner performance and accountability model
- Apply these concepts to transform your partner compensation system so that it rewards partners for both individual and overall firm success