Financial performance:

Are your partners measuring up?

Performance measurement is often considered an HR discipline, but the financials are the key to most clearly establishing whether a partner or practice group is really up to scratch.

BY PETER SCOTT, PETER SCOTT CONSULTING

A year ago *FD Legal* published an article by me in which I wrote: "Managing the financial well-being of a law firm is not so much about figures but all to do with managing the people in the business (particularly partners) to ensure they maximise their potential and the firm gets the best out of them."

Currently in law firms there is (rightly) increasing focus on enhancing performance and, in particular, partner performance. At the same time, firms are developing reward systems, which directly, and in a transparent fashion, link performance to compensation.

How to fairly match reward to contribution is, and will increasingly become, one of the major issues with which management of law firms must face up to and find solutions for.

The perennial problem, though, is how to objectively measure performance so the ideal of fairly matching reward to contribution can be achieved.

The essence of the meaning of performance is 'achievement', and so performance levels by partners need to be measured against agreed and set standards and criteria. But who sets the criteria and standards? Ultimately, it is clients, because if tomorrow's law firms are to be competitive, then they must provide clients with what they need at a price that clients perceive as value for money; and they must do this better in every way than their competitors.

Many firms have now realised that they will not be able to become competitive in this way unless and until their partners are performing at higher levels – and the bar is being raised ever higher. There is also the recognition that, if performance-based reward systems are to achieve the competitive edge so desired by law firms, they also need to be aligned closely with a firm's strategic objectives. At the same time, human nature and ideas of relative worth between partners tend to dictate that those who perform to higher standards should receive higher rewards.

For these reasons performance-based reward mechanisms are now increasingly occupying the middle ground between two extremes, which I describe in more detail below.

Eat what you kill

This is where the only things that matter are personal billings from partners' 'owned' clients and where what you bring in you keep. This leads to silo cultures where the individual interests of partners take precedence over the firm's interests. On the face of it, personal fee

Partners' financial performance and profitability represents the tip of the iceberg – it is often the only thing visible and, more often than not, it is the only thing that is objectively measurable.

income is easy to measure, although it is open to all kinds of abuse.

Why are such firms not measuring profitability (which is what matters) rather than top-line revenue?

These firms are not integrated businesses –they are often no more than collections of individuals sharing common overheads, much like dental practices. The ability of such firms to align the performance of partners with achieving strategic goals (such firms are often unlikely to have any) is difficult if not impossible.

Such models are changing because many (younger) partners are beginning to realise that if their firms are to be competitive, then they will need to rethink what their firms need to do to change behaviour to enhance performance, if they are to achieve their goals. Recently as part of a strategic exercise for a 50-partner firm, I confidentially asked each partner the question: 'What does your firm value most?'

All, except one partner, said in a complaining manner that the only thing that mattered in their firm was personal billing; the one partner who did not say that, was the one who had driven that culture over the years.

Bringing that issue out in the open forum of a partner's retreat was a catalyst for change. Moves are now under way towards putting in place a reward system designed to measure the true profit of each part of the firm and which will also assist that firm in achieving its goals.

The classic lockstep

This is where a partner moves up (but only up) a lockstep, based upon seniority, and arrives at and remains on a plateau based on equality – often until retirement. This can, and does work well for some firms, particularly if there is sufficient profit to go around so that the firm is not vulnerable to the poaching of its best partners. These firms will also often have strong collegiate cultures. In performance terms, however, to successfully combine equality when sharing profits with becoming increasingly more competitive will very much depend upon whether everyone is 'pulling their weight'.

Unfortunately, it is all too often not explained to partners what 'pulling their weight' means so when they are sacked or de-equitised, they can often validly complain that "nobody told me I had to do that". A lockstep of this kind can also suffer from an inability to accommodate intermediate (lesser) degrees of performance, as well as not rewarding the 'stars'. The only options are often to 'counsel out' the underperforming partner or (if appropriate) de-equitise. There is little or no room for fairly matching reward to contribution if not all partners are pulling their weight.

Many firms have now moved on, and it is probably correct to say that there are now as many types of reward systems as they are law firms. Firms are, in particular, developing ideas that focus on having a broad set of performance criteria, achievement of which will help them to meet their competitive goals. They will now judge partner performance against achievement of those criteria and will reward accordingly. Whichever criteria are chosen, however, and however standards are set, the so-called ' soft skills' required for managing clients and people in the business will often mean it is difficult to measure success. For many, therefore, the key to objectively measuring performance remains the Holy Grail.

For many years, as a managing partner and now as a consultant advising professional firms, I have observed that if partners' financial performance is shown to be good, then it tends to follow that standards of performance, in relation to the norms of behaviour on which law firms are now focusing, also tend to be high. Sitting down with a partner and examining in detail his or her matter print-out can often reveal more about that partner's ability to perform across a broad range of performance criteria – including their relationships with clients, and other partners and staff as well – than any formal appraisal can ever do.

Partners' financial performance and profitability represents the tip of the iceberg – it is often the only thing visible and, more often than not, it is the only thing that is objectively measurable.

By measuring the profitability of each partner and group within a firm (accountants have well-tried and tested methods to define profitability for this purpose), it should be possible to arrive at clear conclusions as to whether the required norms of partner behaviour are being complied with and performed to the high standards required. I would suggest it is possible in this way to accurately and objectively measure what really matters to a firm, in terms of partner performance across a broad range of desirable behaviour norms. This can help drive competitiveness and financial success. If partners are doing what they should be doing, the financial results will usually speak for themselves.

In this way, partners' individual billings may become the least important and measured factor. Indeed, fee income as such can often be a misleading measure of a partner's contribution. What may appear at first sight to be a highly profitable partner or group, may

in fact be a far less profitable or indeed a loss-making partner or group.

Why? Because many of the basic performance tasks that drive competitiveness and which should be performed by partners, are not being delivered. Partners should be businesspeople, which should involve, as a minimum, being a business developer and a manager of the firm's clients and its people in the business. It is not sufficient these days just to be a good lawyer.

In particular, being in a partnership involves being a team player, because, *inter alia*, building teams builds 'leverage' (the ratio of equity partners to other fee earners). And leverage, if managed well, tends to produce greater profit. But increasing leverage requires greater delegation and supervision by partners. Partners need to:

- Nurture client relationships, for the good of the whole firm;
- Build their teams;
- Delegate appropriate work to those people with the right levels of skills and expertise, and who have an appropriate cost base;
- Supervise their people;
- Free themselves of inappropriate work in order to develop more work to feed and grow the team;
- Provide leadership to their teams; Develop more profitable areas of work;
- Manage the expectations of their people by providing mentoring when needed and feed back (good and bad);
- Say 'thank you' for work well done.

If they do not do this, not only will their practices fail to grow profitability, but worse, the real cost of partners not performing in these ways will lead to poor morale, with consequent high-staff and partner turnover involving high recruitment costs and training. It will also lead to a reduction in productivity and efficiency, which will reduce competitiveness and profitability.

> Each partner's and practice group's positive/negative contribution to reducing the firm's working-capital requirement can be accurately and objectively measured against the standards agreed and required of partners.

The same degree of objective measurement can be achieved by analysing the cash-management performance of each partner and group in the firm. Taking on new work, managing that work and getting paid for that work require high degrees of client/people-management skills and, I would suggest, a basic financial commonsense. But does every partner have this basic financial know-how?

A weekly 'lock-up' table (lock–up being work in progress, unbilled disbursements and unpaid bills) published internally with a view to building peer pressure on the worst performers, will clearly show up those partners who:

- Without thought for the rest of the firm take on risky cash – haemorrhaging work without first credit checking clients, taking money on account and agreeing billing arrangements with clients;
- Allow work in progress to rise to dangerous levels in terms of age and quantum;
- Have an inability or unwillingness to chase clients for unpaid bills.

Each partner's and practice group's positive/negative contribution to reducing the firm's working-capital requirement can be accurately and objectively measured against the standards agreed and required of partners. In this way, their performance against agreed and set norms of behaviour can also be measured. If in your firm:

- You are suffering cash-flow and profitability problems, which are caused by partners not doing what they should be doing; and/or;
- You are considering how best to structure a reward system to help advance your firm's goals (and in particular to help you to recruit and retain the best people)...

Then I would suggest an initiative along the following lines. Examine and measure:

- The profitability of each partner/group in the firm;
- The cash generation by each partner/group in the firm.

The results may surprise you. Not only are you likely to establish which partners and/or groups are profitable or unprofitable (which may impact not only on how you decide to reward but also on investment decisions you make), but this analysis will have the added advantage that measurement that is seen to be objective is likely to lead to greater transparency, and build trust and confidence, which are all vital if a partner reward system is to be successful.

Above all, this process will begin to show you which partners are really performing in the ways that matter to you. This will be necessary if you are to win the 'war on talent' and successfully compete in the challenging legal landscape of the future. ■

Peter Scott is a solicitor and was, for eight years until 2000, the managing partner of Eversheds' London and European offices. He now runs Peter Scott Consulting and can be contacted at pscott@peterscottconsult.co.uk