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The Armstrong Watson Legal Sector Survey

Methods of Employee Remuneration and Partner Reward January 2018

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Armstrong Watson is endorsed by the Law Society for the provision of accountancy services to law firms throughout the North of England.

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Commentary

The particular topic covered by this survey is fairly complex and therefore the survey had more than our usual number of questions. We are therefore pleased with the response rate, but not surprised given the significant changes in the legal market and the "war" for talent.

The purpose of this survey is two fold. Firstly to establish how partners are assessed and rewarded and the potential disconnect between the two. Secondly to establish the same factors for employed fee earners and any differences between the two categories.

The survey shows that a significant proportion of law firms do consider remuneration on a wide variety of factors. However truly performance related pay - which we would define as pay that is linked to a variety of metrics agreed in advance, that can fluctuate from year to year and that is based on micro factors that are well within the individual's control - is still not commonplace. The "Big three" (Fees billed, Department and Firm profitability) continue to be the most popular options for assessing contribution, but in bizarre disconnect they are not necessarily the same factors used when assessing remuneration.

There is clearly a mis-match between how people are assessed versus how they are rewarded. Perhaps more worryingly, there is also a disconnect between the factors that law firm leaders consider most important in driving growth of their firms and they way those same firms remunerate their partners and their employees.

The highlights from the survey are as follows:-

- The majority of law firms that responded to this survey are based in the North of England.
- The respondents covered a significant cross section of types of law practice, including both niche and specialist firms as well as "full service" firms
- The law firms that responded to the survey are diverse in size with a bias towards <10 partner firms.
- Approximately half of all the law firms that responded have up to 50 employees.
- There is an overall bias towards incorporated structures with the LLP structure the most common
- Whilst approximately 50% of the fee earner base are classified as "senior associates" or above, only 11% are full equity partners.
- Respondents confirmed that a huge variety of remuneration options are used in their firms. Despite the variety of options it is notable that only 1% of respondents had a full performance based model, in effect suggesting that low performers still have an amount of guaranteed remuneration. It is also telling that the models employed with respect to partners (or equivalent) are significantly more varied then those applied to staff

Commentary

- 42% of remuneration policies are built around the "Big three" factors (Fees billed, Department and Firm profitability).
- There is a marked difference between how partners are assessed versus how they are remunerated. Seniority and firm wide performance (both of which are outside the individual's direct control) become relatively more significant in remuneration, whereas lock up is deemed to be important in the assessment of performance but much less relevant in the rewarding of that performance.
- The equivalent question for other fee earners shows a more even spread of assessment factors. But even here there are notable variations, especially with regards to client satisfaction and recovery rates. Firms seem to be telling their staff than client satisfaction and recovery rates are important, but will have no bearing on the staff's remuneration. Even worse, client satisfaction was cited in the "top three" most important issues for driving firm wide performance, but apparently not in driving individual performance.
- 57% of respondents do not have recurring annual pay rises
- Of those that do have recurring pay rises, the average annual increase this year was 3%

In general, firms believe that performance related pay (especially for partners) is the best model, however they seem to fall into basing remuneration on the same blunt measures (e.g. fees billed) that have been popular for many years rather than more bespoke and balanced measures such as:

- Lock up to measure any cash receipts, not just invoices sent out the door
- Recovery rates to measure efficiency and use of junior staff rather than "client hoarding"
- Cross referrals and firm wide improvement initiatives by individuals rather than the nebulous "firm wide profitability"

- 52% of the law firms in the survey thought remuneration was key to attracting new staff. But opinion was strongly split in this area and other replies cited work life balance or other benefits (e.g. pension)

Commentary

The results of the survey illustrate why the most progressive firms are looking to change some or all of the following things:

- the way they remunerate all staff (not just partners)
- the way they generate new business
- their trading structure and associated employment models
- who will run their businesses operationally (with appropriate reward) versus who will do the senior and significant fee earning work (with appropriate reward)

If you are interested in exploring remuneration strategies, bonus schemes and performance improvement programmes for partners and fee earners, please contact me or any of the Armstrong Watson Legal Sector team.

We will be issuing further surveys in the future and we hope that firms will spare the time to complete these too, we would like to take this opportunity to thank those that responded to this survey.

Tom Blandford
Legal Sector Director

Armstrong Watson LLP is a top 35 UK accountancy firm with 16 offices throughout Northern England and Southern Scotland. Further information on our unique offering to law firms can be found at www.armstrongwatson.co.uk/legalsector

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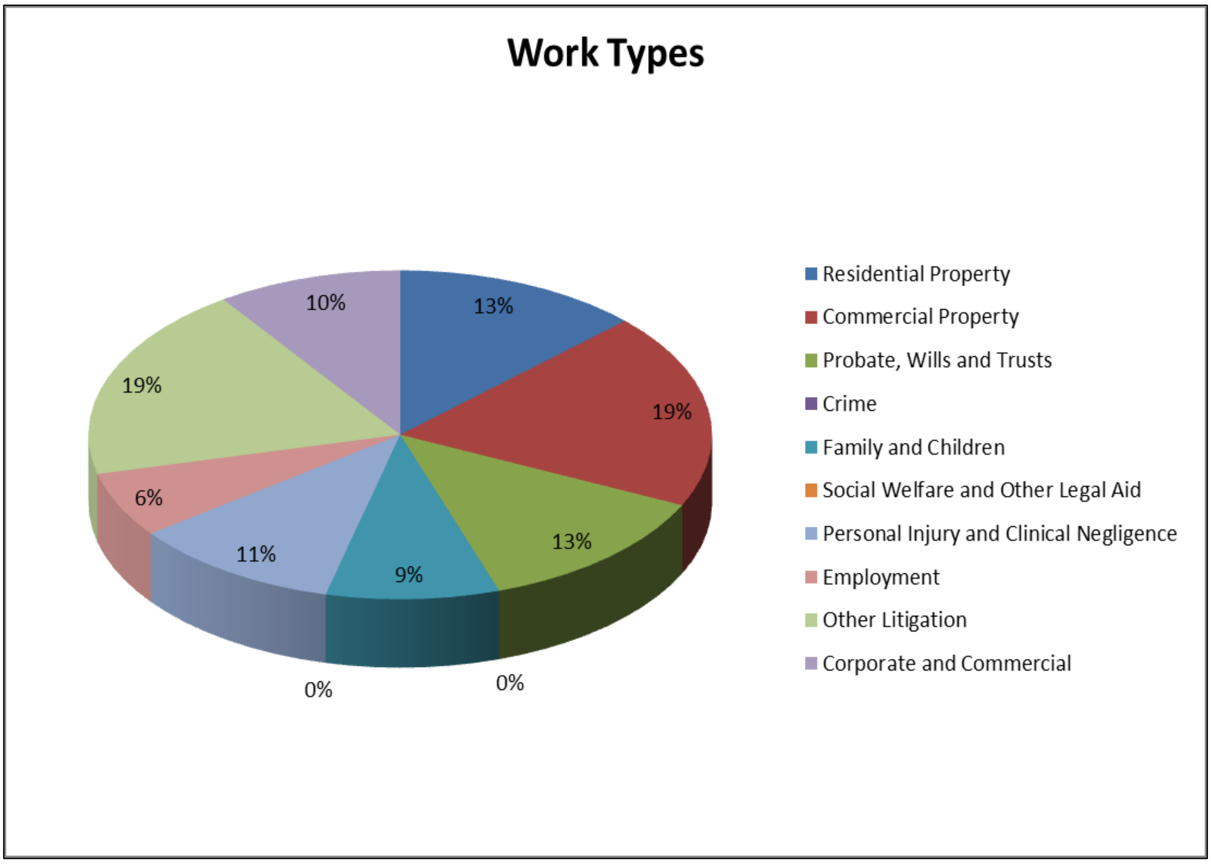
Results

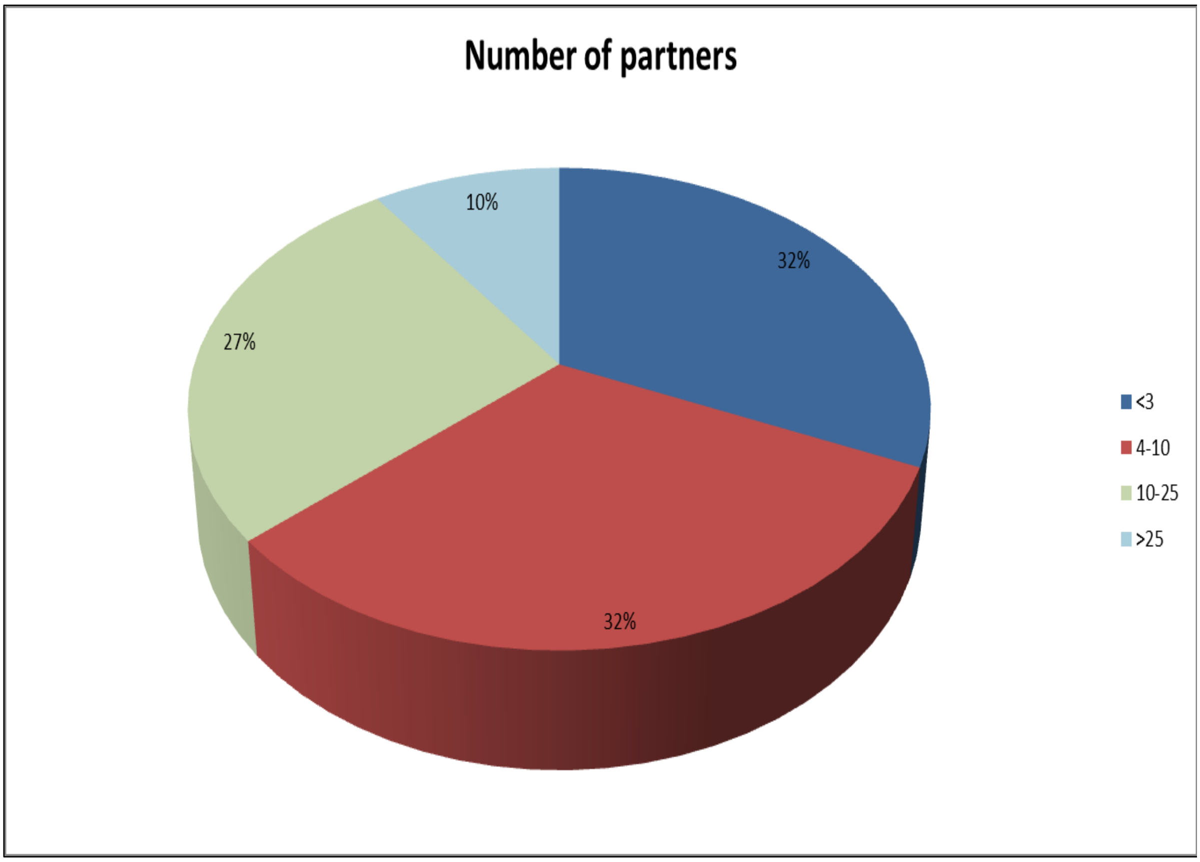
1. What types of law do you practice?



The respondents to the survey cover a broad spectrum of work types. Perhaps not surprisingly (given the significant changes in these areas) no criminal or legal aid practices were represented in the survey population. (note: most respondents selected multiple options for this question.)

Results

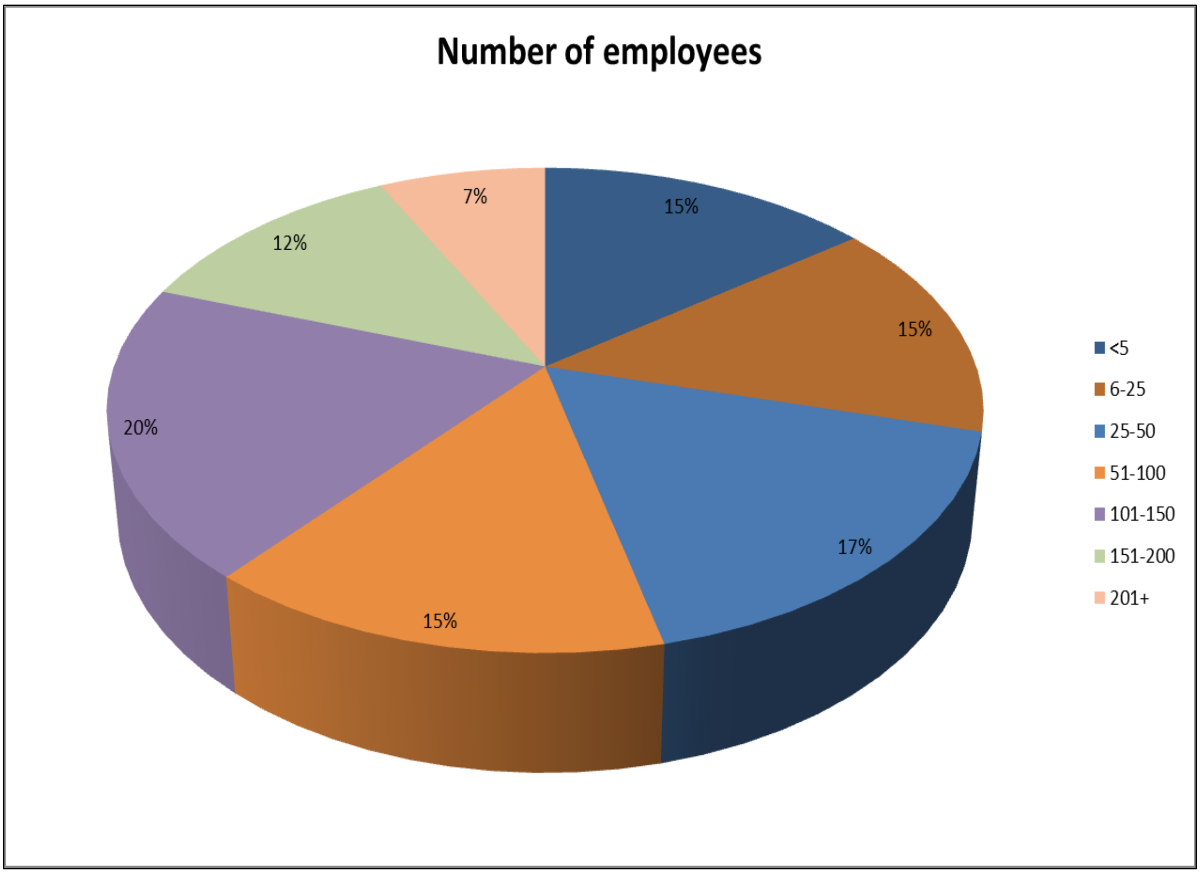
2. How many partners does your firm have?



The survey results show a diverse range of partners per firm with the greatest proportion being firms with fewer than 10 partners.

Results

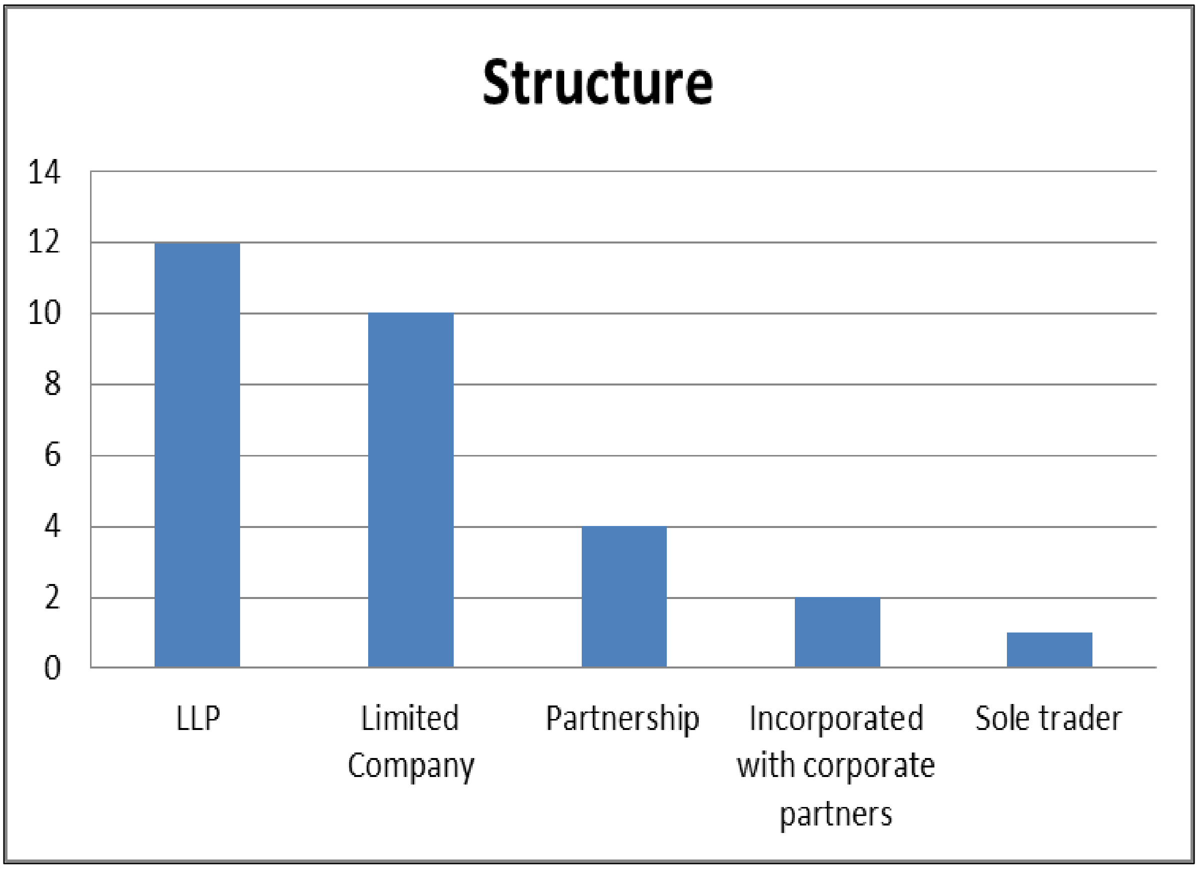
3. How many people work in your firm?



The most significant proportion of law firms responding to the survey have up to 50 employees.

Results

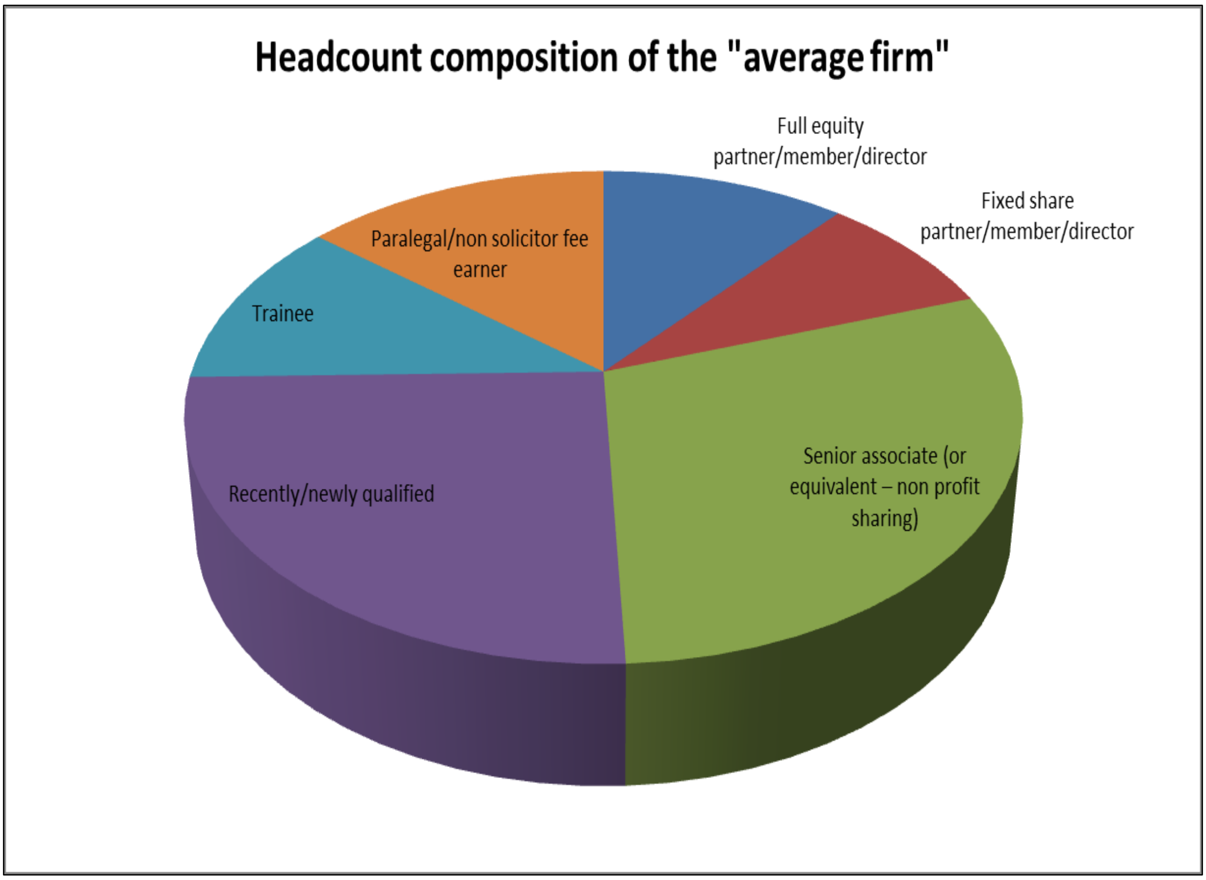
4. What trading structure is used by your firm?



The survey results show there is a clear trend of incorporated law firms with a bias towards an LLP structure

Results

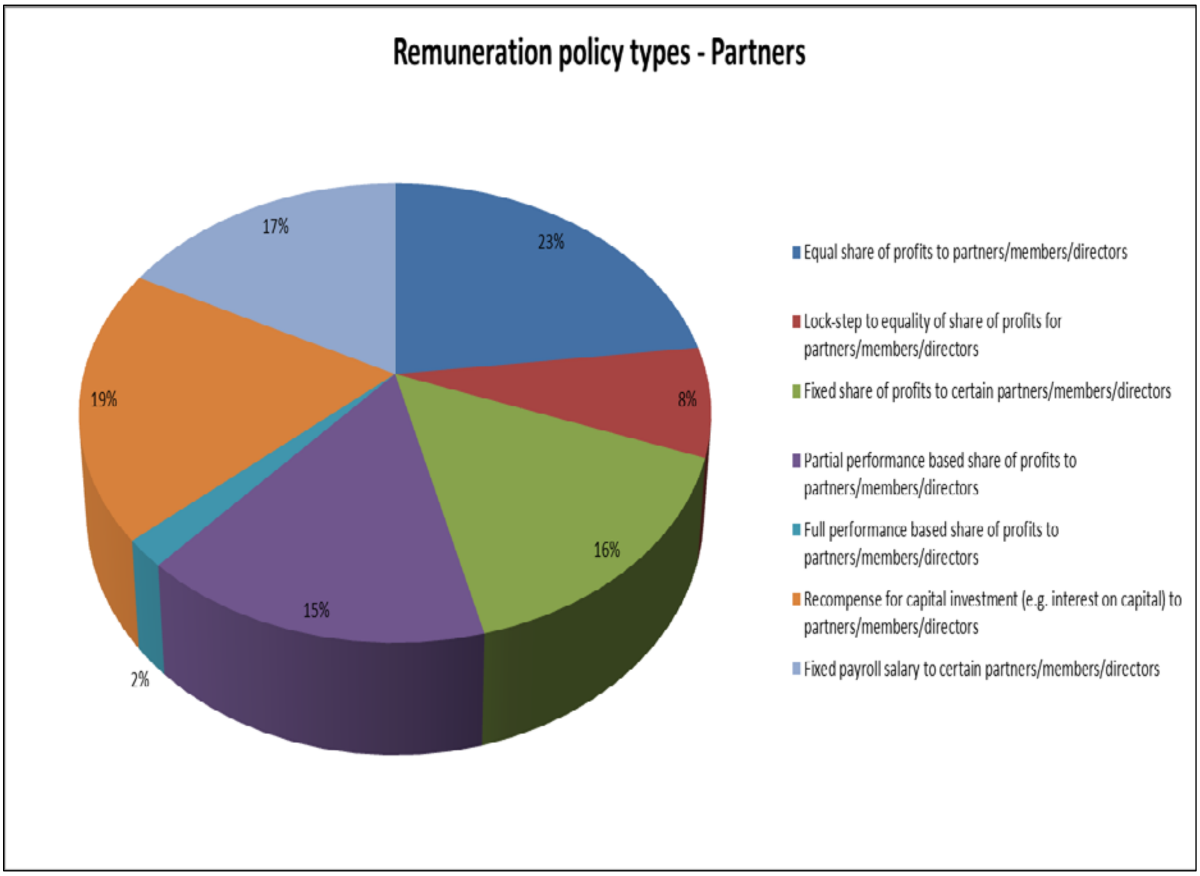
5. What is your current number of fee earners, split by the following types?



Whilst it is notable that "senior " fee earners are 50% of the total, those attaining full equity are still only 11% of the fee earner pool in the average law firm in the survey. It is also (perhaps dishearteningly) of note that trainee numbers are a relatively low proportion suggesting that firms are still not bringing through as many new people into the profession as they may have done pre-recession.

Results

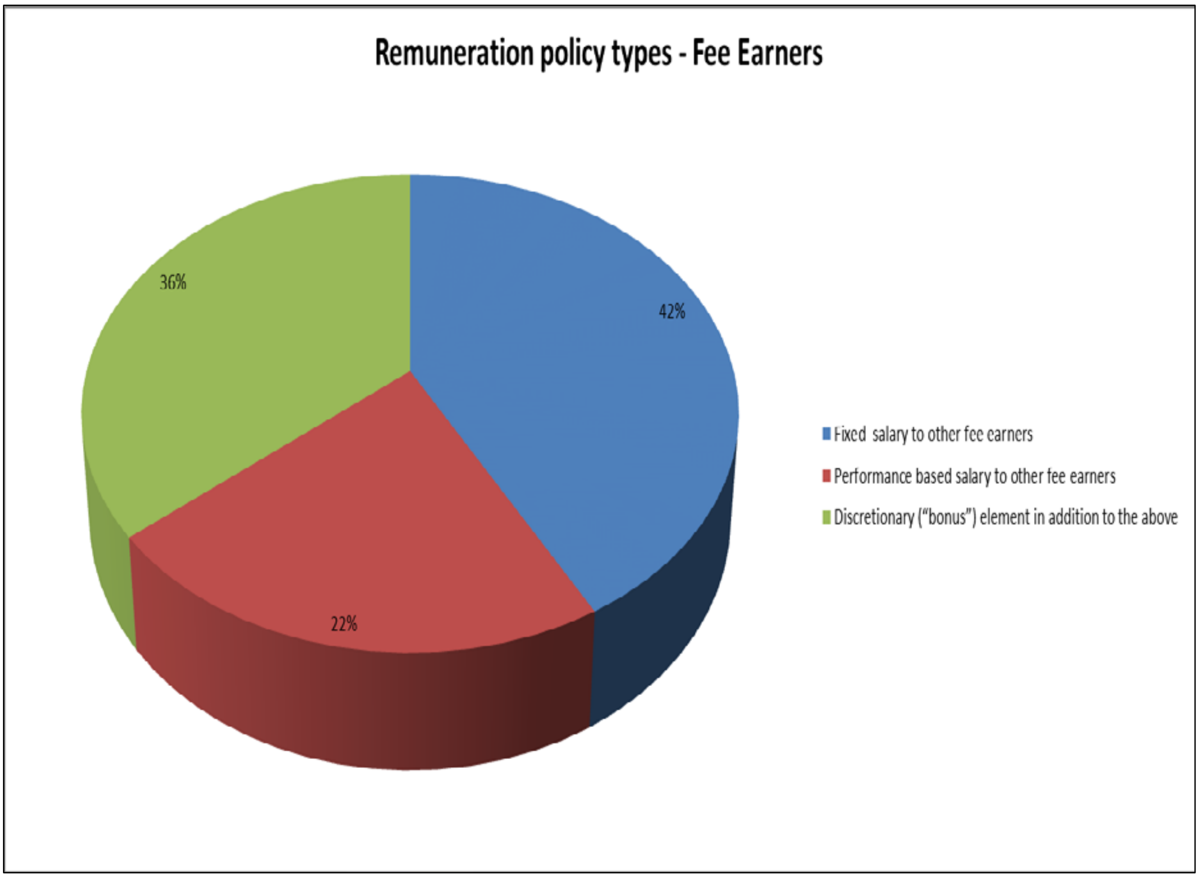
6. Which of the following remuneration policies do you use for partners?



The survey results show an array of types of remuneration strategy with many respondents selecting several options - perhaps illustrating the complexity of policies in place and the requirement to be as innovative as possible to attract high calibre staff. Despite the variety of options it is notable that only 2% of respondents had a full performance based model, in effect suggesting that low performers still have an amount of guaranteed remuneration. It is also telling that the models employed with respect to partners (or equivalent) are significantly more varied then those applied to staff - in effect the right hand side of the pie chart is much more varied than the left hand side.

Results

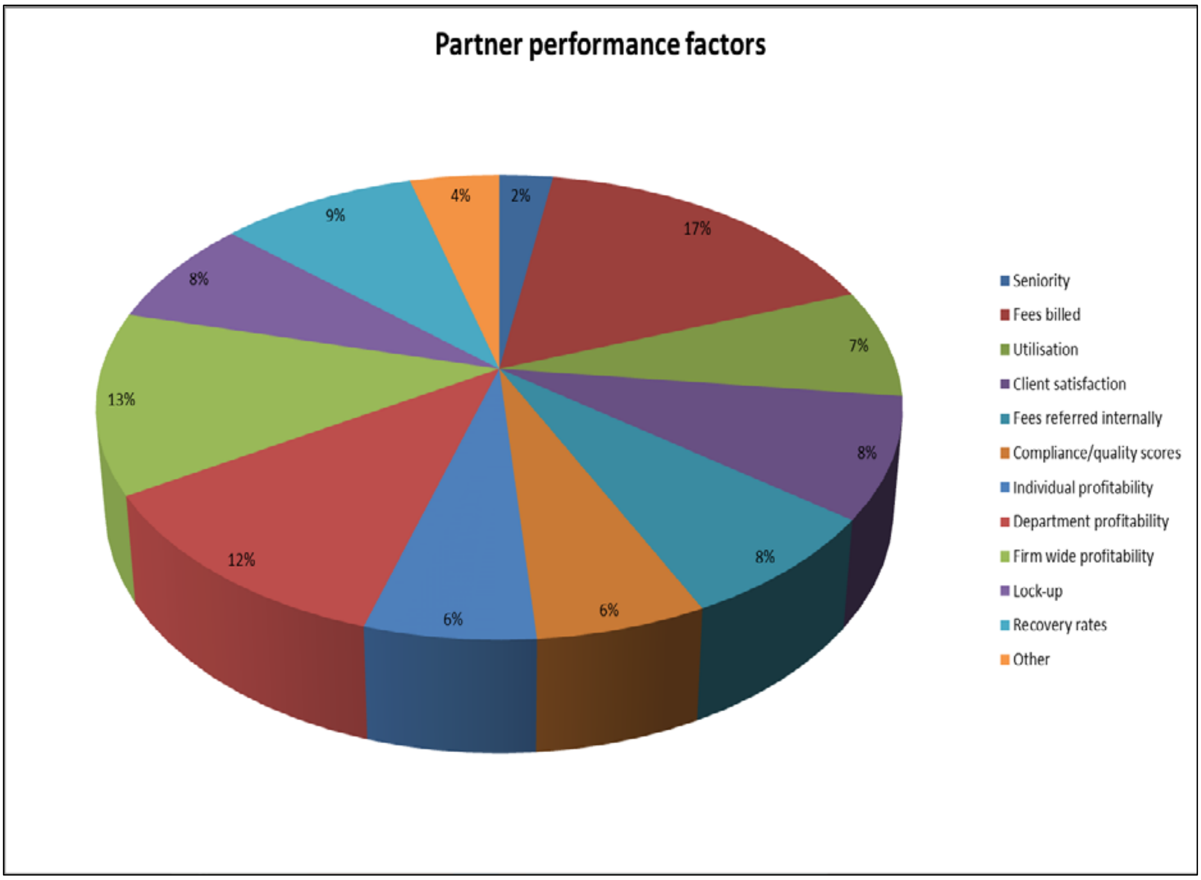
6a. Which of the following remuneration policies do you use for fee earners?



It is telling that the models employed with respect to partners (in the previous question) are significantly more varied then those applied to staff and the models used are much more likely to be simple and fixed rather than using fluctuating pay to incentivise good behaviours.

Results

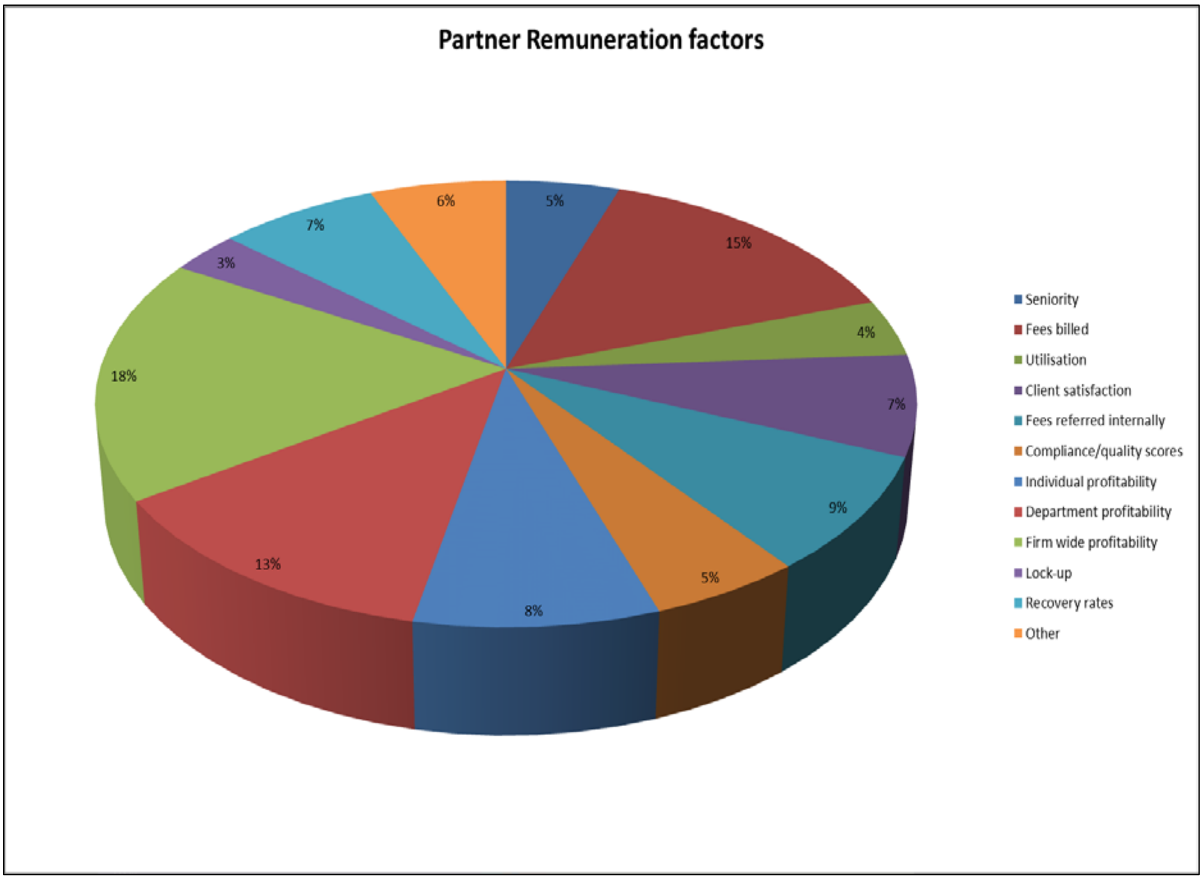
7. **When considering performance for partners, which of the following factors impact on *appraisals*?**



The "big three" (Fees billed, Department and Firm profitability) continue to be the most popular options for assessing the contribution of partners. They might continue to be popular, but they are rather blunt instruments, with some respondents noting that they tried to take a more holistic approach to contribution than pure billing. On that theme, it is heartening to see more accurate financial measures (eg Lock up and recovery) appearing in the list but it is perhaps disappointing that some more intangible (but no less important) measures (eg client satisfaction or quality scores) do not score higher. These areas are even more telling by their absence in the next question.

Results

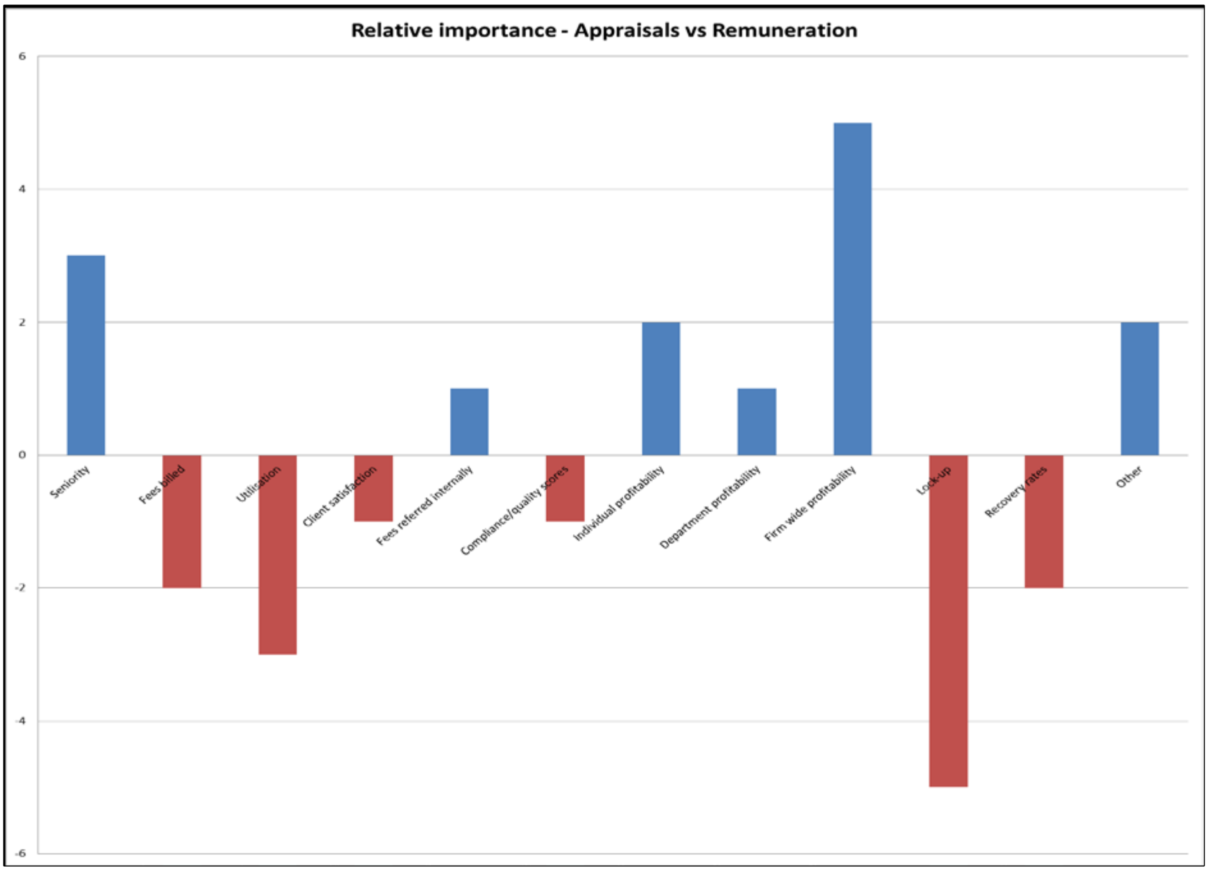
8. **When considering performance for partners which of the following factors impact on *remuneration structure*?**



Taken in conjunction with the previous question we see a further increase in the dominance of the "big three" factors, when it comes to partner remuneration. Conversely others (e.g. lock up) retreat in prominence.
As the next graph will show, there is therefore a pronounced difference between which factors are in use when appraising performance versus how those same factors influence performance.

Results

9. Of the previous factors for **partners**, which do you consider more important in driving the performance of your organisation?

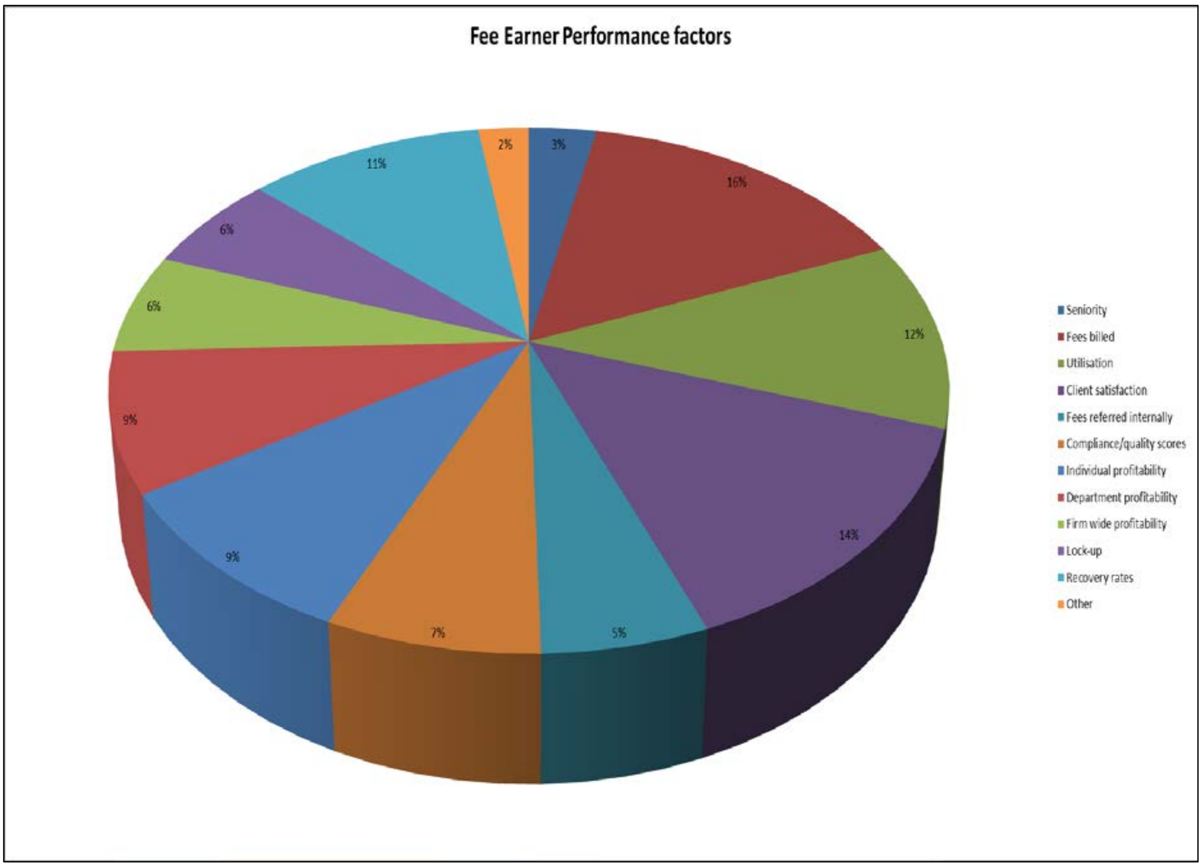


The "swing-o-meter" illustrates that seniority and firm wide performance (both of which are outside the individual's direct control) become relatively more significant in remuneration than in appraisals, whereas lock up is deemed to be very important in the assessment of performance but much less so in the rewarding of that performance. Despite this, the top three answers to this question were "firm performance, fees billed and utilisation" whereas the least popular three answers were "compliance, seniority and lock up".

There is clearly a miss-match between how partners are assessed versus how they are rewarded. Perhaps more worryingly, there is also a disconnect between the factors that law firm leaders consider most important in driving growth of their firms and they way those same firms remunerate their partners.

Results

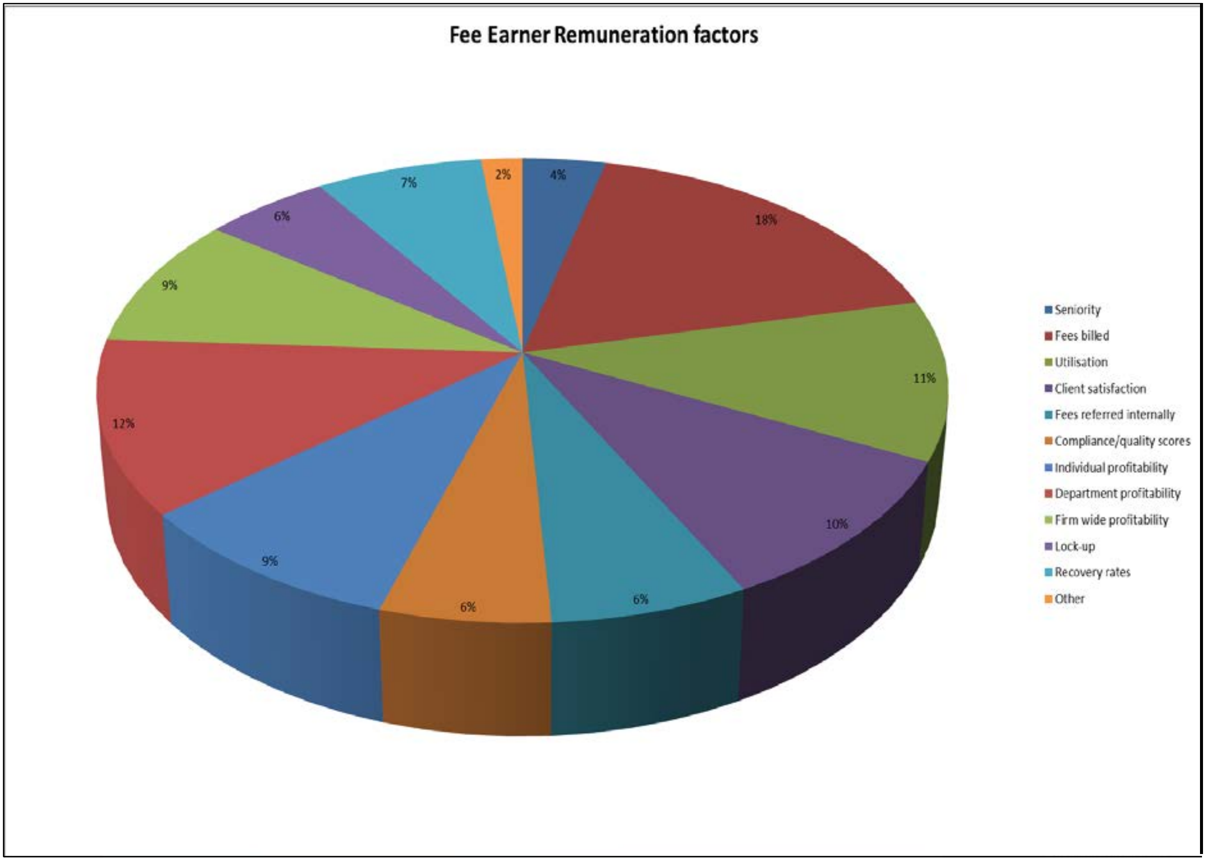
10. **When considering performance for other fee earners, which of the following factors impact on *appraisals*?**



This question is identical to that in question 7, but now focuses on fee earners who are not partners. It is striking therefore that the answers are now much more evenly spread across a range of factors. Only "Fees Billed" continues to show a dominance. It is surprising that other fee earners have a more balanced "scorecard" of performance factors than the partners in the same firms.

Results

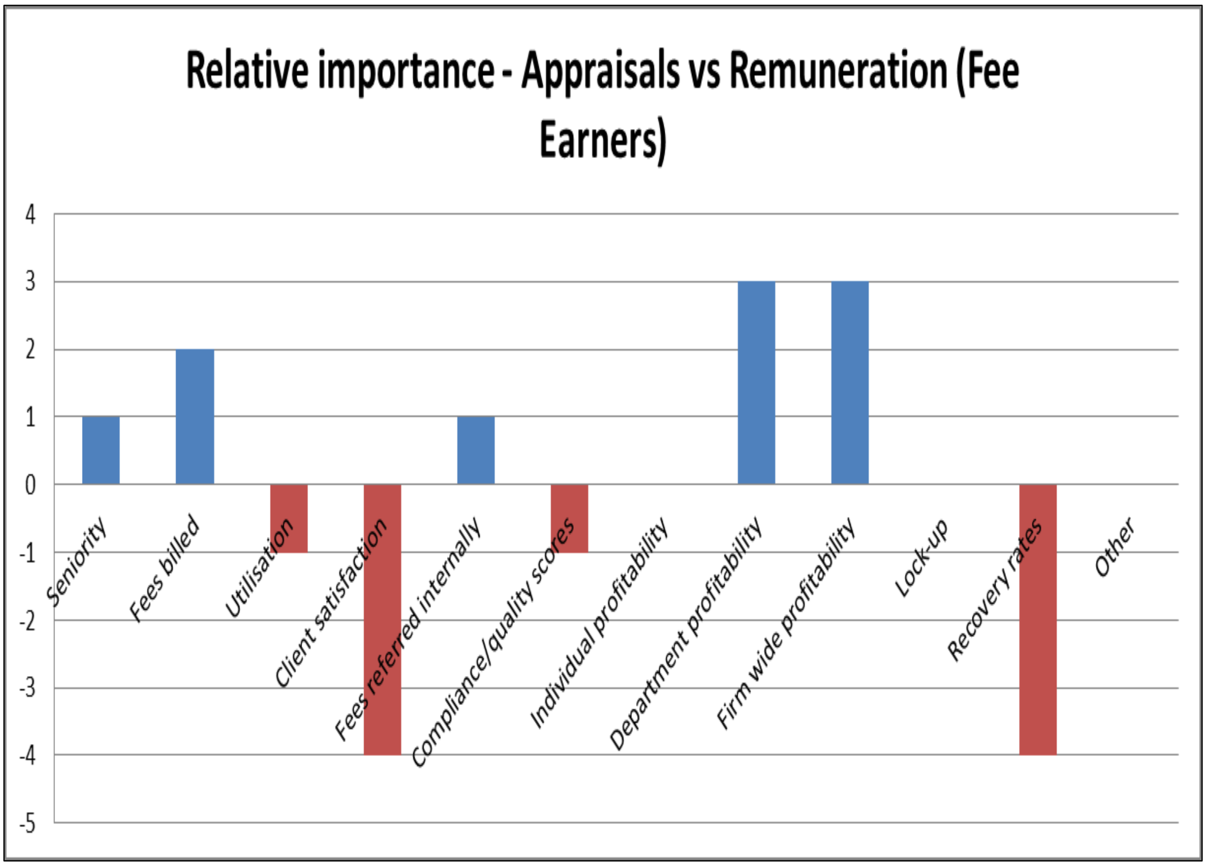
11. When considering performance for other **fee earners**, which of the following factors impact on *remuneration structure*?



The more even spread from the previous question continues when it comes to Fee Earner remuneration. Yet even still "Fees billed" continues to dominate. If fee earners are encouraged (above all else) to chase fees then this could be to the detriment of profitability, cash collection, team working and client service. As the onus shifts to "getting the invoice out of the door" rather than ensuring the quality or efficiency of the work, this impacts the client's willingness (and perhaps ability!) to pay.

Results

12. Of the previous factors for **fee earners**, which do you consider more important in driving the performance of your organisation



Although there is less variance (some categories, like individual profitability do not swing at all) in this swing-o-meter than in question 9 (which regards partners only, but is otherwise identical) there is still the comparable disconnect. Firms seem to be telling their staff than client satisfaction and recovery rates are important, but will have no bearing on the staff's remuneration. Even worse, client satisfaction was cited in the "top three" most important issues for driving firm wide performance, but apparently not in driving individual performance.

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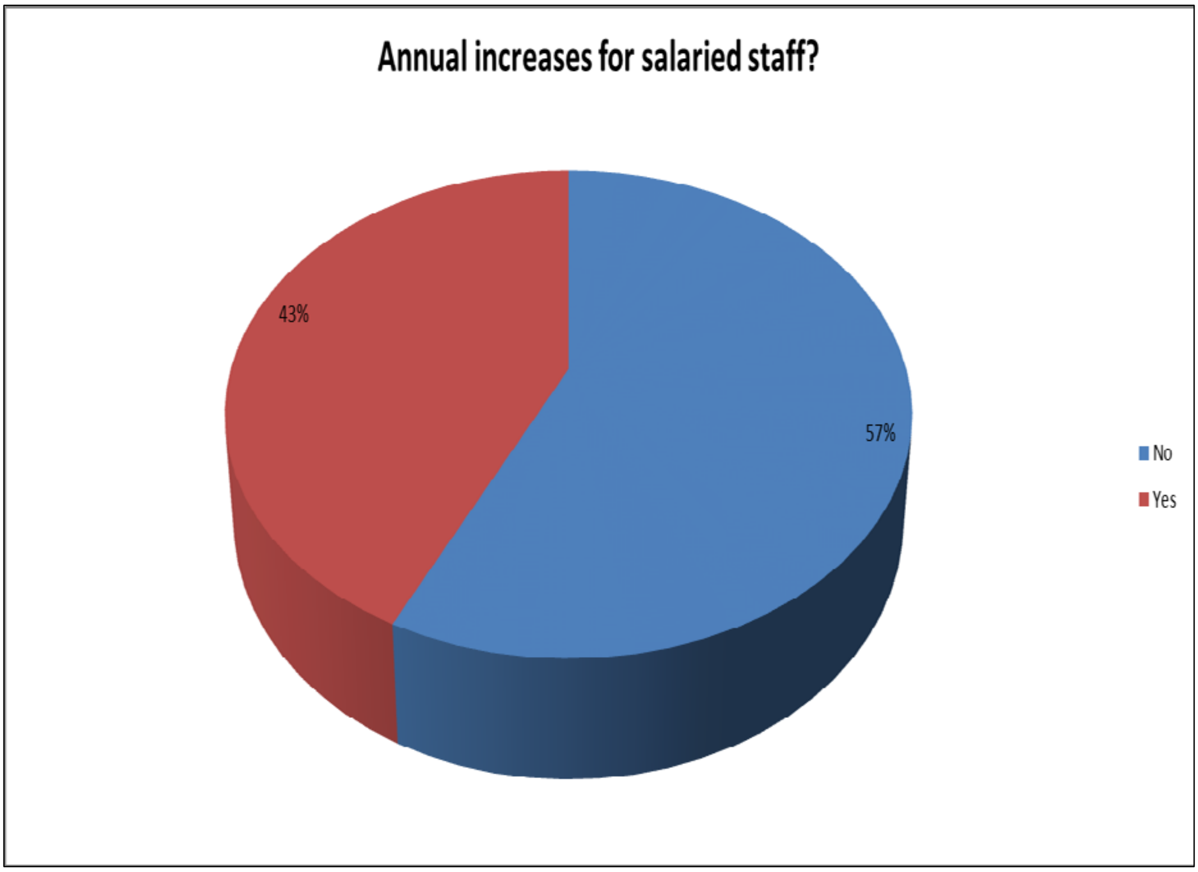
Results

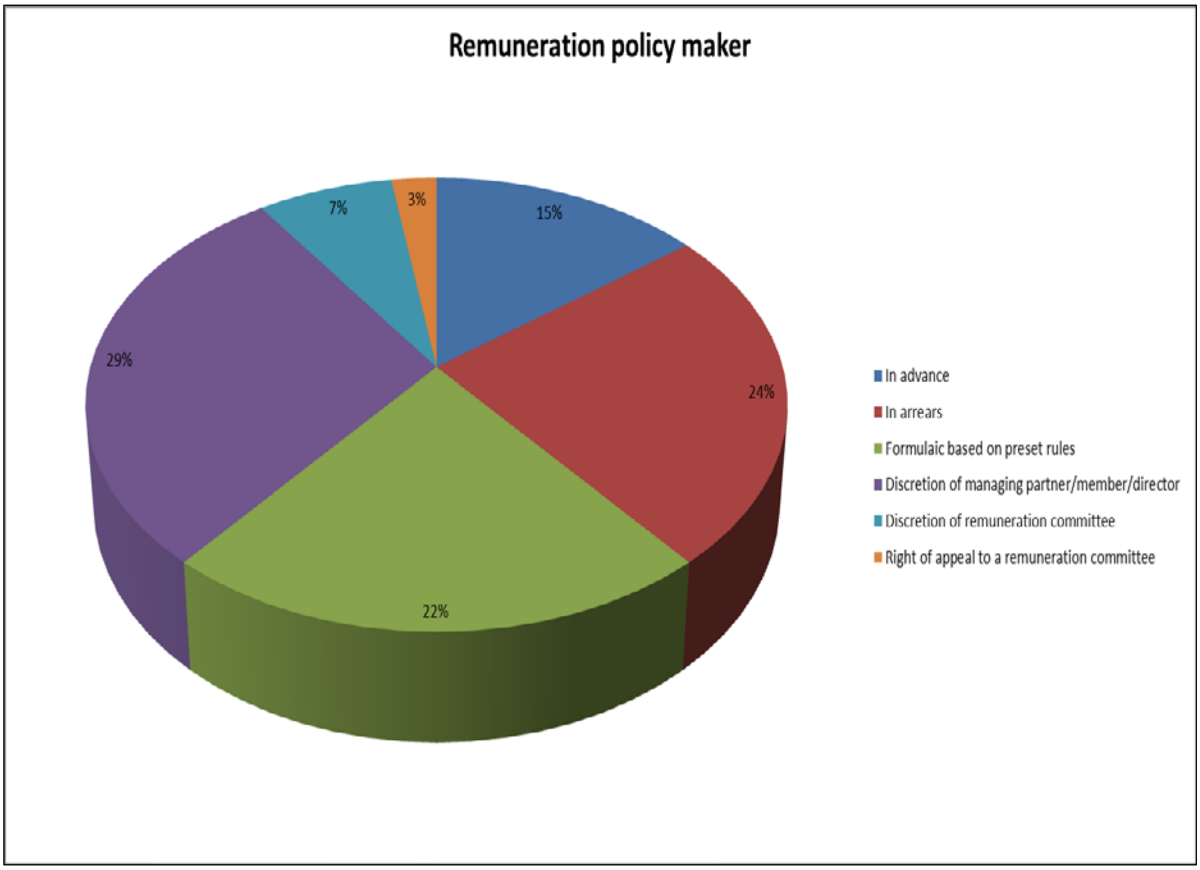
13. For other fee earners, do you have a policy of annual increases for those on fixed amounts/salaries?



In striving for a high performance culture, most law firms do not have an "automated" pay increase, relying instead on some of the performance based measures we have covered previously. Of those that did have this policy the average annual increase was 3%.

Results

14. Where remuneration is based on performance and/or discretion, how is this decision made?



The results above show a surprising lack of transparency in remuneration with many final decisions made in arrears and at the discretion of a small number of decision makers. For any remuneration policy to have a motivational effect throughout the year it needs to have clear communication (of both expectations and progress) throughout the period.

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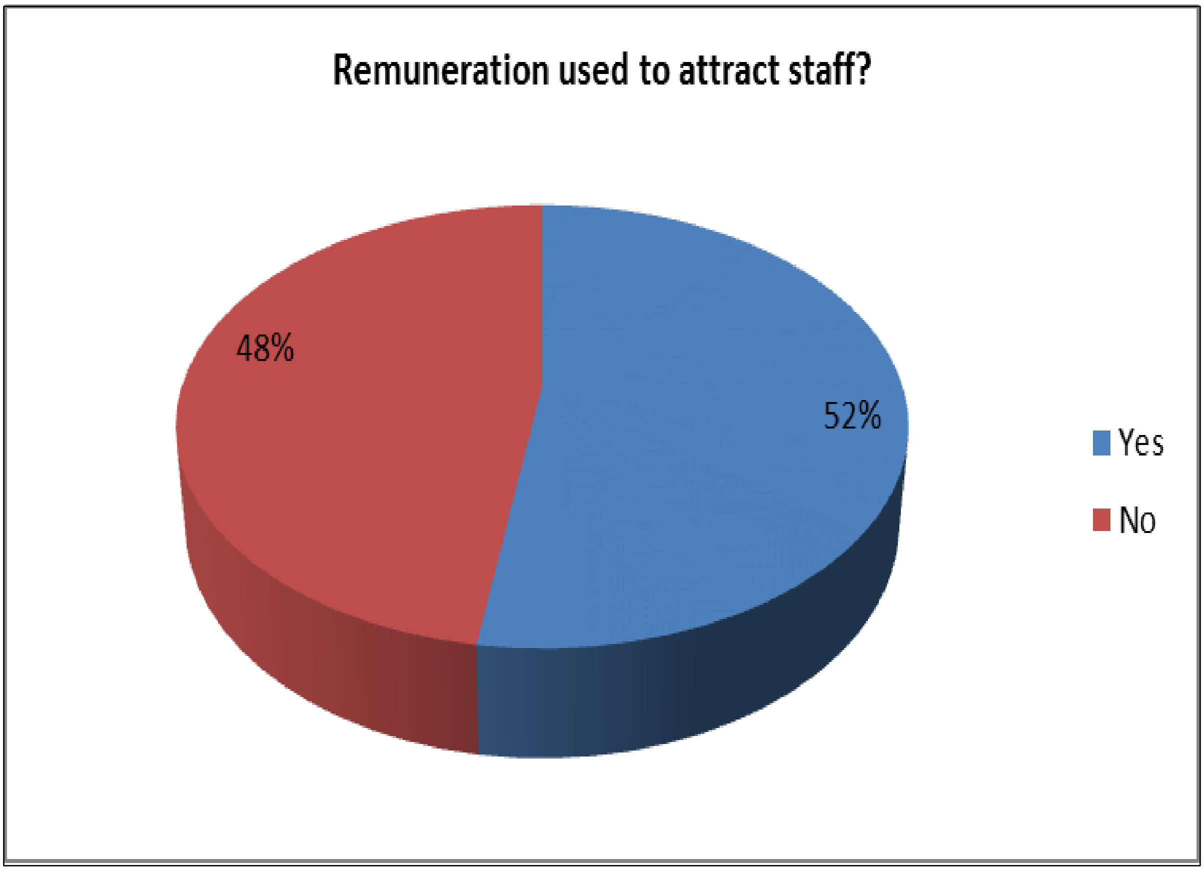
Results

15. Have you used remuneration to attract new fee earners recently?



The interesting 50/50 split in the answers to this question were also born out by the associated comments. There was a clear divide between those who believed that the only way to attract high quality people in the perceived "sellers" recruitment market was through raising wages, versus those who were focussed on other benefits (e.g. pensions, holiday allowance etc.) or less tangible factors (e.g. variety of work, work life balance etc.)

Context of this report

The report has been compiled using the responses from 41 law firms.

This report has been compiled by Armstrong Watson LLP ("AW") using the data supplied from law firms participating in the survey. The names of contributors and their individual responses are held in the strictest confidence.

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