"Do Law Firms Test Partner Compensation for Biases?"

By MesaFive, LLC

Law firms, like most organizations, are increasingly aware of the potential for unintended bias issues in their compensation decisions. And almost everyone understands that eliminating bias is important for legal, social, and moral reasons. But too often people overlook the fact that eliminating biases is one of the more viable means for improving profits and teamwork. Like so many issues the first step is in identifying the problem. Law firms face unique compensation issues, because partner performance tends to be more multifaceted than roles in other businesses that are defined by singular functions. In the article below we address some of the common questions we receive from law firm leaders on bias testing of partner compensation.

Question: Do any law firms regularly test their partner compensation results for biases?

While rigorous, methodical testing is not commonplace most firms still worry about the issue and take some efforts to ensure consistency and fairness. But there are an increasing number of large firms that now regularly test partner compensation recommendations before they are finalized to see if the results reveal any biases or contradict the data in ways that cannot be rationally explained. We first started bias testing thirty years ago with a large international firm because they wanted to make sure they were not discriminating against a growing number of female and minority partners, to ensure they weren't penalizing partners in branch offices, and conversely, to ensure they weren't inadvertently over-rewarding some partners. Their early efforts at bias testing revealed inadvertent discrepancies in how compensation was awarded, and in differing assumptions about the performance and contribution of partners that correlated to gender. While bias testing can initially seem intimidating and fraught with potential liability, testing efforts have steadily gained momentum as more and more firms want to take real steps to encourage better teamwork, inclusion, integration, diversity, and profits.

Question: What is a typical approach for bias testing of compensation data?

Approaches vary by firm but generally fall into one of three categories:

- The most common and informal approach is to have other leaders who do not serve on the compensation committee review the results before they get announced. Those other leaders raise concerns or questions to the committee, and then depending on the firm, changes may be proposed, debated, and resolved. While a common approach it is not necessarily methodical or objective: Results are rarely analyzed with accepted bias testing techniques and are often debated by leaders who may be advocating for changes more reflective of their own practice or office interests, or even their own personal biases. This is not to say it is a bad practice, but it does not qualify as legitimate bias testing.

- Perhaps the second most common approach is when a compensation committee itself looks at the preliminary results and runs some type of analysis. For example, they may run correlation and data sensitivity tests and then discuss the results and whether changes are warranted. This is better than situations where firms do no testing, but it has the obvious risk of having those who made the original decisions check and interpret their own work. As anyone who has sat on a compensation committee in a large firm can attest, after setting compensation for hundreds or even a thousand partners it can become difficult to remember the justification for any one individual. An added complication is that in some firms there is significant turnover among the compensation committee members from year-to-year, so the rigor and statistical approach may vary as well.

- A third approach is when a compensation committee passes the preliminary recommendations to a separate internal or external group whose role is to test for biases. That group then runs a series of tests, assesses the results, and works with the compensation committee to flesh out issues and suggest changes. Firms that use this approach typically provide the compensation recommendations without names or other identifying information, and the resulting analysis is only then checked against gender/race/other information. If the testing group is internal to the firm, it tends to be more permanent, is trained in bias testing techniques and issues, and often reports to the firm's leadership and General Counsel.

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Question: What are some of the common challenges with compensation testing?

One of the most common issues is that partners who are new to setting or testing compensation assume compensation should be quickly and easily calculated by a mathematical formula, and anything that varies from that formula is indicative of a problem. But most quickly realize there can be justifiable, significant differences in compensation between two partners who on the surface have similar statistics yet still make dramatically different contributions. The hard question is, are those differences justifiable for appropriate reasons or do they reveal some bias?

Second, despite popular perception it is not always possible to measure contributions or results objectively. A firm can easily measure effort ("how many hours did you spend on this task?"), but effort does not always correlate to results. And this is an important philosophical divergence point among law firms: Some firms pay for effort, while others pay for results. Neither philosophy is right or wrong, but merely a reflection of a firm's values. It is true that successful firms *tend* to reward results and just expect effort from all partners as the price of admission for becoming a partner. There is nothing wrong with paying for effort but firms that do so tend to experience more challenges in compensation and face greater requirements for clear communication and guidelines. For example, firms that pay for effort face some common, but critical, questions:

- How long does the firm pay for effort *without* results?
- Is the firm consistent among all partners about paying for efforts?
- Are efforts as valuable as results? If not, what is the marginal difference?
- Are all efforts worthy of compensation? If not, who decides which efforts have value and which do not? Does the firm make those clear to everyone?

Third, assessing results routinely gets easily confused with and inflated by measuring efforts, especially when partners are explaining their own performance.

Fourth, one of the most widespread misconceptions is that all data is objective. It is easy assume that because a number appears in a spreadsheet it is a fact. The reality is data can be either **objective** or **subjective**.

- **Objective data** is measurable and produces the same result each time it is measured.
- **Subjective data** is an allocation of objective data to someone or some activity, based on judgement. It is that allocation process that makes it subjective.

If subjective data is not allocated the same way each time or at least within statistically acceptable norms its reliability and integrity is eroded. And some of the most critical data used to judge results and thereby compensation in law firms is appropriately subjective data.

One common example of subjective data is origination (which goes by many different names depending on the firm) – essentially an assertion as to who either creates and/or maintains a client relationship. Billings and/or collections, which are both objective data, are allocated to individuals to credit them for the results thereby making it subjective data. But what if the firm does not allocate that data fairly, or consistently? Subjective data is legitimate and far more common across all industries than most people realize. Its weakness is that that it can be manipulated.

But there are successful methods to make subjective data more consistent and reliable. The three common criteria are:

1. Does everyone in the organization allocate subjective data in the same way? If allocation varies by individual, then the data has no integrity and won't produce consistent or comparable results.
2. Does everyone use the same definition of the data (because the organization has clearly defined it and told everyone what the data should and *should not* be measuring), or can each partner choose their own definition which then impacts how they allocate it?
3. If your answers to questions 1 and 2 are "it varies," then the third criterion becomes all-important: Does the firm have a process for examining and adjusting subjective data in the compensation process so that it conforms to consistent firm standards? This is a common and successful approach. But some firms avoid defining their data, avoid interpreting or adjusting it, and take everything at face value even when they know partners apply differing standards for creating subjective data. In these cases, the subjective data has no integrity which tends to create significant problems in compensation.

Question: What are some of the surprising results in conducting bias testing?

- **Bias testing of compensation results does *not* reveal all discrimination issues** – it is just one tool for assessing one type of issue. It reveals whether a firm rewards compensation consistently based on the data and other information available. If a firm has discrimination issues regarding allocating opportunities fairly, in training or development, in promotions, or in hiring, those will not be revealed by compensation testing. Fortunately, those problems are easier to diagnose and address through other means.

- **Biases are an ever-present issue**: Every person/every organization has them to some extent and will *always* have them in some form. One of the important lessons learned is to be open and disciplined in looking at compensation results, and to be willing to constantly identify, address and improve as old issues are resolved and new issues emerge.
- Perhaps the most gratifying surprise in our experience is that even in firms where bias testing has revealed problems, **most compensation committees are surprisingly open and interested in learning about the results and addressing issues**. We find that most compensation committees are legitimately interested in treating partners fairly and want to improve their own decision-making. Data testing has helped those firms to ask better, more meaningful questions about how they can change their firm to improve opportunities, and to have more honest, constructive conversations with partners.
- **True bias testing is agnostic in that it shows biases of all types**, so for example, one of the surprising findings is that some firms show a bias *against* rainmakers. That may be due to a firm value that limits maximum partner compensation, and there is nothing wrong with that if it is well understood and accepted within the firm. But if that value creates significant discrepancies compared to the rest of the market it can put the firm at risk of losing some rainmakers.
- **It is easy to predict when a firm is suffering partner dissension about compensation, just by looking at their data**. It isn't unusual for two partners with identical performance *data* to have compensation differences of 20% to 30% due to soft contributions and/or behavior issues. But when compensation differences exceed that range, or such differences become widespread throughout the firm and yet the reasons are not apparent to the average partner, then there is typically dissension about compensation.

Bias testing of partner compensation is increasingly common and rather than being a process that firms fear it is being used to foster important, meaningful discussions that improve teamwork, diversity, inclusion and even profits.