

CHEQUES AND THE CITY



About the High Pay Centre

The High Pay Centre is an independent non-party think tank established to monitor pay at the top of the income distribution and set out a road map towards better business and economic success.

We aim to produce high quality research and develop a greater understanding of top rewards, company accountability and business performance. We will communicate evidence for change to policymakers, companies and other interested parties to build a consensus for business renewal.

The High Pay Centre is resolutely independent and strictly non-partisan. It is increasingly clear that there has been a policy and market failure in relation to pay at the top of companies and the structures of business over a period of years under all governments. It is now essential to persuade all parties that there is a better way.

The High Pay Centre was formed following the findings of the High Pay Commission. The High Pay Commission was an independent inquiry into high pay and boardroom pay across the public and private sectors in the UK, launched in 2009.

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Foreword

Deborah Hargreaves

The legal and accountancy professions are an integral part of our corporate landscape. They are important guardians of business behaviour and fulfil a vital public role in holding companies to account.

However, their disclosure of financial information has lagged behind that of our big public businesses.

Chief executives of quoted companies are required to reveal most of the details of their complex pay packages in their annual reports. Corporate remuneration reports and policy are also voted on by shareholders.

Given the high levels of disclosure, the pay of top bosses has attracted much opprobrium from public and policymakers alike.

Professional services firms are more opaque, but their pay can approach the levels of the corporate world. This makes them part of a highly-paid corporate and City elite. It also raises questions about their ability to challenge the entrenched high pay culture.

This report is our attempt to understand the forces at work in remuneration of top accountants and lawyers and how they contribute to the top pay culture of the City.

Executive Summary

Lawyers and accountants are part of a closely-connected corporate elite that is paid extremely well. We estimate that the nine elite law and accounting firms covered in this report, paid around 1,400 partners more than £1m last year. But while public company executives must disclose most of the details of their pay packages, remuneration for professional services firms has slipped below the radar.

The professional firms are crucial to effective corporate governance. They grow out of society's deep-seated distrust of the power of business. As such, they ensure that company accounts are true and accurate, and that companies obey the law. Without functional, effective lawyers and accountants, a fair and open economy that enjoys the confidence of the public is not possible.

However, their role has become one of facilitating corporate strategy, rather than holding companies to account. The professional services firms also reinforce the culture of high pay that is prevalent at big companies and benefit from it themselves.

Accountants

The 'Big 4' accountancy firms – PricewaterhouseCoopers, Deloitte, KPMG and EY – dominate the UK accountancy market. The revenues of their UK arms are similar to those of publicly-listed companies in the top half of the FTSE 350, although the Big-4 are all structured as 'Limited Liability Partnerships'.

The Big-4 all originated in the UK although they have built large global businesses. They are a spectacular British success story. Between them, they are responsible for the auditing of 96% of FTSE 350 companies and also run thriving consultancy arms. The proportion of profit accounted for by consultancy ranges from just over 20% at PwC to over 50% at KPMG.

Remuneration practices at the Big-4 are also comparable with those at large corporations. Average 'profit per partner' is just over £700,000 per year for each firm, although this is not divided equally across all partners. We estimate that there are around 270 partners across all firms earning over £1m per year. The senior partners at PwC, Deloitte and KPMG were paid £3.6m, £2.7m and £2.4m respectively, last year.

The accountancy firms share and reinforce a mind-set that emphasises corporate and individual financial gain. There is little or no apparent self-doubt attached to the receipt of high rewards and they are hardly likely to restrain those that they advise and assist in enjoying similarly substantial gains. Indeed, the ability of the Big-4 partners to sustain their income streams depends on their ability to respond to the priorities of the corporate executives who employ them.

Alumni of the Big-4 – all imbued with the culture and worldview of those organisations – are heavily represented on FTSE 100 company boards – 331 out of 976 FTSE 100 executive and non-executive

directors have a background in accountancy or finance. 58 FTSE 100 Finance Directors are qualified Chartered Accountants, with 46 having previously worked for the Big-4.

Representatives of the Big-4 also dominate the Financial Reporting Council, responsible for regulating auditing and accounting practices, as well as the development and enforcement of the UK Corporate Governance Code, responsible, amongst other things, for guidelines on pay for corporate executives.

As of May 2014, five of the fifteen FRC board members were accountants (all former partners of PwC, KPMG or EY). The Codes and Standards Committee, which has responsibility for Corporate Governance, is composed of nine people including four accountants, two from PwC and two from EY.

The close relationship enjoyed between the Big-4 firms, the FRC and the executives of Britain's largest companies can raise questions about the influence of the elite accountancy firms over UK corporate governance.

Lawyers

The dominance of the 'Magic Circle' of law firms – Allen and Overy, Clifford Chance, Linklaters, Freshfields Bruckhaus Derringer and Slaughter and May - is arguably even more striking. The first four are all Limited Liability Partnerships, generating revenues of over £1 billion each, while Slaughter and May is a smaller General

Partnership, meaning it enjoys complete secrecy and does not have to produce audited accounts.

The profit margins for Freshfields and Linklaters were an astonishing 45% in 2011, while average profit-per-equity-partner (PEP) for each firm was more than £1m in 2013. Though PEP has remained reasonably constant since 2008, it increased by 98% from 2000 to 2008, despite significant increases in the number of partners.

We estimate there are around 1,100 senior lawyers at the Magic Circle earning over £1m. The highest-paid partners at Allen and Overy, Freshfields and Linklaters were paid £1.6m, £2.5m and £2.3m respectively in 2013. (Figures are not available for the other two Magic Circle firms)

Taken with the 270 accountants, this means that the nine firms looked at as part of this study account for roughly 13% of the 11,000 people in the UK with incomes of more than £1m.

Studies have indicated that trainees at law firms are 13 times more likely than the average person to have been privately educated. One third of trainees at Magic Circle firms attended Oxford or Cambridge University.

The role of the Magic Circle firms appears to go beyond ensuring mere compliance with the law to converting 'the law' into a resource which can be employed by corporate management to mould and deliver corporate strategy.

This is reflected in a number of areas. For example in interpreting the law: On the basis of experience, expertise and depth of knowledge of industrial sectors, the lawyers can define what the law will permit, rather than what it forbids.

Second, as formidable adversaries in dispute resolution they can liaise, negotiate and litigate against legal challengers, regulators and the courts themselves, to minimise constraints on corporate activity.

Third, they can assist companies in influencing legislation, designing regulation and, increasingly, in creating platforms of self-regulation which facilitate corporate goals. This is a role which includes advising and lobbying government through secondments or the outsourcing of legal advice.

All the Magic Circle firms stress their commitment to innovation and entrepreneurship. They search for new business opportunities. Much of this involves the definition and even the creation of new markets. A recent example is provided by the rapid growth in the utilisation of 'big data' which raises tricky legal issues to do with ownership, privacy, storage and intellectual property.

The creation of huge transnational law firms has been another extraordinary British success story with UK and American firms dominating the international legal profession. However, although they behave as very private undertakings, the Magic Circle firms are reliant on the whole apparatus of English law. They draw on the

respect accorded to English law, on the institutions of British justice, and the whole infrastructure of commercial law created and safeguarded by the British state.

Conclusion

While big companies produce very high levels of information on the pay of their top executives, professional services firms are more opaque. Yet we would argue that more transparency is justified in enabling us to understand a sector crucial to the health of the British economy. Their services are, after all, conducted on behalf of government and the public.

The professional firms represent a substantial part of the British corporate landscape and also reinforce a culture of high pay across corporate Britain. When their own partners are so well rewarded, it is not likely that they will provide a counterweight to the prevailing pay practices of top companies.

The Big-4, the Magic Circle and the Corporate Elite

Professionals within the corporate elite.

The debate about inequality in Britain can draw on some stark contrasts. It can, for instance, contrast the 5.2 million workers in Britain paid less than the living wage (of £7.65 per hour, see Living Wage Commission, 2014: 13); with the average FTSE 100 CEO remuneration of £4.5 million (High Pay Centre, 2013: 4). Such contrasts emphasise a growing polarisation in income distribution which requires better understanding at both ends of the scale to facilitate a more sophisticated debate. This Report deals with the top end of the remuneration scale and extends the discussion beyond CEOs to look at other elements of what has been termed *'the corporate elite'* (Wilks, 2013, ch. 4).

The corporate elite is conventionally equated with the boards of quoted companies. In a way this is a soft target, biased towards easily available data. Quoted companies are required to publish substantial details of remuneration packages in annual reports. But the corporate elite is much wider covering, for instance, private equity and the senior executives of many non-quoted companies and service providers.

The professional services provided by accountants and lawyers are special because they guarantee compliance with two mandatory requirements imposed by society on the operations of companies. They must produce true and fair accounts, and they must obey the

law. If they can be seen clearly to comply with these accounting and legal requirements, they are regarded as legitimate and are free to pursue their commercial strategies. Companies cannot operate without capable accountants and lawyers but the dependence is two-way and this Report explores the reciprocal relationship between a managerial elite and these professional elites.

It is striking that the large companies upon which the corporate elite is centred are serviced by a small group of accounting and law firms. The 'Big-4' and 'The Magic Circle' firms constitute the elite of their respective professions and are so closely involved with the corporate elite that they appear as indispensable constituents of that wider elite. The partners of these large professional firms have close commercial relations with senior corporate management, they appear to share their norms, are engaged with shared social networks, and they share their access to exceptionally generous remuneration. This Report seeks to explore that relationship, initially with a factual review of the firms and their remuneration patterns, and going on to present some more speculative impressions of their modes of influence as members of the corporate elite. The Report seeks to increase the level of transparency, and hence debate, about the financial performance of the firms and their partners. The impetus for promoting debate springs from the High Pay Centre's interest in inequality, as previously mentioned, but also by three

further areas of unease to which we return in the conclusion. In a word they are uneasy about: persistent dominance; the normalisation of very high levels of remuneration; and the implications for the proper exertion of countervailing power. We begin with a profile of the Big-4 accountants before turning to the Magic Circle.

Partners in the 'Big-4' accounting firms: organisation, remuneration and influence

Notes: UK figures are for 2013 from annual reports; EY figures from Accountancy Age 13/1/14; global turnover is from www.Big4.com, Performance Analysis, 2012; global employees (and EY UK employees) from CC (2013): 22 and relate to 2011. Note also that, despite much discussion of diversity, and an average female employee proportion of over 50%, only about 15% of partners are women. The highest level is in EY with 18%.

There is a very clear elite of accounting firms in the UK. The 'Big-4' dominate the major accounting services of audit, tax planning and management consulting. In fact they dominate the global markets for these services and are each part of huge global networks. The Big-4 are: PricewaterhouseCoopers

(PwC); Deloitte; KPMG; and EY (formerly known as Ernst & Young). Until 2002 the "Big-4" had been the 'Big-5' but, in the wake of Enron, Arthur Anderson melted down and its audit business was absorbed by the others. The current profile of the Big-4 is as follows:

table 1 Profile of the 'Big-4'

	UK			GLOBAL	
	Partners	Employees	Turnover (£mn)	Employees	Turnover (\$bn)
PwC	874	18,000	2,689	161,000	32.1
Deloitte	740	14,549	2,515	181,566	31.3
KPMG	583	10,500	1,814	145,000	23.0
EY	529	10,800	1,630	152,000	24.4
Total	2,726	53,849	8,648		

It is important to emphasise the sheer size of these firms. Their global networks are breath-taking but the UK firms are huge in their own right. On the basis of their revenue figures, if they were listed they would all be in the upper

half of the FTSE 350 – Deloitte the same size as ITV, PwC about the same size as Tate & Lyle. The elite accounting firms have become big business.

Sources: SCEA (2011): 162; CC (2013): 46.

table 2 Audit share of the 'Big-4', 2010

	FTSE 100 (%)	FTSE 250 (%)	FTSE 350 (%)
PwC	40	27.3	31
KPMG	23	22.2	23
Deloitte	20	26.6	25
EY	16	18.7	17
Total	99	94.8	96

The extent of their market dominance is clearest in the audit of large publicly quoted companies. A House of Lords select committee emphasised their monopoly of large audits noting that *'the audit of large firms, in the UK and internationally, is dominated by an oligopoly'* (SCEA, 2011: 9) and the Report was influential in persuading the OFT to refer the audit market to the Competition Commission which reported in October 2013. The pattern of market dominance is stark:

These firms also dominate the markets for high-level tax advice and planning, and have a big share of the management consultancy and mergers and acquisitions markets. They may also advise big companies on executive remuneration.

The 'Big-4' firms are astonishingly successful. Like the law firms, they expanded rapidly from the late 1980s through organic growth and mergers which culminated with the creation of PwC in 1998. Subsequently they have shadowed the globalisation of their corporate clients to become steadily larger global entities and have strengthened their hold on UK and global accounting markets. From 2004 to 2008 they grew their global revenue at an annual compound rate of 14% and, although they suffered setbacks in 2008-2011, the trajectory of growth is re-establishing itself. Clearly, their dominance of their markets has raised suspicions of collusion, are they operating a cartel? The Competition Commission did not find evidence of a cartel and did not find evidence to substantiate other possible areas of wrongdoing such as 'bundling' advice and audit activity; engaging in predatory 'low ball' pricing to retain audits; or exercising undue influence over regulators. Yet their dominance is remarkable. Their great incumbent advantages appear to be their reputational success and their global networks which make them indispensable for global companies. The Big-4 all originated in the UK and continue to be strongly influenced by their UK components. In that sense they are a spectacular

British success story. Perhaps partly for this reason the Competition Commission did not move aggressively to end their control of the audit market or to break them up. Indeed, there is regular concern expressed about the risk that another Arthur Anderson could reduce the Big-4 to the Big-3, that would be regarded as a disaster and to that extent these four firms are, in a familiar cliché, 'too big to fail'.

The dominance of the Big-4 has, if anything, been consolidated by the modest remedies put in place by the competition authorities (basically requiring companies to re-tender their audit providers every ten years). That dominance is seen in absolute size; in market share; in partner remuneration; in prestige and in their professional self-confidence. Their confidence and ambition could be symbolised by their mission statements which, for KPMG, includes the rather disconcerting declaration that they have '*one clear ambition – to dominate professional services in the UK*' (KPMG, 2013: 12). Those who have had regulatory dealings with the firms observe a level of professionalism and commitment that is simply not found in the medium sized firms.

Organisation and operations

The firms have various configurations of national and global legal forms but in the UK they are all established as 'Limited Liability Partnerships' (LLPs) under the Limited Liability Partnership Act, 2000. The Act provides for the firms to be recognised and

act as a corporate body. Unlike a traditional partnership the liability of the members is limited to the capital they have subscribed and otherwise they bear no liability for the debts of the partnership or for the actions of any of the other partners. There is no limit on the number of partners. The disclosure requirements include the deposit of annual accounts at Companies House but the level of detail is modest and the only remuneration requirements are to show the overall total profit, the names of the partners, and the amount paid to the highest paid partner. This is a decidedly advantageous form of organisation and was introduced specifically to help large law and accounting firms.

LLPs pay no corporation tax, but since the entire profit is attributable to the partners, they pay income tax on their share of the firm's profits. There is a tax advantage inasmuch as, since partners are not employees, the firms do not pay employer's NI on partner's remuneration. The Revenue is currently challenging this arrangement and firms are considering increasing the amount

of capital partners are required to pay into the firm to 'prove' that they are not 'employees'.

Ironies of Cooperatives and Cobbler's Shoes

This organisational model deserves a moment's consideration. Basically, as far as partners are concerned, they are running a cooperative. Formally every partner is equal and the firms religiously maintain this myth (see Empson et al, 2013). There is a degree of democracy since the Senior Partner (effectively the CEO) of each firm is formally elected and there are various accountability mechanisms – certainly more democracy than a standard plc. In fact since partners contribute capital (which is repaid when they retire) they are effectively employee shareholders. So, the first irony is that these acolytes of the corporate form, whose audits and advice underpin the reputations and brands of large companies, follow a far more participative organisational model than their clients. The second irony is that the accountants are the designers and custodians of the British model of corporate governance, yet they themselves avoid the whole corporate governance framework, including disclosure of board composition and remuneration. This is 'the cobblers children' irony – in the fairy tale the cobbler's children have no shoes; in this case the auditors do not disclose.

In operational terms these firms are something of a professional conglomerate. Their pattern of income is shown in table 3.

Source: Accountancy Age, 50+50 Survey, 13/1/2014
Evidently, the firms do specialise to some extent. PwC is biased to audit whilst KPMG is more reliant on consulting. Within the audit market there is also specialisation by industry, thus Deloitte do no real estate audits with the FTSE 350 and, more importantly, EY do not audit any banks.

table 3 Big-4 revenue from main activities, 2013, (£mn)

	audit	tax	consulting	total
PwC	963	659	438	2,060
Deloitte	663	529	524	1,716
KPMG	469	380	925	1,774
EY	478	431	416	1,325

Profitability and remuneration

The Big-4 are all highly profitable. Profits fell from 2009 but have now recovered to pre-crash levels. Three of the firms declare their UK profits in their annual accounts but provide relatively little detail. EY has adopted a European structure and in an odd incestuous relationship, the UK partnership is owned by EY Europe which is, in turn, owned

by its member firms. In any case EY does not appear to submit UK accounts. Deloitte and KPMG declare profit on each of their main activities but beyond that matters are opaque. The Competition Commission found the lack of data frustrating. It tried and failed to work out profits per audit engagement or profits per partner. The overall figures are:

Source: annual reports. EY do not disclose UK profitability and KPMG stopped producing UK reports in some of these years.

table 4 Profitability of the Big-4, (£mn)

	2013	2012	2011	2010	2009	2008
PwC	765	740	727	665	668	675
Deloitte	642	560	542	593	581	621
KPMG	455	358	n/a	n/a	n/a	n/a
EY	n/a					

These profits are all attributable to the partners. They tend to be distributed in full with deductions for annuities and benefits to retired partners and in some cases a small proportion is held back for new projects.

Three of the firms declare information on 'average profit per partner', plus the legal requirement to disclose the remuneration of the senior partner. This is what they tell us:

Sources: annual reports; transparency reports; financial statements (and some specialist press coverage).

table 5 Average profit per partner of the Big-4 (£'000)

	2013	2012	2011	2010	2009	2008	2007	2006
PwC	705	679	763	759	777	797	778	716
Deloitte	772	789	756	873	883	970	877	765
KPMG	712	580	683	763	671	685	685	806
EY	n/a							

There are some inconsistent figures floating around which may derive from a contrast between ‘average profit per partner’ and the profit actually distributed, ie. ‘distributed profit per partner’. These figures indicate a broad comparability between the remuneration of partners across the firms. The Competition Commission found that remuneration of partners across the Big-4 was very similar so that we can safely assume that the rewards going to partners in EY will be similar to, but perhaps slightly lower than, those in their sister firms. There is a huge gulf between partner remuneration in the Big-4 and that in medium sized firms. Big-4 partners receive at least twice as much as partners in their nearest rivals and Deloitte partners do particularly well. At an average of over £700,000 in 2013 remuneration is substantial but has not (unlike the lawyers) breached the £1 million barrier, although it should be noted that the averages are sensitive to the number of partners.

about these levels of partner remuneration. They are widely reported in the technical press and included in annual league tables. Firms seem comfortable with these numbers as evidence of the talents and marketability of the firms and their partners. Also, of course, they provide very attractive incentives for recruitment and retention of highly talented graduates and newly qualified accountants. In contrast there have been occasional rumblings about the remuneration of Senior Partners. In 2005 a poll found that ‘84% of the 261 finance directors polled believed that Big Four senior partners were paid too much. Julian Groves, FD of Herts College, said partners were earning ‘silly money’ and questioned whether they were ‘really earning it’ (*Accountancy Age*, 11/8/05). This outburst was provoked by the £3.6 m pay package of Deloitte Senior Partner, John Connolly. This storm in a teacup does not appear to have affected Connolly’s remorselessly rising pay but it is interesting, as seen in the figures below, that his successor, David Sproul, has been taking more modest remuneration.

There is very limited criticism in the popular or the technical press

Note * Deloitte paid an old and a new senior partner in 2011. It is very difficult to find a Deloitte number for 2009.

table 6 Profit distributed to the Senior Partners of the Big-4 (£mn)

	2013	2012	2011	2010	2009	2008	2007	2006
PwC	3.6	3.3	3.7	3.6	3.3	2.9	2.8	716
Deloitte	2.7	2.8	2.6/4.4	5.1	n/a	5.7	4.6	765
KPMG	2.4	n/a	2.6	2.7	n/a	n/a	n/a	806
EY	n/a							

The Senior Partners are powerful but not as dominant as CEOs (Empson et al, 2013). Although they are elected by all the partners, they personally choose their executive groups and are effectively managing large corporations. They are paid at slightly lower levels than FTSE CEOs and two of the firms have begun to disclose the total remuneration of their Executive Groups (equivalent to the Board of a company but without non-executives) which helps to give some sense of remuneration at the upper levels of the partner hierarchy. Thus the 12 members of the PwC Executive Group (excluding the senior partner) received an average profit distribution of £1.49 m in 2013, down from £1.54 m in 2012 see table 7.

This information on remuneration is thin and patchy. The firms are extremely sensitive about releasing more detailed remuneration data and exploit the legal requirements and accounting recommended practices to remain highly secretive. They released remuneration data to the Competition Commission inquiry but insisted that it be treated as commercially confidential and it was fully redacted from the published report. None of the recruitment and survey agencies publish information on partner's remuneration. The firms do not participate in Income Data Services surveys. Towers Watson undertake a survey of partner and senior executive compensation but the results are confidential to the participating firms

The Big-4 and their influence in the corporate elite

Why does it matter that this small group of huge firms dominates the market for accountancy services, and pays its senior people so lavishly? There are many different answers but here we concentrate on the role of the Big-4 in defining and disseminating a set of ideas about the operation and priorities of large companies and how to define success in terms of financial and personal gain. This could be set in a larger picture about the role of financiers, finance and accounting criteria in British stock market capitalism. It is regularly remarked how British boardrooms and CEOs are disproportionately selected from the world of finance and accounting (as opposed, say, to scientists in German boardrooms). For the time being, however, we will concentrate on the mechanics of influence.

The partners of the Big-4 are closely integrated into the operations of large corporations, into the workings of the City and the key issues of raising finance, and into the regulatory frameworks within which large companies conduct their business. They authenticate and establish trust through audit and professional standards. They

Note: the Executive Group includes the Senior Partner
Source: Annual Reports

table 7 Profit distributed to the executive group of PwC and KPMG (£mn)

	2013	2012	2011
PwC	21.5	18.7	n/a
KPMG	22	15.1	17.1

advise on strategy, on presentation, on minimising tax, and on key decisions such as mergers and acquisitions. And they are part of an invisible but ubiquitous and indispensable network of accounting personnel. As they engage with corporate executives (through consultancy rather than audit) they share and reinforce a mind-set that emphasises corporate and

individual financial gain. At the corporate level, this stresses the need to achieve success defined in standard criteria of maximising revenues, cutting costs, increasing profits. At the individual level, they enjoy exceptional personal financial rewards and the expectation that those rewards will continue to grow over their careers. There is little or no apparent self-doubt attached

Box 1: The Hierarchy

It is evident that there is an elaborate hierarchy of status, influence and remuneration within the firms, reinforced by rigorous evaluation processes. There appears to be a gradation of rankings based on performance, ability and internal managerial roles rather than the type of work undertaken. The CC found that *‘there was no systematic difference in remuneration per partner for audit and non-audit partners’* (CC, 2013: 62). There are well-defined executive positions including the CEO and the equivalent of Chief Operating Officer, Chief Financial Officer and leaders of the main components of the matrix of services and products. It is wholly speculative but we might envisage a hierarchy composed of say:

Team leaders	40 %	of total, average salary perhaps	467,000
High performance leaders	30 %	of total, average salary perhaps	697,000
Sector/area managers	20 %	of total, average salary perhaps	943,000
Top-level managers	10 %	of total, average salary perhaps	1,190,000

Note: wholly speculative assumptions but based on PwC 2013 numbers and the projection that each ‘group’ gets 150/ 200/ 250% more than basic partner remuneration.

So, given the total partner population of the Big-4 at 2,726 we might speculate that there are 270 top-level partners, all of whom have an income of well over £1 million. These are the people who are members of a more broadly defined corporate elite.

to the receipt of such rewards and they are hardly likely to restrain those that they advise and assist in enjoying similarly substantial gains. Indeed, the ability of the Big-4 partners to sustain their income streams depends on their ability to respond to the priorities of the corporate executives who employ them. In helping to deliver corporate and individual financial success they are securing their own financial security. This is a powerful combination of legitimating ideology and personal reward, nurtured in a rather closed and introverted world but celebrated by the City and the financial press and consistent with the dominant expectations of shareholder capitalism.

To put a morsel of flesh on this argument that the Big-4 have influence which they employ to benefit the corporate elite let's look at a couple of avenues of influence, starting with the alumni network. Former employees and partners of the Big-4 are ubiquitous in the leadership of large corporations and financial regulation. A 2013 study of the 976 executive and non-executive directors of the FTSE 100 found that 331 of them were either accountants or had senior finance experience. Of the 100 finance directors on these boards 58 were qualified chartered accountants of whom 46 had previously worked for one of the Big-4 (Accountancy Age, 2/11/13). These directors have considerable political influence. For instance, Finance Directors of the FTSE 100 organise themselves in 'The 100 Group' to define and defend their commercial interests

and to lobby for favourable regulation. As non-executives as well as finance directors many retired Big-4 accountants join the boards of large companies.

A second mode of influence is through regulation and the involvement of Big-4 accountants in the design and even the implementation of financial regulation. One example is the extent to which Big-4 tax advisers have influenced government tax policy through advice, consultancy and the secondment of staff to work on tax regulation. After a direct investigation of the Big-4 the Public Accounts Committee presented some of the most direct criticism to be found in an official report observing that 'the close relationship that the four firms enjoy with government creates a perception that they wield undue influence on the tax system which they use to their advantage' (PAC, 2013: 4).

Who regulates the regulators?

Then we come to the regulation of the profession itself, and the design and enforcement of corporate governance, both of which fall within the remit of the Financial Reporting Council (FRC). The FRC began life as a purely voluntary exercise in self-regulation but it has steadily gained in stature and importance and now is one of the central bodies in financial regulation. It regulates audit standards, the conduct of the audit firms and, since 2012, accounting standards, using delegated powers originating in the 2006 Companies

Act. It is also responsible for the development and enforcement of corporate governance through the 'UK Corporate Governance Code' and the 'Stewardship Code'. This second aspect of its work remains essentially voluntary. Hence the FRC 'audits the auditors', but who controls the FRC? Why, the accountants of course. The accounting profession has captured the whole apparatus of corporate governance and the regulation of professional standards, or rather, the Big-4 have. This can be illustrated by the FRC Board which is composed of 15 people. In May 2014 five of those members were accountants (all former partners of PwC, KPMG or EY). One of the accountants was an executive director and two of them chaired the Audit and Assurance Council (which oversees audit standards) and the Accounting Council (which sets standards for the preparation of accounts). The Codes and Standards Committee, which has responsibility for Corporate Governance, is composed of nine people including four accountants, two from PwC and two from EY (details from FRC website www.frc.org, accessed 2/5/14).

This colonisation of the FRC by the accountants is aided by two further factors. First the FRC remains a self-regulatory body. It has no statutory basis and no requirement to pursue the public interest, although from 2013 its annual report was submitted to Parliament. Second, the FRC receives only trivial funding from government. Its activities are financed by a 'voluntary levy' on companies and professional firms

of accountants and actuaries. There is scope for the levy to be made compulsory by government but the suspicion is that the FRC is anxious to maintain financial independence (its CEO, a former civil servant, is paid £447,000). This arguably makes it less independent and more deferential to its clientele, especially the Big-4.

Conclusion on accountants

Partners in the large accounting firms are hardworking, highly professional, rarely corrupt, well-respected members of society. And this is the danger. It might be thought that professional accounting (and law) firms would act as a countervailing force to limit corporate power. Their professions grow out of a deep-seated societal distrust of commerce and business. Can we trust business accounts to give a true and fair view? Can we trust business people to act within the law? Can we, as a society, call them to account? But this aspect of the professional activities of the Big-4, especially outside audit services, appears to have been subordinated to efforts to facilitate corporate strategy led by partners fully integrated into a wider corporate elite. Rather than engaging in sceptical semi-adversarial review of corporate activities the Big-4 have become what Gourevitch and Shinn (2005: 33) call '*reputational intermediaries*'. Their priority is to protect their own reputations (which suffered in the wake of the financial crisis, and 'building trust' is prominently addressed in their public statements); and to protect the reputations of their clients.

Individual partners may have misgivings about the companies they audit and advise. They may object to blatant offshoring to sweat shops, to casualisation of the workforce, or to transfer pricing to reduce tax, but collectively they are locked into a system which facilitates and even encourages such commercial behaviour. This is not mere speculation, the disgrace and collapse of the respected firm of Arthur Anderson is as recent as 2002. The profession and their firms buy the loyalty of their partners with professional standing,

financial security, influence and money. They are ludicrously well paid. The top-level of partners will be earning around £100,000 per month, receiving roughly the average annual wage every week. In turn they defend a system that emphasises short-term gains, financial opportunism, and a share price obsession. They work in the interests of the corporate managerial elite who control the contracts and the revenues upon which they depend and they can themselves be regarded as a vital component of the corporate elite.

Partners in the ‘Magic Circle’ law firms: organisation, remuneration and influence

The elite of London commercial law firms has come to be known as the ‘Magic Circle’. This small group of large, immensely profitable and highly influential firms dominates the London and global markets for high-level commercial transactions and acts for the vast majority of large corporations operating in the UK. The term Magic Circle has become standard usage, it is employed without irony as a straightforward description and can be seen as a brand or, in more academic usage, as an institution (Fairclough, 2005). The Magic Circle firms have grown up since the early 1990s and have consolidated their dominance with astonishing invulnerability.

The Magic Circle firms are: Allen & Overy; Clifford Chance; Freshfields Bruckhaus Deringer; Linklaters; Slaughter and May. Their profile can be seen in table 8.

The four largest firms are very similar in size whilst the fifth, Slaughter and May, follows a rather different model. It is smaller, more specialised, and has not developed a global network of offices. It has been described as a ‘boutique’ firm and is sometimes omitted from discussions of the Magic Circle, but it is hugely profitable, very high status (described as ‘the definitive City blueblood’) and clearly an elite firm. As with the accountants it is necessary to emphasise the sheer scale of these firms. The top four all have turnover of over £1 billion and in total have 2,113 partners. The creation of these huge transnational firms has been another extraordinary British success story following the liberalisation of financial markets in the mid-1980s. Clifford Chance, for instance, was created by a merger in 1987 when the combined firm employed only

Notes: Figures for 2012 taken from *The Lawyer* UK 200, undated supplement; profit and employee figures are for 2011 and taken from *The Lawyer*, UK 200 Preview, 15/8/11

table 8 Profile of the Magic Circle Firms

Firm	Rank by turnover	Turnover £mn	Profit (2011) £mn	Partners	Lawyers	Employees (2011)	Global offices (countries)
Clifford Chance	2	1,303	381	568	2,518	5,997	23
Linklaters	3	1,206	515	466	2,150	4,659	29
Allen & Overy	4	1,183	420	512	2,253	4,776	29
Freshfields Bruckhaus Deringer	5	1,139	544	445	2,010	4,561	28
Slaughter and May	10	426	235	122	553	1,308	2
Total		5,257	2,095	2,113	9,484	21,301	

640 lawyers, it has grown fourfold over the last 25 years. In 1985 the Magic Circle firms had 281 partners, by 1990 this had risen to 512 and the era of the giant international law firm was beginning (Galanter and Roberts, 2008: 157). The global legal industry is monopolised by British and American law firms. The Americans have weathered the recession better than their British cousins but in 2012 the four largest Magic Circle firm were all in the top ten of global law firms ranked by turnover (at 5, 6, 7, 8 with Slaughter and May at 48, see Legal Week, Global 100, 19/10/2012). The first non-Anglo-American firm appeared at number 58, and that was Australian. So, again, like the accountants, the London law firms have been extraordinarily successful, servicing global corporations from London and forming a vital component of City capability, income and 'invisible exports'.

The Magic Circle firms are not quite as distinctively dominant as the Big-4 accountants. Firms such as the Anglo-American DLA Piper have similar turnover and Norton Rose has more partners. Indeed, The Lawyer has suggested that there is a 'silver circle' of firms challenging the dominance of the Magic Circle. But the Magic Circle is distinguished by size, reputation, profitability, client base and partner earnings. They are the largest firms in London; they have outstanding reputations for high quality legal work; they have high profit margins; they advise the largest corporations; and their partners are very well paid. It has been remarked that access to the

club of elite firms is average partner remuneration of over £1 million and this elite can be defined by reference to its most salient indicator which is PEP 'Profit per Equity Partner'. What is most remarkable about this group of firms is the way in which they have sustained their dominance for decades. In this respect they exactly replicate the Big-4 accountants. Their reputations are such that they are the 'must have' legal advisers for large corporate transactions and they have succeeded in creating a Magic Circle 'brand' that appears to insulate them from serious challenge or market volatility. Their practices embrace tax, real estate and litigation but the big money spinners are in what can be termed 'corporate transaction law' covering commercial contracts, mergers, finance, private equity, capital markets, competition and restructuring.

The durability of the Magic Circle provides an interesting example of reputational consolidation. Originally, from the 1980s, the Magic Circle appears to have been a secretive group of London law firms who agreed not to poach one another's partners and agreed on rates to pay trainees and junior lawyers. As these arrangements evaporated in the early 1990s the term began to be used by the legal press and in particular was taken up by *The Legal 500*, one of the key client guides to choosing law firms. The company and commercial law section of *The Legal 500* was regarded as the key criteria for elite firms and by 2000 the five Magic Circle firms were established at

the top of the list of recommended firms. Subsequently the Magic Circle firms have exploited the legitimacy encapsulated within this labelling. As Fairclough (2005: 36) remarks, *'by choosing one of its five members, clients, employees and the like will be associated with a large firm with an excellent reputation'*. Fairclough (2005: 38) also points out that *'no longer a secret society – like its magicians namesake – the tag became a badge of honour, a phrase denoting prestige, yet its original connotations remained: that of a closed, impenetrable group, with special powers or skills above the norm. These firms were 'magicians' in respect of their abilities to attract blue chip clients and star employees, turn in enormous profit, and produce work of an exceptional quality'*.

Organisation and operations

In contrast to the accountants, there is a substantial literature devoted to the study of law firms including their growth, influence, organisation and decision-making. There is also a range of specialist legal journals such as *The Lawyer* and journals specialising in law firm management such as *Managing Partner*. The literature recounts the emergence of large international law firms which have come *'to look and behave much more like international businesses'* (Galanter and Roberts, 2008: 168). Such firms could be said to have been *'corporatised'* although Empson et al argue that they have become *'sedimented'* inasmuch as *'the structures and systems in these firms may have*

become more corporatised, but the beliefs and behaviours associated with the traditional professional partnership persist' (Empson et al, 2013: 817). Certainly they have been remarkably entrepreneurial *'concerned to develop law that facilitated the bridging of gaps between what seemed commercially possible and what was legally allowable'* with the result, as noted above, that London, came to dominate the global law firm model (Morgan and Quack, 2005: 9 and 19). But despite the attention given to these firms the evidence base remains sketchy with firms reluctant to publish material about their finances and often self-reporting in their release of information. So let's start with their formal legal and accounting position.

The four largest Magic Circle firms are, like the accountants, all established as Limited Liability Partnerships (LLPs). In contrast Slaughter and May remains as a General Partnership which does not therefore enjoy the privileges of limited liability for individual members. On the other hand, it does enjoy the privilege of complete secrecy and does not publish a report or submit audited accounts. Unlike the accountants, and with the exception of Allen and Overy, the other law firms do not publish their accounts, and review of the accounts deposited at Companies House shows that they reveal the minimum necessary for legal compliance. For instance, segmented analysis of turnover or profit by area of activity is not revealed, with the firms using the formula that *'the Members believe*

it would be prejudicial to the firm'.

The Magic Circle firms all publish a variant of an annual review which may say something about governance but concentrates on corporate responsibility and main commercial activities. These tend to be classic glossy publications full of happy pictures and with cherry-picked numbers relating to charitable engagement or pro bono work, although, to their credit, Linklaters and Freshfields recount close involvement with the UN Global Compact. A key source of information is the annual survey, The UK 200, conducted by *The Lawyer* magazine. It provides comparable data on size, partners, profits and remuneration but from 2013 the full data-set is only available on payment of a substantial subscription. A drawback to this and similar surveys is that much of the data is self-reported. This carries a risk of manipulation since the survey and league tables are very widely reported within the sector and have a substantial effect on reputation. The direction of variance is itself interesting, thus both Freshfields and Clifford Chance give PEP numbers in their annual reviews that are substantially below the numbers included in The UK 200. This sort of divergence has been picked up in US debates where many firms are felt to exaggerate their PEP numbers in order to bolster their reputations.

Overall the amount of information available about the management, financial performance and remuneration patterns of the Magic Circle firms is limited and inadequate for an informed assessment of their performance.

The glowing exception to this generalisation is Allen and Overy. The A&O Annual Review gives a full survey of the firm's activities and it is genuinely interesting and engaging. Moreover, they give extensive detail of management arrangements, they explain the remuneration system for partners, they give key statistics (including profit and remuneration) over a five year period, and they publish their accounts on their website. The accounts review community affairs with the heartening observation that *'we work hard to find solutions to some of society's most pressing issues'* for instance, *'developing the rule of law in Rwanda and other emerging economies'* (Allen & Overy, 2013: 3). It may be impressionistic, but Allen & Overy appear in a different league of transparency, at the other end of the spectrum from the opaque Slaughter and May.

The organisation of the firms as partnerships means, as noted above, that they are *'co-operatives'* as far as the partners are concerned. Their governance arrangements typically involve the election of a senior partner and the election of a partnership council or board (16 people in Freshfields, 8 in Clifford Chance). The firm will be run by a managing partner and the organisational divisions will include *'practice areas'*, for instance, Linklaters' website lists 25 practice areas ranging from capital markets to litigation and arbitration. The firms are both more and less *'democratic'* than the accountants. On the democratic side, remuneration is only marginally driven by individual performance. Instead, as examined

below, these firms treat partners very equally in a seniority system. On a less democratic note, there are divisions of partners into salaried (non-equity) partners and full equity partners who share profits. The balance between equity and non-equity partners is quite variable. Thus the huge DLA Piper had only 31% of its partners as equity partners in 2011 and the average for the Top 100 UK firms was 55%. The Magic Circle has far higher levels of equity. One source puts the total of equity partners in Magic Circle firms at 81% in 2005-06 rising to 85% in 2012-13 (*Big Law*, 11/9/2013), the detailed numbers in 2011 can be seen in table 9.

As we see below, these proportions have an effect on the figures for PEP but the policies on which they are based also have an effect on the strategies and effectiveness of the firms. The full equity model which the Magic Circle tends to endorse is said to have substantial advantages in motivation, collegiality, coordination and longer-

term strategic thinking. Whether these benefits are fully shared by female employees is less certain. A very small proportion of partners are women, around 15%. Freshfields' proportion is 12% and they concede that 'gender diversity is one of the biggest challenges we face' (Freshfields, 2013: 13).

Another challenge is potentially posed by the 2007 Legal Services Act which formalised regulation of the professions through a new Legal Services Board, and permitted a range of legal services to be offered by an ABS (alternative business structure). The ABS could be a company (the so-called 'Tesco law') or it could be a partnership. By Spring 2014 over 240 ABSs had been licensed and a spate of mergers between law firms had got underway. This innovation mainly concerns basic legal services and is unlikely to affect Magic Circle firms but it is interesting that some of the Big-4 accountants are moving more deliberately into legal services. Thus PwC is using the Act to organise its team of over 2,000 lawyers and in June 2014 EY announced that it had poached a senior partner from Freshfields to lead its global transaction law practice.

Source: The Lawyer, 15/8/2011

table 9 Equity Partners in Magic Circle firms, 2011

	Total	full equity	% equity
Allen & Overy	487	398	82
Clifford Chance	552	379	69
Linklaters	473	441	93
Freshfields BD	445	416	93
Slaughter and May	125	122	98
Total	2,082	1,756	84

Profitability and Remuneration

All the Magic Circle firms are highly profitable, and substantially more profitable than the accountants. As an example, in 2011 PwC and Deloitte made collective profits of £1.3 bn on a turnover of £4.6 bn; whilst Freshfields and Linklaters made profits of £1.1 bn on a turnover of £2.3 bn. This gives a

substantial profit margin for the accountants of 28% against a remarkable profit margin for these two Magic Circle law firms of 45%. It must be noted, however, that the full equity policies of the Magic Circle (and the accountants) inflate their profit figures and margins because no costs are charged for the value of the equity partner's services. But, even taking this into account, the high profitability of the Magic Circle sets them apart. Other large law firms typically have profit margins of 20 to 30 % and in 2011 the next most profitable firm was Hogan Lovells with net profits of £185m. There is very little information available about which activities are most profitable and how the law firms cost their work. Despite a broader picture of 'brutal trading conditions' (Byrne, 2012: 18) the Magic Circle have sustained their high profitability although it has dipped below the peak year of 2008. Some of the firms introduced restructuring measures which included a reduction in the number of partners and often a

larger reduction in the number of non-partner lawyers. On the whole, however, they weathered the recession relatively well and expansion is again the order of the day.

We can first review the pattern of profit per equity partner in table 10 before exploring various aspects of the pattern.

These are average profits and conceal considerable variation between individuals. Several points emerge from the Table. First, profits have grown substantially since the turn of the century. The top 30 law firms saw PEP rise by 93% between 2000 and 2008 (The Lawyer, 14/7/2010: 16). The Magic Circle did slightly better with an average PEP rise of 98%, and bear in mind that this was despite a sizeable increase in the number of equity partners. Second, PEP has remained very stable and above £1 million since 2008 (with the sole exception of Clifford Chance in 2010). This is a startling trend, the

Source: The Lawyer, UK200, various issues: 2013, The Lawyer, 21/10/13. 2012, undated supplement, 2012. 2011, 15/08/11. 2010, 13/09/10. 2008, 14/07/08. 2000, Ibid.

table 10 Average Profit per Equity Partner: Magic Circle Firms

Firm	2013 (£ '000)	2012 (£ '000)	2011 (£ '000)	2010 (£ '000)	2008 (£ '000)	2000 (£ '000)
Slaughter and May	1,887	1,780	1,930	1,840	2,250	960
Clifford Chance	1,271	1,078	1,005	933	1,170	685
Freshfields	1,221	1,299	1,308	1,406	1,484	675
Linklaters	1,195	1,243	1,225	1,214	1,440	710
Allen & Overy	1,189	1,100	1,100	1,100	1,120	744

consistency of earnings indicates significant market power and an effective oligopoly. Third, the sheer size of earnings is remarkable, these are over 2,000 immensely well paid professionals who earn on average over £1 million a year, year in, year out.

As with the accountants the profits are all attributable to the equity partners and are similarly distributed in full. Income tax is levied on partner remuneration so the partners pay tax at something approaching the higher rate of 45% rather than a lower rate of corporation tax. The pattern on pensions is also much the same as the accountants with defined benefits schemes for staff closed in the late 1990s and defined contribution schemes operated for partners and staff.

When it comes to partner remuneration the picture is somewhat different to the accountants. Instead of the rigorous and complex set of performance criteria which drive accounting remuneration, the magic circle firms

operate a 'lockstep' system which is based on seniority. Each firm has slightly different arrangements and only Allen & Overy give full details so we can consider their model. When a new partner is appointed they are put on a fixed share of profit for two years. Then the partner is allocated 20 profit sharing points which are increased by two points each year until they reach the maximum of 50 profit sharing points (often referred to as 'the plateau'). Linklaters use a scale of 25 'parts' but arrangements in the other firms are unclear. In 2013 the 20 points in Allen and Overy were worth £627,000 and the 50 points worth £1,566,000 (Allen & Overy, 2013: 18). At 2013 levels an Allen and Overy partner could therefore expect to get a pay rise of about £62,000 a year and it would take 17 years to reach the plateau following promotion to partnership. The partners would be required to subscribe additional capital in proportion to their profit sharing points.

The spread of remuneration between equity partners is thus substantial. For 2011 The Lawyer gave figures for top and bottom of equity for the Magic Circle as seen in table 11.

Comparison with the average indicates that Freshfields and Slaughter and May have a large proportion of their partners at or near the plateau.

For the casual observer one might expect a hint of apology from the firms and their partners about the sheer scale of remuneration. It

Source, *The Lawyer*, 15/8/2011

table 11 Range of Equity Remuneration

	bottom of equity	top of equity	average (£'000)
Allen & Overy	642	1,604	1,100
Clifford Chance	495	1,240	1,005
Freshfields	590	1,475	1,308
Linklaters	624	1,559	1,225
Slaughter and May	1,005	2,100	1,930

is, after all, at a level which has raised criticism of banking pay packages and it is substantially greater than the partners in the Big-4 accountants. Indeed, the accountants cited high pay in law firms to the Competition Commission in mitigation of their own high partner remuneration. Thus, *'PwC and Deloitte considered that their profit per partner ranked lower than Magic Circle law firms'* (CC, 2013, A7(3): 31). In fact there is little hint of apology from the firms and very little explicit criticism in the general or the specialist press. This dimension of high pay has passed beneath the radar, a point we come back to in the conclusion. And the Magic Circle firms are not alone. In 2011 18 law firms paid their top partners over £1m but some of these were small boutique practices and all of them were flattered by a lower proportion of equity partners. Rather than an air of hesitancy PEP exhibits the reverse syndrome, celebration instead of apology. High PEP appears to be considered as a badge of honour, as proof of excellence and as a vital element in continued membership of the Magic Circle. In the US serious falls in PEP put firms under threat with potential loss of clients and staff along with the fall in status and reputation. In London changes in PEP also attract extensive comment with heated debates about rivalries and pecking order between the big firms, and much of the debate is conducted with an air of restrained admiration. There is what might be described as a sense of entitlement.

The hierarchy

Returning to the theme of partnerships as co-operatives (as far as the partners are concerned) there does seem to be a greater degree of collegiality and democracy in the law firms. We know quite a lot about the intensification of internal management from recent research (see Empson et al, 2013) but the treatment of partners retains traditional courtesies. Leadership has become more managerial with a senior partner, a managing partner and finance and personnel partners (who may be non-lawyers) but the hierarchy remains rule bound and flatter. The 'lockstep' seniority system is intrinsically more inclusive and the Magic Circle firms have resisted performance based criteria or US-style 'eat what you kill' remuneration. Curiously, lockstep firms appear less tolerant of poor performance and tend to be more profitable. The equality of remuneration extends to some extent to the leadership. LLPs are obliged to reveal the payment to the highest paid partner and the recent figures are as follows in table 12.

Source: 2013 annual accounts

table 12 Total remuneration for highest paid partner, £'000

	2013	2012
Allen & Overy	1,566	1,604
Clifford Chance	n/a	n/a
Freshfields	2,500	2,900
Linklaters	2,300	2,500
Slaughter and May	n/a	n/a

There is no figure for Slaughter and May, who do not publish accounts, and Clifford Chance give a global figure (of £18m) for the sixteen people on their Management Committee. How they escape the regulatory requirement to report on the highest paid partner is unclear. Overall, however, despite higher average earnings, the highest paid partners (who may or may not be the senior partners) are paid slightly less than their equivalents amongst the Big-4 accountants. Allen and Overy again stand out. They pay their highest paid partner at exactly the same rate as all the other 'plateau' partners.

The total partner population of the Magic Circle in 2013 was 2,113. Of these about 84% are full equity partners and of those a reasonable estimate would be that over half, perhaps 60%, receive remuneration of over £1 million, around 1,100 partners. The equivalent number of £1 million-plus earners for the Big-4 accountants was estimated above at 270. For the lawyers the top-level partners, the managers and practice leaders, could be regarded as members of the corporate elite.

The Magic Circle and their influence within the corporate elite

This discussion is necessarily more speculative. A thorough review of influence would involve extensive research applying theories from sociology, anthropology and organisational studies. Instead this section raises some areas for debate drawing on the major premise of this paper, namely

that the elite professional service firms are themselves members of, and foundations of, a wider corporate elite.

The Magic Circle firms are, above all, 'client facing'. Their reputations, their stability and their fees depend on winning work commissioned by large corporate clients and their success is publicised in the quoted company 'Adviser-Rankings' (formerly the Hemscott Rankings). Their overriding preoccupation is to enable profitable activity by large corporations and they facilitate, innovate and reassure corporate executives. They deal with, and are commissioned by, senior managers and there is much attention paid to face-time and relationship management. Magic Circle partners are accomplished members of the inner circles of senior management and they inevitably share those norms, observe the conventions and follow the unwritten rules. Indeed, recruitment is biased towards individuals who are likely to fit seamlessly into these circles (see below). Like the accountants, the lawyers are there to help corporations cut costs, increase sales, grow profits and reap rewards. This seems almost too obvious to rehearse but it is worth re-emphasising that these are law firms and that the law is conventionally felt to emphasise access to justice, equality before the law, legal compliance and restraints of the exercise of power. However, it might be felt that the Magic Circle firms reinforce rather than restrain corporate power and help to tilt the legal and regulatory playing field towards corporate interests.

The elite standing of the Magic Circle has several dimensions. The discussion above has emphasised performance but they also perceive themselves as an elite, the term is used in the specialist legal press and in interviews and reports from the firms themselves. Clearly there is an element of meritocracy at work. These are clever people, well-educated, well-trained and very hard working. But there is also a thread of old-fashioned social elitism which seems to be more pronounced in the Magic Circle than in the Big-4. To put it bluntly, *'law firms continue to discriminate on the basis of social class when recruiting'* (Ashley and Empson, 2011). Thus Cook et al (2012: 1747) found that *'privately educated candidates are thirteen times more likely to enter an elite City law firm than are their state-educated peers'* and Legal Week found that *'more than one third of magic circle trainees ... have studied at either Oxford or Cambridge'* adding that *'at Slaughter and May, the figure rose to almost half (48%), with Freshfields Bruckhaus Deringer not far off at 44%'* (Legal Week, 24/3/2010). Thus, despite increased emphasis on diversity, *'there continues to be a strong link between attendance at particular educational establishments (private education followed by the 'right' university) and recruitment into City law firms'* and this naturally leads into the cadre of partners so that Cook et al also found that 42% of partners from the top 10 firms held Oxbridge degrees (see Cook et al, 2012: 1755). Ashley and Empson (2011) argue that these upper middle class lawyers are able to project the desired

up-market image and are better at convincing clients of their claim to expertise, hence *'in the short term, discrimination on the basis of social class can be seen as an entirely rational commercial strategy'*. This re-emphasises the client-facing imperative within the firms. We could speculate at length on the effects of a class bias in Magic Circle firms but at the very least it could be expected to consolidate a rather narrow, privileged, uncritical body of people insulated from the realities of societal problems; either paternalistic or, in a more strident interpretation, *'embracing particularly aggressive forms of elitism and masculinity'* (Cook et al, 2012: 1746).

Turning from the social background to their influence on corporate strategy and the regulatory environment we can consider the Magic Circle involvement in enhancing corporate power. Large business corporations are embedded in a dense environment of national and international legal and regulatory systems. They need to be compliant with the law in every jurisdiction in which they operate and their in-house lawyers will seek to ensure compliance. But the role of the Magic Circle firms appears to go beyond mere compliance by converting *'the law'* into a resource which can be employed by corporate management to mould and deliver corporate strategy. This may be regarded as a radical claim, or it may be regarded as absolutely obvious, but the high fees charged by Magic Circle firms have to be justified by offering value to the company. There are many areas

where law as a resource appears to be deployed but let's take four. First, in the area of legal interpretation law firms will construct interpretations that favour the profitable interests of the company and the senior management. On the basis of experience, expertise and depth of knowledge of industrial sectors, they can define what the law will permit, rather than what it forbids. Second, as formidable adversaries in dispute resolution they can liaise, negotiate and litigate against legal challengers, regulators and the courts themselves to minimise constraints on corporate activity. Third, they can assist companies in influencing legislation, designing regulation and, increasingly, in creating platforms of self-regulation which facilitate corporate goals. This is a role which includes advising and lobbying government through secondments or the outsourcing of legal advice. Here we see law firms innovating to create new products and new markets, which brings us to the fourth use of law as a resource. All the Magic Circle firms stress their commitment to innovation and entrepreneurship. They search for business opportunities and engage in self-conscious intellectual creativity which in Linklaters, for instance is termed *'thought leadership'*. Much of this involves the definition and even the creation of new markets. A recent example is provided by the rapid growth in the utilisation of 'big data' which raises tricky legal issues to do with ownership, privacy, storage and intellectual property.

Bringing together some of these speculative threads we can end

this section with some reflections on the Magic Circle and the corporate elite. The lawyers are less important 'reputational intermediaries' than the accountants inasmuch as they do not report to shareholders on true and fair accounts. On the other hand, they do trade on their own reputations and also protect the reputations of their clients. Those clients are the core of the corporate elite. They include the big quoted companies, the large unquoted multinationals operating in Britain, and the more diverse range of financial companies. By ensuring that these corporations operate within the law, and to some extent ensuring that the law is both sympathetic and sympathetically enforced, so they legitimise corporate activity and the integrity of the City. It is perhaps worth emphasising that, although they behave as very private undertakings, they are reliant on the whole apparatus of English law. They draw on the respect accorded to English law, on the institutions of British justice, and the whole infrastructure of commercial law created and safeguarded by the British state. That might require an enhanced level of accountability to a British public, a point we come back to in the conclusion.

For the large corporations operating in the UK and globally, the Magic Circle therefore provides a legal shield. For the members of the British corporate elite they provide reassurance and confidence through expert advice and legal protections. They appear to be integrated into the corporate elite through commercial activities, social

ties and multiple networks ranging from schools to sporting interests and charitable activities. They help the corporate elite to acquire and retain substantial remuneration in which they share. It would, in conclusion, be hard to maintain the security of the corporate elite without the authoritative legal certainty provided by the Magic Circle.

Conclusion: transparency, incumbency, remuneration and countervailing power

The main and most robust component of this Report is to do with transparency. It provides a profile of the nine professional firms that make up the Big-4 and the Magic Circle and we should consider whether we know enough about their activities to understand the contribution they make and to call them to account. This question should be considered in the context of the headline – the sound bite – that dominates this Report. Between them the nine firms reviewed in this Report have 4,500 equity partners (2,726 accountants, 1,774 lawyers). Their average annual remuneration, based on 2013 figures, is over £700,000 for the accountants and over £1,100,000 for the lawyers. A reasonable estimate would suggest that about 1,400 of them enjoy annual remuneration of over £1,000,000 (270 accountants, 1,130 lawyers). The headline is therefore that:

> ‘1,400 partners in elite accountancy and law firms were paid over £1 million in 2013, continuing a pattern that has been in place for at least ten years’.

Whether this is defensible will depend very much on where one stands in the larger debate about income inequality. Let’s for the moment continue the discussion of whether we have enough information to undertake that debate.

It appears that we have access to a fair amount of headline material. The LLP format provides for the mandatory publication of just enough financial information

to validate the self-reporting of professional firms and the numbers that are incorporated into technical surveys. The accountants are significantly more transparent in publishing accounts and details of governance (especially audit governance) through the transparency reports published alongside their annual reports. Even so, much of the detail of management, decision-making, financial results and remuneration is restricted in practice to the specialist community who have the time, money, expertise and motivation to access the technical and expensive publications prepared by the specialist press. There is limited access to information for journalists, policy commentators and the public at large. Should more information be freely available? Material, for instance, on revenues, profits, decision-making, risk and remuneration? Before turning to more detailed conclusions on remuneration we can note the following general features which seem to apply to all nine of these elite firms:

- > the revenue streams which generate the income display a remarkable consistency.
- > the firms are successful in generating consistent profit over a substantial period, they undoubtedly have market power.
- > partner posts are very secure, there is some horizontal movement between firms as they recruit partners from other firms but on the whole these people progress within

one firm and have long, stable careers.

> while there is little indication of additional income earned from outside the firm, there are extensive opportunities for post-retirement work, either lucrative, especially as non-executive directors, or often public service or charitable.

> there do not appear to be extravagant 'extras' in the form of allowances, bonuses and pension rights or, of course, share options.

> on retirement partners receive back the amount they have paid into the firm. There is no upward adjustment to take account of the 'present value' of the investment although it earns them additional equity payment as part of their annual profit share.

In pursuit of the question of information about remuneration, the firms would probably argue that it is not necessary to publish additional information, similar to that published by quoted companies, because their ownership structure is different. Plcs publish details of remuneration so that shareholders can reassure themselves that the managers are taking reasonable and proportionate rewards, the information allows principal-agent monitoring. For partnerships the owners are themselves the partners and they all have complete access to the details of their colleagues' remuneration. There is no principal-agent divide and the wider public have no further legitimate interest in the operation of a private undertaking. But it can be argued that this is a

narrow perspective, derived from the standard British corporate governance framework which is itself defective (see Wilks, 2013: 250). In favour of more extensive release of information there are three arguments.

First, the services operated by professional firms are, at their core, undertaken on behalf of government. They audit companies in accordance with the dictates of company law, and they resolve legal disputes defined by, and sometimes resolved through, commercial law and the commercial courts. Further, they undertake these activities within a framework of professional ethics policed by professional bodies in a regulatory framework mandated by government. These firms are to a significant extent undertaking a public interest role and should therefore be accountable to the public.

Second, in recognition of the importance of their activities, government has allowed them an advantageous mode of legal organisation in the form of limited liability partnership. This was introduced as a major innovation in 2000 after lobbying by accounting firms and involves a melding of company and partnership law. It defines the firm as a corporate body and allows the partners limited liability which has allowed the rapid growth of 'professional corporations'. The LLPs have therefore been awarded by the state a 'license to operate' parallel to the license given to all limited companies. This is a point much debated within company law

but one position is certainly that in recognition of this 'license' an LLP should not be regarded simply as a collection of private individuals but as a body with public responsibilities which requires adequate sharing of information with the public.

The third argument in favour of greater disclosure derives from sheer size. As noted above, these are very large commercial organisations with a total collective turnover of about £14 bn, (twice the size, for instance, of BSKyB). Their activities are surely of legitimate interest to their clients, who pay their large fees; to their employees, who work notoriously hard; and to consumers, who ultimately pay for their fees and salaries. Is it acceptable for five of these entities to publish no financial information at all, for three of those five simply to deposit 20 pages of minimalist accounts at Companies House, and for the other two to observe complete financial secrecy? The question posed above was whether we have enough information to hold them to account? Clearly we do not, and equally clearly it would be possible to increase the level of disclosure, Allen & Overy's exceptional levels of voluntary disclosure illustrates the potential.

The discussion of transparency is relatively straightforward, anchored in the availability of factual material. There is, however, a range of other areas of unease provoked by the interpenetration of professional and corporate elites. Three of those have been raised in a more speculative fashion in the earlier discussion

and can briefly be summarised here. They concern the persistence of dominance; normalisation of high levels of remuneration; and countervailing power.

The Big-4 and the Magic Circle have maintained their dominant positions for perhaps 25 years. They clearly enjoy certain incumbency advantages which appear to be related to their close and sustained relationship with their large corporate clients. But how do the big corporations benefit from this relationship, do they too gain incumbency advantages? This is, after all, the whole point of elites, they seek to defend and perpetuate social and economic dominance. Almost by definition the corporate clients gain access to superior financial and legal advice which should give them an advantage in resolving disputes with trading partners, competitors, regulators and governments. This will apply across the whole field of mobilising financial data, implementing corporate strategy, devising legal solutions and access to legal dispute resolution, including litigation and arbitration. For the accountants the Big-4 audit advantage is more to do with reputation than skill, but when it comes to tax planning many large firms appear to have been able to tilt the system in their favour. For the lawyers the argument that a combination of deep pockets and top calibre legal expertise is able to gain legal advantage is almost too obvious to assert. The unease, then, is that there is a self-serving reciprocity between the partners of elite professional service firms,

and the corporate elite, that allows the professional firms to maintain their favourable position whilst at the same time enabling corporations more fully to exploit accounting ingenuities and the law, and hence to protect their own market positions.

The second area of unease is the degree to which remuneration patterns in the elite professional service firms normalise very high levels of remuneration. Within the worlds of accountancy and the law, the scale of remuneration is widely understood but not widely criticised. Clients will complain about the high fees charged by the top firms, and there is occasionally comment that partners may be earning more than their clients, but there is nothing like the tide of revulsion that has fuelled criticism of hundreds of bankers earning over £1 million. Perhaps there is a recognition that partners are risking their own money, and that they have worked their way to the top of their professions, but should we regard £1 million plus as normal remuneration? HMRC statistics reveal that in 2012-13 there were 31 million income tax payers. 8,000 of these reported income of over £1 million, and a further 3,000 income of over £2 million. If the estimates in this Report are correct, then around 13% of 'income tax millionaires' are the partners of our nine elite firms. This is, of course, a single comparison that excludes the many other types of tax, and it could even be regarded as a measure of honesty, many other high-income earners will have concealed their income from tax. Nonetheless it

demonstrates how exceptional is this level of remuneration.

The firms would no doubt justify this level of remuneration as necessary to attract the best trainees and to prevent their partners from leaving. But more modest future rewards would surely still entice trainees, and there does not seem to be a very well developed labour market in lateral partner movement, indeed, partners are often fiercely loyal to their firms. Instead the rapid growth in PEP in the early 2000s appears to have followed the rapid growth in executive compensation (HPC, 2011: 28). It is hard not to conclude that the professional elite were building on the same permissive mood and increasing their share of corporate wealth generation. The rising tide of remuneration raised all elite boats with perhaps an understandable tendency for the professional advisers to the corporate elite to take a sympathetic, rather than a critical stance, in reviewing rapidly escalating managerial remuneration.

The third area of unease is rather broader and brings us back to the opening view that accountants and lawyers are 'special' in the services that they provide. Accounting and the law are basic constituents of a well regulated market system. Markets must have trust and confidence based on honest accounts and binding contracts. Society supplies trust through professionals who are well trained, licensed, governed by codes of ethics, independent, trustworthy and loyal to universal standards. They provide 'countervailing

power' intended to limit dishonesty, deception, and gross unfairness. These commercial professionals provide one means by which society limits the abuse of economic power. Clearly, however, professionals have to balance professional integrity against commercial opportunities, for them and for their clients. The concern is therefore self-evident and has prompted some regulatory intervention. We have in particular seen the inquiry by the Competition Commission into the Big-4 and the Public Accounts Committee investigation of the Big-4 over tax avoidance. It is perhaps surprising that it is the accountants who have encountered investigation when they are more transparent, and less well paid, than the Magic Circle. In any case, can partners working

within large, quasi-corporate commercial firms retain sufficient independence and comply with the best professional standards? More particularly, how are those judgements affected when firms impose tough requirements on generating huge income, and when the individuals concerned share that income? In their transparency reports the accountants confront these issues head-on, but across the whole spectrum of financial and legal services offered by the Big-4 and the Magic Circle there must be unease that countervailing power is moderated in order to retain clients, to sustain income, and to protect a corporate elite of which the top partners in these nine firms are a major component.

Notes and sources

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