

# **The financialization of large law firms: situated discourses and practices of reorganization**

## **Introduction**

It is perhaps not surprising that large and global corporate law firms have prospered in the latter parts of the twentieth and early twenty-first century. A broad range of literature has revealed that corporate law firms have grown in size and geographical reach thanks to their central role in lubricating financial markets and activities from currency trading and the work of hedge funds, to mergers and acquisitions and the financial restructuring of transnational corporations (Faulconbridge and Muzio, 2008; Flood, 2007; Quack, 2007). Massive increases in profits, such as the 157 percent absolute increase in profit per equity partner experienced by the ten largest English corporate law firms between 1993 and 2008 (*Legal Business*, 2008) are, therefore, unlikely to come as a shock to people familiar with the workings of the international financial system and the economies of world cities such as London and New York.<sup>1</sup> But, we contend, the story of the growing profitability of large corporate law firms and the increasing remuneration of leading partners in these firms is not as simple as it might first appear. Specifically, in this paper we suggest that the extraordinary increases in the profitability of large and global corporate law firms recorded, in particular, over the past decade are not only a result of firms generating more and more demand for their work and charging ever higher fees for their services. Whilst this is part of the story, in this paper we argue that spikes in profitability are also the

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<sup>1</sup> The 157 percent increase refers to growth in profit levels excluding inflation.

result of a process of financialization that has reengineered law firms to make them appear to be ever more profitable and successful.

As a concept, financialization is used in the existing literature to capture a diverse array of changes associated with the penetration of financial market logics into the management and organization of business. Here we draw on one particular line of work which highlights how financial logics have redefined corporate governance and re-orientated the mandates of Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) towards the generation of shareholder value through the payment of dividends and sustained increases in the firm's share price (see Feng et al. [2001] and Froud et al. [2006] for theoretical explanations and Froud et al. [2002], O'Neill [2001] and Pike [2006] for empirical case studies).

We are, of course, at an interesting juncture in the process of financialization. Events during 2007 and 2008 in the banking sector have shown the frailties of the short term profit maximisation associated with shareholder value logics in terms of the long-term stability of firms. Indeed, the financialized model of capitalism and its focus on shareholder value has come under so much scrutiny that the former GE chief Jack Welch, one of the accepted 'fathers' of such logics, declared in early 2009 that the idea was 'dumb' because shareholder value has become *the* focus of strategy, not the *outcome* of successful strategy (*Financial Times*, 2009). Such a realization comes as no surprise to the authors cited above, who have offered a range of critiques of financialized shareholder logics. But it does pose a number of interesting strategic questions for firms that have become enchanted by the logic of shareholder value and proxy indicators of such value, for example Economic Value Added (EVA™) or in the case of the legal industry Profits Per Equity Partner (PEP)..

In this context, this paper draws on cultural economy debates which focus on the discursive construction and reproduction of management practices designed to enhance shareholder value to interpret the restructuring and apparent growth in profitability of large English corporate law firms between 1993 and 2008. Firstly, the paper makes an empirical contribution to debates about financialization by considering the intriguing case of large law firms, the rise to pre-eminence of PEP as a metric in the legal industry, and the resultant way that privately held organisations, not listed on stock markets, have become enchanted by management logics similar to those promoted by shareholder value discourses. As another example of what Leyshon and Thrift (2007) would call the capitalization of everything, we also consider how large law firms' obsessions with PEP as a financial performance metric might explain the impacts of the current credit crunch on law firms and the fact that these have been much more severe than in previous recessions. This potentially provides another empirical example of the frailties of financialized practice and the short-termism associated with shareholder value discourses. Secondly, and theoretically, the paper explores the geographies of financialization in the legal industry by focussing on the specific contextual factors that led large English corporate law firms to reengineer themselves to enhance performance as measured by the new PEP metric. We argue that whilst such a process of financialization has affected the strategies of large law firms worldwide, the specific *timing* and *nature* of changes in the English context are mediated by a series of geographically contingent factors. In particular, we consider the way changing regulatory environments and the resultant changes to institutional logics were intimately tied to the construction of a particular conjunctural moment in which financial discourses associated with the PEP metric gained legitimacy and took hold of law firm strategy in England. This reveals the power of *situated* analyses of financialization in explaining the proliferation of financial logics both across space and between industries.

## Theories of financialization

### *Constructing models of the financialized firm*

One of the main contributions of cultural economy perspectives on financialization has been to highlight the new metrics used by pension fund managers and other capital market actors in financial analyses of firms over the last 20 years or so. Shareholder value measures such as EVA<sup>TM</sup>, Market Value Added (MVA), Total Shareholder Return (TSR) and Cash Flow Return on Investment (CFROI) have now become well known both within the business world but also in academic studies (e.g. Gleadle and Cornelius, 2008; Lazonick and O'Sullivan, 2000) as firms have become intertwined with financial markets in ways which force them to constantly prioritise the delivery of shareholder value. Such models, and the practices they promote, gained legitimacy because of the powerful voices of the media, of activist investors such as pension funds and of consultants like the Boston Consulting Group and Stern Stewart who present shareholder value as *the* only way to assess the success of a firm and *the* only influence to consider when managing a firm (Feng et al., 2001). This is, then, an example of the effect of what Thrift (1997) describes as the circuit of soft capitalism in which management gurus, the media and business schools advance economic practices claimed to optimise performance in the 'new' knowledge economy (see also Clark et al. [2004] and Greenfield and Williams [2007] on the role of the media).

As a result of these discourses of shareholder value and their power, measures such as EVA<sup>TM</sup> increasingly guide the actions of senior managers (O'Neill, 2001) because of the way they produce a series of measurable quantitative 'facts' about the success

of the firm. These facts then become the target of management strategies. Indeed, one of the outcomes of the pre-eminence of shareholder value logics, according to Lazonick and O'Sullivan (2000), is a series of important changes as strategies designed to pursue long-term objectives such as market share get replaced with short term strategies designed to immediately enhance performance as measured by metrics such as TSR and EVA<sup>TM</sup>. According to Lazonick and O'Sullivan (2000), such forms of *financialized management* involve a shift away from a 'retain and reinvest' allocative regime in which growing the firm through the recycling of profits is the main priority, to a 'downsize and distribute' regime in which changes to the labour force structure and/or capital divestures and/or strategic re-focussing of the firm are used to allow more surplus profits to be distributed to shareholders. As Lazonick and O'Sullivan show, this leads to surprising strategies such as redundancies at times of boom as part of attempts to cut costs, reduce investment in the business and free up capital for distribution to shareholders, thus enhancing shareholder value as defined by metrics like TSR.

However, as Froud et al. (2006) show using case studies of GlaxoSmithKline, Ford and GE, 'downsize and distribute' regimes may help to boost a firm's short term performance as measured by TSR or other metrics of shareholder value, but in reality hide deeper problems with the firm's market or products; problems which are eventually brought to light in a downturn when the firm can no-longer 'hide' its weaknesses. Consequently, as Froud et al. (2006, 65) put it, we might say that "the rhetoric of shareholder value sets management on a utopian quest for growth and higher returns from capital which has variable and uncertain consequences". As Froud et al. argue, measures such as EVA<sup>TM</sup> and TSR do not lead, then, to the stable adoption of homogeneous financialized management and 'surgery' strategies designed to enhance shareholder value. Following du Gay and Pryke (2002) and adopting a performative perspective (see in particular MacKenzie and Millo, 2003),

Froud et al. (2006, 71-72) argue that discourses of shareholder value *produce* financialized management practices rather than *represent* practices that already exist. Models such as TSR influence the thinking of managers and lead to the development of a range of untried and untested techniques designed to enhance the firm's performance as measured by shareholder value metrics. Hence those adopting a cultural economy approach suggest that the affects of such 'improvised' financial management practices on firms are at best unclear and at worst damaging because unexpected side effects can erode the long-term ability of the firm to respond to market challenges or opportunities.

In the second half of the paper we examine how such interpretations of financialized management practices can be used to explain the drivers of changes in the structure and ultimately profitability of law firms over recent years. First, however, it is important to consider how geography influences financial management practices and the way such practices are developed, diffused and enacted.

### **Geographies of financialization**

Geography exercises multiple influences over the development and diffusion of the discourse of shareholder value and the resultant financially orientated management practices. For example, Pike (2006) shows how, in assessments of shareholder value, both the geography of the firm being assessed and the geography of those making the assessment influence management practices. Using the case of the closure of the Vaux brewery in Sunderland, Pike (2006, 216) reveals how "phenomena such as financialization and shareholder value are necessarily shaped and contested by specific and particular arrangements of spatialized social relations, social agency, and socio-institutional contexts over time, across space and in place".

This suggests more attention needs to be paid to the way geography can determine the impacts of financialized practices, something Leyshon and Thrift (2007) also call for by highlighting how capitalization both actively exploits the geographical specificities of places but also unevenly effects (positively and negatively) different locations. Similarly, Froud et al. (2001, 104-105) note that “Financialization is not an immanent principle because its spread is limited by structural barriers within, and by institutional differences between, national economies”.

As a result, it is now generally accepted that the homogenisation thesis in relation to the spread of shareholder value logics and financialized management practices is misleading (Lütz, 2004). However, this does not mean that forms of shareholder value driven financialized management are not becoming more and more common in different national contexts. As Clark et al. (2002) show using the case of Germany, Anglo-American Accounting standards and pension fund practices have begun to penetrate continental European countries as negotiated compromises are reached about the implementation of financial models of management that prioritise shareholder value. Culpepper (2005) makes a similar point using the example of France and shows that regulatory reform, whilst not automatically leading on its own to the adoption of financialized management models, is, when accompanied by wider institutional change in attitudes and opinions relating to work and management practices, an important ingredient in the international diffusion and reproduction of shareholder value logics and financialized management. Table 1 offers further examples of the connection between regulation and the adoption of financial business practices. This suggests, following Jackson and Deeg (2008), that it is important to develop explanations of the effects of functional change - i.e. political change relating to regulatory context - and of institutional change - i.e. business norms, on the adoption of new financialized management techniques in different contexts.

[Insert table 1]

The rest of the paper, therefore, examines, firstly, the nature of financialized management in law firms and the way discourses of financialization have shaped firms' strategies over recent years. The paper then, secondly, examines the situated context influencing the emergence and adoption of financialized practices in English law firms. In doing this analysis shows how the reproduction of financialized logics is conjunctural and mediated by broader political-economic and institutional context which defines the timing and nature of the process of financialization. We conclude with some reflections on how financialization may have contributed to the impact of credit crisis on the legal profession.

## **Methodology**

Our analysis is constructed using a triangulation of data from various sources. Quantitative material charting the composition and performance of large English law firms was taken from *The Legal Business 100* survey between 1993 and 2008. This longitudinal analysis allows us to extrapolate historical trends in the financial performance and organizational structure of English law firms whilst also providing insights into the changing management practices that are associated with financialization. We focus our analysis on the 10 largest firms, primarily because of the emphasis that these firms have placed on financialized management techniques in recent years. The trends identified are, nonetheless, relevant to the wider sample of firms analysed in the aforementioned survey. These trends are also relevant more broadly to large law firms worldwide, and in particular to US based practices. However, here we focus on the largest firms in England to help tease out the

geographically specific way in which English firms 'became financialized' in the late 1990s and early 2000s.

We also completed an extensive survey of articles in legal publications aimed at practitioners in the UK (*The Lawyer*, *Legal Business* and *Legal Week*). This provided further detail of the changing financial performance and strategies of firms as well as insight into media reactions to these changes. Finally we undertook twenty interviews during late 2006 and early 2007 in large corporate law firms in England. Interviewees were drawn from firms representing different segments of *The Legal Business 100* survey, ranging from the largest, multi-office international firms through to nation-wide firms and single office practices. Interviews lasted between 40 and 70 minutes, were recorded, transcribed and then coded. All interviewees were questioned about the strategy of the firm they worked for, recent changes to the organization of the firm, working conditions and practices within the firm, managerial structures and styles, and the impact of commercial (financial and client-driven) pressures on their day-to-day work. Analysis of the interviews is used to help explain the trends identified in the quantitative data collected.

### **The emergence of financialized large law firms**

In many ways, the adoption of financial practices by large law firms is a significant development. Law, as one of the few state sponsored professions like accountancy, is supposed to have a fiduciary duty towards clients and the broader public and, historically at least, is supposed to represent a public safeguard service. Law firms had not, therefore, traditionally been seen as organisations in which commercial logics prevailed. To this end, until recently law firms In England and in many

countries throughout the world could only exist as partnerships in which the owners of the firm were those delivering the services.<sup>2</sup> In many ways the logic of this takes us back to the work of Berle and Means (1932) who studied the dangers of separating ownership and control in firms because of the moral hazard it creates. In law firms, it was assumed that if lawyers owned and managed the firm they would place the client's interests and their professional responsibilities above all else because profitability relied on the firm's reputation for service quality and the long-term development of this reputation, rather than on the extraction of short-term profits to enhance the firm's success in financial terms (Empson and Chapman, 2006). In addition, it was also assumed that the owners, the partners, would also be acting as the managers of junior lawyers and would ensure all staff maintained the levels of quality expected so as to protect the reputation of the firm.

In today's post-Enron context, many would be rightly sceptical of suggestions that professionals, and corporate lawyers in particular, provide publicly spirited services. As Hanlon (2004) describes, idealistic visions of what lawyers and law firms are and do, if they were ever accurate, have today certainly been diluted by the rise of mega-law firms (see table 2) with their business orientated outlook. However, whilst such large law firms were always firmly rooted in what Heinz and Lauman (1982) referred to as 'the corporate hemisphere of the law', over the past 15 years or so the largest corporate law firms have undergone a significant reorganization and, as a result, increasingly mirror in their structure and operations the market-listed, financially motivated clients which they advise.

[Insert table 2 here]

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<sup>2</sup> As we discuss below, reforms in Australia and England and Wales have changed this situation in the period post 2000.

Table 3 captures the main changes involved in this process. Two trends are particularly significant:

1. In the 1990s a rapid growth in profits as measured by PEP, which outstrips growth in revenue, together with a significant increase in the number of salaried solicitors (associate and assistants). Growth in the category of salaried solicitor outstripped expansion in equity partners (senior lawyers), thus leading to growing leverage ratios (the ratio of junior salaried lawyers to senior equity partners).
2. In the 2000s the remarkable expansion of a relatively new employment category: salaried partners. This occurred alongside an unprecedented year on year increase in PEP.

In the next section we consider the causes and consequences of these trends and explain how they are related to the financialization of the largest law firms in England. In particular, we consider the role of PEP as a metric used to measure law firms' success and the way the discourses associated with this metric, which is premised on a similar logic to that of shareholder value, encouraged the penetration of financial management practices deep into the fabric of law firms.

[Insert table 3 here]

### *PEP and new financial discourses in the legal industry*

Originally developed in the USA in the 1980s by the *American Lawyer* magazine, just like shareholder value, PEP has become *the* metric of law firms' success. In the English context, the first PEP rankings were produced in 1993 by *Legal Business* and, since then, the publication's annual reports of PEP have become a key

reference for those wanting to assess the success of different firms. Indeed, by the late 1990s other publications had also begun to champion the PEP metric and in 2007 *The Lawyer*, one of the most influential legal publications in England, trumpeted its own 'Top of the PEPs' table designed to provide "the definitive inside track on the performance of the UK's biggest law firms" (*The Lawyer* 2007a). In addition, as well as specialist legal publications, the financial press has also played an important role in the rise to prominence of this metric. *The Financial Times* now gives annual 'innovative lawyers' awards, one category being management which can include "issues such as international expansion and rising profitability" (see <http://media.ft.com/cms/d1fbb852-ce3a-11db-b5c8-000b5df10621.pdf> [last accessed 28th April 2009]). The winner of the first management award in 2007 was Eversheds for its partner profit sharing scheme.

The influence of the media in the production and proliferation of PEP as a discourse should, therefore, not be underestimated. Mirroring the findings of Clark et al. (2004) and Greenfield and Williams (2007), it seems that the way the media analyses, ranks and publicises the performance of law firms legitimates certain types of action and, in particular, attempts by management to improve PEP. Winning an award from the FT or improving one's position in the relevant PEP tables has become a key concern for law firm leaders. Senior and managing partners, often supported by developed media and public relations departments, actively engage with the press as a way to secure favourable write-ups which could enhance their firm's reputation. Reflecting this obsession, the managing partner of Freshfields Bruckhaus Deringer made the following comment about the firm's past performance after restructuring delivered a massive rise in PEP, "we did not have the financial performance that is necessary or appropriate for a firm of the calibre of ours" (Lawyer Podcast, February 2007. Available from [www.thelawyer.com](http://www.thelawyer.com)). Similarly, after the announcement that the firm had broken the £500,000 PEP barrier, the managing partner of Eversheds said,

“profitability has been one of our key targets over the past year, and with PEP breaking the £500,000 barrier, we have proven our ability to deliver on our promises” (*The Lawyer* 2007b).

Of course, the result of this new obsession is a devastating critique of firms failing to increase PEP. These firms are seen as poorly managed organisations in need of refurbishment. So when the firm Shoosmiths reported a 27 percent increase in turnover but only a three percent rise in PEP, these results were described as ‘mixed’ and blame was placed on “a period of sustained expansion and a major recruitment drive across seven UK offices [that] have taken their toll on the firm’s profitability” (*The Lawyer* 2007c). It would seem, then, that in the new epoch of financialization, long-term investments associated with growth, which are typical of a ‘retain and reinvest’ regime (Lazonick and O’Sullivan, 2000) are not necessarily seen as wholly positive. The next section of the paper, therefore, considers the way the discursive power of PEP metrics and rankings has influenced the management of law firms and has led to introduction of new organizational structures and employment patterns in the legal profession.

### **Financialization in action: the restructuring of English law firms**

Despite the fact that law firms, with the exception of one Australian firm, continue to be structured as partnerships and have no external shareholders or institutional investors to satisfy, the effects of media-inspired concerns about PEP seem to have led to the adoption of similar management logics to those used in shareholder-value driven organizations. This implies a series of radical adjustments and structural developments resonant of the forms of ‘surgery’ (Lazonick and O’Sullivan, 2000) and strategic re-focussing usually associated with processes of financialization (Feng et

al., 2001). Firstly, large law firms, and particularly a number of those listed in table 2, have refocused on a limited array of practice areas, such as capital markets and especially work associated with derivatives and 'exotic' financial products, which are closest to the logic and operations of 'finance capitalism' and which offer some of the more handsome financial rewards. Secondly, and consequently, there has been a shift in the largest firms from retainer relationships, whereby lawyers act as long-term advisers, to a focus on one-off transactions from which maximum fees can be generated. Finally, there has been the introduction of new organizational structures (e.g. industry focused groups), again designed to maximise profits through specialisation in particular types of legal transactions at the expense of full service provision.

Perhaps most significantly, though, law firms have engaged, over recent years, in a radical restructuring of their own internal division of labour. Such surgeries are designed to improve performance as measured by PEP and have turned law firms into very different organizations to their predecessors. However, as our analysis below demonstrates, the changes associated with the reorganization of firms' internal divisions of labour are intimately related to the frailties of PEP as a measure of success in the legal profession. Our analysis shows the ease with which management techniques can improve PEP without actually improving (or by even damaging) the underlying performance of the firm, something which is particularly pertinent in the context of the current financial crisis.

#### *Leverage as financial management*

PEP, crucially, does not measure the total profits generated by a firm, but the total profits divided by the number of equity partners. Equity partners are the 'owners' of

the firm and, as such, share the profits but also risks associated with legal practice. To become an equity partner, an individual will usually have to serve many years as an 'apprentice' lawyer, or be accepted into the partnership by existing equity partners as a 'lateral hire' from another firm (incidentally a practice which is increasingly significant as firms scramble to build their profitability by poaching key profit generators, known as 'rain makers' in the legal profession). As the 'traditional' legal partnership was made up of equity partners only, profit per partner in the past was effectively the same as PEP. Increasingly, though, an expanding cohort of salaried solicitors, whose remuneration is not linked to profits (besides the effect of bonus schemes), operate as a new and growing tier in what is an increasingly pyramidal division of labour. These salaried workers allow more profit to be generated but, as a consequence of their salaried status, do not affect the number of people sharing the profits, hence delivering an increase in PEP and improvements in the relevant ranking tables. In reality, then, profits per partner (PPP) or profits per lawyer (PPL) might be better measures of the performance of a firm. Indeed, analysing PPP and PPL between 1993 and 2008 reveals that the reorganization of law firms has led to exaggerated increases in PEP (157 percent 1993-2008) compared to more 'accurate' measures of efficiency and success (85 and 80 percent for PPP and PPL respectively). However, because of PEP's hegemony as *the* measure of law firms' success, managing partners have focussed on reorganizing the labour process in ways that optimise performance as measured by this metric.

As a result, in the first stage, as Ackroyd and Muzio (2007) report, throughout the 1980s and 1990s attempts by partners in law firms to drive up profitability involved leveraging the performance and contribution of a rapidly expanding cohort of salaried junior solicitors (associates). Consequently, the legal profession endured a monumental shift from a predominantly self-employed to a predominantly employed occupation with associate to equity partner ratios climbing from 1:2 in the mid 80s to

1.8:1 in 2006. These figures look even more impressive if we focus on the largest firms, where such changes have been most pronounced. As indicated by table 3, in 2008 the average leverage ratio for the ten largest English firms was 6.9:1.

Such changes respond to a clear financial logic: a salaried lawyer can generate substantially more fees than her labour costs (this surplus can oscillate, depending on the firm's size, between 2.5 and 4.8 times wage costs). Indeed, as illustrated by table 4, the appropriation of surpluses generated by non-equity workers currently constitutes the foundation of law firm economics and a key avenue to enhancing profitability. The rule of the game in the financialized law firm is therefore simple: increase the number of people who bake the cake (the number of salaried lawyers) whilst stabilising or reducing the number of people who can share the cake (the number of equity partners) (Maister, 1993). Larger helpings will inevitably follow in the form of enhanced PEP, even though actual profits per lawyer may have remained stable or even declined.

It is not surprising, therefore, that Table 3 shows an increase in associate numbers and, therefore, growing leverage ratios throughout 1993 to 2003 period and that this coincides with gradual improvements in PEP. However, the increases are perhaps not as large as might have been expected, particularly in the period 1998-2003. In addition to broader contextual factors such as the dot.com slump of the early 2000s, this situation can also be partly explained by the aggressive expansion and globalization of firms in the late 1990s which involved many mergers and the acquisition of partners in offices inside and outside of England. This led to a marked increase in equity partners which somewhat diluted the effect of the leveraging strategies which were being implemented in the latter part of the 1990s. In effect, firms had not completely developed a recipe to maximise the growth of PEP. The post 2000 period, as discourses of performance and profitability gained traction,

therefore, led to the development of even more radical forms of surgery as firms restructured to maximize PEP.

[insert table 4 here]

### *Restructuring the partnership to manage PEP*

The redefinition and dilution of the concept of partnership through the creation of the new role of salaried partner and the increasing recourse to de-equitization have been key strategies adopted by law firms in their post-2000 restructuring. As table 3 shows, from 2000 the number of salaried partners found in firms has expanded significantly. These individuals do not share profits, are not co-owners of the firm, but are handed the title partner because of its symbolic value. Whilst this category has existed from sometime prior to the period in question, numbers of salaried solicitors were so marginal that both *Legal Business* and *The Lawyer* did not collect data on them. However, since 2002 salaried partners have become the fastest growing section of the professional labour force, expanding by over 34%. Thus, salaried partnership, from an anomaly found only in a minority of firms, has been recast as a formal step in an increasingly elongated professional career structure. Writing in the 80s, Richard Abel (1988) estimated an average wait of 5.5 years after qualification for a lawyer to achieve equity status in a firm; today this has doubled to over 10 years. Furthermore, promotion is increasingly tied to some formal financial targets such as the ability to generate 3 times more revenues than ones own wage costs (Hanlon, 2004). Thus, introducing salaried partners as a form of labour market 'surgery' responds to a clear financial logic: this new position delivers a convenient and acceptable device to prolong leverage and increase profitability.

Most radically, recent interventions have actually sought the reduction of equity partner headcount in a period of boom for legal services. Indeed, as indicated by table 3, between 2003 and 2008 the number of equity partners employed in the 10 largest firms in the UK contracted by 1% despite revenues growth of over 27%. These trends corroborate growing anecdotal evidence of de-equitization (redundancy of equity partners). This is a momentous and somewhat contested development and signifies a dramatic break with the past because of how partners, the owners of the firms, are treated as costs to be efficiently managed. 'Chopping dead wood', to use a common expression, is a useful instrument in today's increasingly bloated, heterogeneous and geographically dispersed partnerships. This reduction in equity partners seems to be bound up with the quest of sustaining and expanding profitability by downgrading lesser performing partners or simply those working in less remunerative offices or practice areas that would otherwise dilute PEP and affect a firm's position in key ranking tables (The Lawyer, 2009h). Thus, the updated strategy may be to actually reduce rather than simply stabilize those who share the cake, whilst of course continuing to expand those who participate in profit generation.

It seems, then, that financial considerations and, in particular, the quest to enhance PEP, lie at the heart of one of the key developments in the legal profession: the reorganization of the ownership of firms – i.e. the partnership – through the creation of new positions in the division of labour in the form of the salaried partner and the redefinition of the very notion of partnership as a contingent and temporary status that can be withdrawn according to profitability considerations. Importantly, though, from a geographical perspective, the development and acceptance in the English context of PEP discourses and metrics can only be fully understood by considering the situated political-economic context in which English firms have been operating and the way this has helped create a conjunctural moment in which PEP league tables and financialized management gain legitimacy.

## **Situating the financialization of English law firms: neo-liberalism and regulatory reform**

When *Legal Business* first published its PEP tables in 1993, the re-regulation of the English legal market had already led to concerns about the profitability of English law firms. The key re-regulatory process causing this was the re-discovery in the 1980s by Thatcher's conservative administration of a neo-liberal political agenda which emphasized and celebrated competition, customer choice, open markets and private enterprise in economic affairs, including in the professions (Abel, 2003). However, the English system of the professions, with its emphasis on occupational licensing, self-regulation and restrictive arrangements that effectively created monopolies for services, did not sit comfortably with the new-found neo-liberal ideology. In the legal profession this led, amongst other things, to the suspension of some restrictive arrangements (on advertising and minimum fees for example) (Abel, 1988; 2003) but also the reduction of governmental expenditure on legal services through reforms of the Legal Aid scheme (Paterson and Goriely, 1999) and the partial liberalization of key monopolies such as conveyancing (Abel, 1988; 2003; Sherr, 1994; Muzio and Ackroyd, 2005). Perhaps most significant for our argument here, though, was the impact of neo-liberal ideals on London's financial markets and their subsequent affects on the legal industry.

### *Re-regulation and financialization I: The legal 'big bang'*

The 1986 'big bang', which opened financial markets in London to foreign firms for the first time, was intimately related to the neo-liberal reforms of the 1980s and a desire for market competition in all areas of the economy. Indeed, 'big bang' acted as

a blue-print for successive de-regulatory initiatives designed to maintain and develop London's world city status. In particular, the financial 'big bang' helped to position London as a global marketplace for professional advisory services, including law, thus preparing the ground for the legal profession's very own 'big bang' that eventually took place in 1990. This reform opened up, for the first time, the English legal market to overseas law firms (Cullen-Mandikos and MacPherson 2002). Previously many US firms had entered London but only to provide advice on US law. After 1990, however, re-regulation allowed these firms to recruit English lawyers, provide advice on English legal issues and thus compete with London's Magic Circle firms (Clifford Chance, Linklaters, Freshfields, Allen & Overy and Slaughter & May). This created new competition and, most significantly for our argument here, positioned English incumbents against competitors with significantly higher levels of profits.

Here is not the place to review the complex array of differences between English and US large law firms (but see Faulconbridge, 2008a; Faulconbridge and Muzio, 2007). It is, however, well known that one of the major differences has long been the approach taken to profitability and the remuneration of lawyers, with the US 'eat what you kill' system prioritising financial success by tying equity partners' take-home salary to the profits they generate themselves (Regan, 2004). In contrast, the English lockstep system bases partner pay on years of service and rewards loyalty ahead of profitability. As a result of US firms' emphasis on profits through the eat what you kill system, their closer ties to firms such as GE who first adopted shareholder value logics, and the earlier development by the US media of PEP ranking tables, it is perhaps not surprising that when US firms arrived in England they were much more profitable. This had, then, two effects that encouraged the adoption of financial practices in English law firms. First, it created reputation problems for English firms. Being less profitable than US competitors created the risk of clients defecting to US

firms that were apparently more successful. Second, and more pragmatically, the more profitable US firms were also able to pay solicitors significantly more money and, therefore, poach star players from English firms. As one senior partner interviewed commented about this dilemma:

“I think it’s fair to say that they [reports of PEP] must have some impact. For example potential recruits may regard them as significant. Perhaps some clients make a judgment on the quality of a law firm by how well it seems to be doing in those terms. So you cannot completely ignore the league tables” (Senior partner, top 10 English firm).

It could, then, be argued that US law firms themselves were vectors of financialization. Indeed, the increasing numbers of US-UK mergers, of which the Clifford Chance/Rodger Wells deal is the most prominent example, exposed UK firms to the more individualist and performance orientated remuneration systems, to financialized practices and most crucially to the higher profitability rates of their US counterparts. However, ultimately, this move towards financial practices was first instigated by local regulatory developments that led to important changes to the political-economic landscape in which English law firms had to operate and survive. Indeed, the effects of re-regulation on the financialization of English law firms can also be seen in more recent times when further regulatory changes have helped to reproduce and legitimize financialized management practices in law firms.

#### *Re-regulation and financialization II: The Legal Services Act*

In the post 2000 era a second regulatory ‘big bang’ - The Legal Services Act – further reinforced the importance of financialized management in the legal profession in England and Wales. As another example of reform inspired by neo-liberal doctrines,

under the provisions of the Legal Services Act it will be possible, for the first time, to separate ownership and control in law firms. Firms will, therefore, be able to attract external investors, such as private equity houses, and potentially 'go all the way' with a full stock-exchange flotation. Indeed, it was anticipated that up to fifty percent of the firms in *The Lawyers'* UK 100 survey might seek outside investors and even a stock exchange listing (*The Lawyer*, 2007d).

Whilst the Act has not taken full effect yet and its implications are still emergent and not properly understood, anticipation of its provisions has certainly fuelled financialized logics and practices. Indeed, at first, metrics such as PEP were seen as a way of valuing law firms so as to facilitate investment decisions. This led to multi-billion pound stock-market valuations of the UK's leading firms (see for example *The Sunday Times*, 2007). Perhaps unsurprisingly, partners may, therefore, have been keen to maximise the value of their partnership equity by enhancing PEP and ultimately the supposed value of the firm to outside investors. More recently concerns have been raised about the value of PEP as a metric for investment purposes because of, amongst other things, the previously discussed ease with which firms can manipulate PEP through short term surgeries without improving underlying performance. Nevertheless, the regulatory change associated with the Legal Services Act certainly led to an intensified interest in PEP rankings, at least in the 2003-2008 period. This helps explain the unprecedented increases in PEP levels noted in this period in table 3.

#### *Institutions guiding the adoption of financial practices*

Regulatory reform constitutes, then, the situated political-economic context in which the financialization of English law firms was possible. Neo-liberal reforms and the

changes in the English legal marketplace they inspired played a key role in the formation of a conjunctural moment in which financialized management practices gained legitimacy. But, in line with ideas developed in existing work (Culpepper, 2005; Feng et al., 2001; Lütz, 2004), institutional transformations were equally important, alongside and as part of the re-regulation process, in the development of PEP's legitimacy in the English context. It is, then, the dialogue and interaction between the regulatory and institutional that led to a period in time, between the late 1980s and early 2000s, in which the reforms described above appeared legitimate and in line with common beliefs about how firms should operate.

Re-regulation helped change the cultures of lawyers because of the way it elevated profitability up the list of law firm partners' concerns, thus making PEP a core preoccupation for those running large firms. This is not to say the norms and values (the institutions) of English lawyers were completely changed by events of the 1990s and 2000s. Rather, and in line with the ideas of Vitols (2004), a form of negotiated compromise emerged with financial performance, measured in terms of PEP, coexisting with other pre-existing values and norms; a compromise which at times can break down into conflicts as the norms and value of lawyers clash with the financially driven changes previously described. For example, English lawyers have often resisted the development of the performance related cultures associated with financially inspired management practices (see Faulconbridge, 2008b), something the firm Freshfields Bruckhaus Derringer has experienced most notably.

Freshfields Bruckhaus Derringer has undergone a number of changes in the period from 1993 to 2008, including a merger with a German law firm designed to enhance the competitiveness of the original firm in the European marketplace (the firm was originally called Freshfields and gained its extended name after the merger). Indeed, this merger is partly the result of but also a cause of financialized management. As

figure 1 shows, the trend in terms of associate, salaried and equity partner numbers, and the effects of these on PEP reflect well the story outlined above. The firm grew leverage by expanding associate numbers in the late 1990s, introducing salaried partners and reducing the size of the equity partnership in the post 2000 period so to extract further gains in PEP. In particular this 'surgery' on the equity partnership was associated with the need to offset the effects of less profitable offices and individuals, many of which inherited as a result of the earlier merger, on the relevant profitability metrics. But not all the lawyers affected by these changes have accepted the logic of reform. In England the firm was recently taken to an employment tribunal by a former partner who claimed de-equitization was unjustifiable and in a spirit contra to the partnership convention. The tribunal deemed that the firm had taken proportionate steps in pursuit of a legitimate (profit enhancing) goal but debate continues about whether this strategy is an appropriate way to manage a partnership and has led to many firms reassessing the appropriateness of PEP driven strategies and their related surgeries (The Lawyer, 2007d).

[insert figure 1 somewhere here]

The reactions of lawyers to the introduction of financialized practices such as partner de-equitization in English law firms represent, then, a brake on the financialization process because, as one competing firms' managing partner put it:

"You get to a certain level – say the £500,000 partner profits point – and the squeezing more out of the machine becomes increasingly difficult; particularly if you are not going for the big de-equitization push. You cannot ask associates to do much more than they are doing" (quoted in *Legal Week* 2007a).

Similarly, the role of the salaried partner within partnership forms of governance has also been questioned. As one interviewee commented:

“salaried partnership is effectively glorified employees and if I wanted to have an input, which I did, it would be very difficult to be heard. And even if you were heard whether anyone took any notice was a whole different matter again” (Lawyer, firm in Lawyer’s UK 100 table).

Thus the case of large law firms represents an example of ‘negotiated financialization’. A dialogue between political-economic influences (regulation) and institutional influences creates both the moment in which financialization gains legitimacy but also a context that defined its place-specific characteristics. In the case of English law firms text book models of reform were not always being possible because of the situating of restructuring processes in a specific institutional context at one moment in time. The case of English law firms shows, then, that geographical analyses of financialization processes are vital because of the way regulation and institutions interact and can affect both the *timing* and *nature* of change. This means that whilst law firms worldwide might have undergone surgeries as part of moves towards financialized management, this may not have occurred at the same time (the conjunctural moment emerges, or fails to emerge, in different ways) or in exactly the same way as in English firms.

### **Questioning financial reform and the fall-out from the credit crisis**

In many ways, the financialization of law firms in the early 2000s was, then, a sign of the times. But, unsurprisingly, like the attempts by managers to prioritise shareholder value metrics like EVA<sup>TM</sup>, the PEP inspired surgeries described above have been increasingly questioned by a range of commentators over the past 12 months as a result of the credit crunch and ensuing financial crisis and recession. In a recent report, Hilderbrandt/CitiBank (2008) argue that non-equity partners are actually less

productive than equity partners as they lack motivation because they do not share profits and feel that the increasing requirements for equity status make promotion a more uncertain and less realistic career target. Indeed, in light of such concerns some English lawyers originally involved in promoting financially driven practices are now publicly asking questions about the dangers of the PEP 'game' and suggesting that alternatives are needed. Guy Beringer, who at the time was the managing partner of Allen and Overy, commented in an editorial placed on his website:

"I argue that PEP is not an appropriate measure of the success of a law firm and should be replaced with measures which take account of sustainable profitability, client satisfaction and staff motivation" (see <http://www.allenoverly.com/AOWEB/Knowledge/Editorial.aspx?contentTypeID=1&itemID=34073&prefLangID=410>).

Similar comments were made by the Editor of Legal Week (see Legal Week 2007) whilst *The Lawyer* now reports earnings per partner (EPP) as a way of revealing which firms are 'cooking the books' to enhance PEP. Indeed, comparing the change in PEP between 1993 and 2008 with EPP reveals that again, as a more 'accurate' measure of efficiency and success just like PPP and PPL, EPP offers a much less impressive account of 'growth' (70 percent growth in EPP between 1993-2008) than frailer measures such as PEP (157 percent growth).

The financialized model of the law firm deserves even more scrutiny in the context of the impacts of the current financial crisis on firms. The law firms listed in table 2 are now scrambling to maintain profitability by slashing costs, leading to redundancies and de-equitizations (The Lawyer, 2009b, 2009c, 2009d,). Indeed, by February 2009 job losses in the 200 largest English law firms since the onset of the credit crisis totalled over 3000 (The Lawyer, 2009e). And there is evidence that PEP calculations are influencing key decisions as downsizing programmes try to safeguard key

profitability measures by targeting equity partners as well as salaried solicitors in redundancy schemes. Indeed, firms such as Linklaters and Addleshaw's have culled 13% and 11% of their partnerships respectively in their attempts to pursue 'smaller and more profitable' configurations (The Lawyer 2009a). Others, including Clifford Chance and Freshfields Bruckhaus Derringer, are currently undergoing 'partnership reshaping' exercises, another term for downsizing the equity partner pool. It seems, then, that PEP is still a key consideration in the current reorganization of the profession and falls in PEP are deemed unacceptable even in a recession. Questions might be asked, therefore, about whether responses to the current crisis are likely to reproduce the hegemony of financialized logics in law firm management or whether the broader questions now being asked about the logics of financialized capitalism might impact on the way law firms view management inspired by metrics like PEP. It is entirely possible that the conjunctural moment in which PEP gained legitimacy has now passed and the future will involve very different measures of law firms' success and very different management strategies.

In this context, and perhaps more fundamentally, it could be argued that the PEP phenomenon is partially responsible for the severity of the crisis many law firms are now facing and should therefore be disbanded in future attempts to assess law firm performance. Whilst the global downturn that occurred in 2007-2008 is unprecedented in recent history, the structure of law firms post-PEP surgery seems to have left them more vulnerable than they were during previous recessions. This suggestion can be developed by looking at the experience of one firm, Slaughter and May, from 1993 to the current recession. The firm remains one of the most profitable (see table 2) despite operating in a largely traditional fashion and following a now atypical model when compared to the financially-driven management practiced by the majority of firms in our sample. This firm has a broad business base and in the post-2000 period did not focus excessively on the transactional work generated by

securitisation and other 'exotic' financial instruments. It has not merged or expanded overseas and, as table 5 shows, does not use salaried partners in significant numbers and has the most compressed leverage ratio in our sample which has actually declined over the period of observation. In other words, this firm has secured exceptional levels of performance, as measured by PEP (240 percent growth) but also other indicators such as EPP (187 percent growth), PPP (223 percent growth) and PPL (353 percent growth), despite making only limited concessions to discourses and practices of financialized management and continuing to operate in a more 'traditional' mould. Significantly, at the time of writing, Slaughter and May has not yet made any redundancies, suggesting such 'traditional' structures are more stable and sustainable in the long-term because of their maintenance of an emphasis on broad-based high quality, high margin work that uses relatively small pools of junior lawyers as leverage for profit generation. It would seem, then, that those running Slaughter & May did not buy into the financialized logics that had their moment in the 1990s and 2000s. In contrast, many firms that did buy into this ideal and followed PEP-inspired management practices and focussed on quality but also quantity in order to boost measures of PEP through leverage, have suffered much more severely as diminishing demand takes an exaggerated toll on revenues and profits. The downturn has left large pools of under-employed junior lawyers in firms that have adopted PEP-inspired management, pools which cannot now be sustained; thus turning leverage from an asset to a liability. For example, whilst Slaughter and May has to utilize 5 salaried lawyers for every equity partner, Clifford Chance has to support 8, meaning reductions in fee income escalate at a much more rapid pace and become quickly unsustainable. It seems, then, that the recession has again revealed one of the major frailties of financially-inspired management in law firms: short term gains at the cost of long term instability.

## **Conclusions: the situated emergence of financialized English law firms**

This paper explains the radical reorganization of large law firms in England in terms of the ascendancy of new financialized discourses and practices which, through the proxy indicator of PEP, somewhat unexpectedly reproduced the logics of finance capitalism in the domain of law. Thus, the case of the English legal profession represents another strand to the 'capitalization of everything' thesis (Leyshon and Thrift, 1997) and shows how selective management designed to optimise perceived financial performance can reconfigure organizations that might be assumed to be less directly affected by the logics of financial markets. The paper reveals how in the profession of law, like in other market-listed industries, the new concern for financial targets and metrics fuelled a series of unprecedented surgeries leading to a radical reorganization of professional practices, structures, values and labour markets. In particular, financial logics pervaded the shift of law towards a largely employed occupation as well as the redefinition of the concept of partnership itself, which previously had stood still for over two centuries.

In terms of the literatures on cultural economy and on financialization, this reveals the importance of further analysing how, what Thrift (1997) calls the 'circuits of soft capitalism', help to 'script' the behaviours of firms through their promotion of performative models such as PEP. In the case of law, the role of PEP league tables cannot be underestimated and led to law firms embarking on what Feng et al. (2001) would call a utopian quest for success that had uncertain consequences. The crisis facing law firms as a result of the credit crunch and ensuing recession exemplifies the dangers of such an approach. Firms following PEP-inspired management strategies are now apparently facing unprecedented challenges in terms of the need for redundancies both to offset the bloating associated with PEP-inspired leverage

and to ensure the impacts of the recession on PEP performance are minimised so to maintain the position of the firm in league tables. This shows that reforms associated with financialized management affect workers not only at times of the initial 'surgery' but also in the long-term as the stability of the firm and employment is potentially jeopardised.

This paper has also sought to develop understanding of how geographically specific contexts mediate the reproduction of financialized logics in particular conjunctural moments. At one level the paper shows that whilst the discourse of PEP and the media's role in proliferating its logics helps explain much of the surgery that occurred in English firms, re-regulation also had a significant influence on the financialization of firms because it created a context in which the logics of PEP and associated surgery gained legitimacy. Without the neoliberal reforms of the 1980s and 1990s, and without the Legal Services Act, the incentive for change would not have existed and the legitimacy of financialized models would have been harder to attain. Thus, following Culpepper (2005), Vitols (2004) and Jürgens et al. (2000), this suggests that the situated development of financial practices has to be understood as not just a cultural-economic phenomenon tied to financial discourses but also a political-economic phenomenon with timing related to broader changes in regulation that reflect particular situated perspectives on how firms should operate. But re-regulation also needs to and does inspire situated institutional reconfigurations, in this case to ensure that the norms and values of those running firms changed to support the structural reforms associated with financialized management. This was a negotiated change that was not completely successful, suggesting that the financialization of (law) firms, whilst a worldwide phenomenon, is taking place at place-specific moments, in place-specific ways with place-specific forms of resistance that lead to continuity and change in the structure of firms.

It would seem, therefore, that further situated analyses of financialization, in a range of industries as the financialization of everything continues, will be important in the future as firms react to and emerge from the current financial crisis in place-specific ways.

### **Acknowledgements**

Much of the data reported in this paper was generated as part of research funded by the Socio-Legal Studies Association. We are most grateful for this funding. We thank the anonymous referees for their comments which were most useful in focusing and refining the arguments made in the paper. The usual disclaimers apply.

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