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An Investigation into the Corporate Governance
of Limited Liability Partnerships in the
Professional Services Industry

By

Simon Cooper

2006

A dissertation in part consideration for the degree of
MA Corporate Strategy and Governance

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Abstract

This thesis provides an empirical investigation of corporate governance in the limited liability partnerships of the professional services industry. It can be seen as one of the first pieces of research to assess corporate governance within this LLP organisational structure. As a result it is an exploratory piece of work that focuses on the mechanisms of corporate governance and their role in combating agency problems in LLPs. In particular an assessment of the governance instruments in place, a review of the attitude of LLPs towards this issue and a comparison with the traditional governance template of a PLC is undertaken. The results obtained highlight the governance issues that are faced by LLPs and show a clear disparity between the public and private view of LLPs towards corporate governance. The limited sample in both size and breadth means that none of the conclusions found can be considered as a generalisable interpretation of corporate governance of all LLPs, but it is hope that it has highlighted areas of interest for future research.

Contents

Chapter 1: Introduction	P. 1
1.1 Background to the study	P. 1
1.2 Choice of sample	P. 2
1.3 Research questions	P. 2
1.4 Significance of the research	P. 4
1.5 Reflexive accounting	P. 4
1.6 Project Outline	P. 5
Chapter 2: Literature Review	P. 6
2.1 Introduction	P. 6
2.2 The origins of corporate governance	P. 6
2.3 The perspectives of corporate governance	P. 7
2.4 The corporate governance of publicly traded companies	P. 9
2.5 Corporate governance in alternative organisational structures	P. 13
2.6 Position in literature	P. 17
2.7 Methodology	P. 19
Chapter 3: Methodology	P. 21
3.1 Introduction	P. 21
3.2 Methodology	P. 21
3.3 Credibility of qualitative research	P. 22
3.4 Reflexivity	P. 23
3.5 Sampling Methodology	P. 24
3.6 Research design: research breadth	P. 24
3.7 Research design: research depth	P. 29

3.8	Interview profiles	P. 32
3.9	Interview structure, layout and content	P. 34
3.10	Interviews as a research method	P. 35
3.11	Analysis of interviews	P. 37
3.12	Methodology limitations	P. 38
Chapter 4: Analysis		P. 41
4.1	Outline of analysis	P. 41
4.2	Setting the scene	P. 41
4.3	Research questions	P. 43
4.3.1	Is there a lack of corporate governance in LLPs?	P. 43
4.3.2	Is there a generic corporate governance template for LLPs?	P. 47
4.3.3	How does company structure affect corporate governance?	P. 53
4.3.4	What is the attitude of LLPs to Corporate Governance?	P. 56
4.3.5	How should governance regulation in LLPs be organised?	P. 59
4.3.6	What are the future concerns for governance within LLPs?	P. 61
4.4	Discussion points	P. 63
Chapter 5: Discussion		P. 64
5.1	Outline of discussion	P. 64
5.2	Discussion of issues	P. 64
5.2.1	Research methods	P. 64
5.2.2	The PLC governance template	P. 65
5.2.3	Public and private attitude	P. 67
5.2.4	Governance as a differentiating factor	P. 69

Chapter 6: Conclusions	P. 72
6.1 Overview	P. 72
6.2 Contributions to the field	P. 72
6.3 Limitations of the thesis	P. 73
6.4 Future research	P. 74
Chapter 7: Bibliography	P. 75
Chapter 8: Appendices	P. 85
Appendix 1: Letter of contact	P. 85
Appendix 2: Interview structure, layout and content	P. 86
Appendix 3: Interview transcripts	P. 88

CHAPTER 1: INTRODUCTION

1.1 Background to the Study

‘Corporate governance, a term that scarcely existed before the 1990s, is now universally invoked wherever business and finance are discussed’ (Keasey et al, 2005)

In the business world, corporate governance is becoming increasingly important as part of the strategic management process (Ward, 1997). Solid governance procedures can enhance corporate credibility and reputation as well as create a competitive advantage for firms. Corporate governance has also been propelled to forefront of media as the result of recent large corporate failures such as Enron and WorldCom. These corporate collapses have highlighted the need to improve and reform corporate governance at an international level (Solomon and Solomon, 2004). Corporate governance is therefore a key issue at all levels of business where there is a focus on developing a ‘system that allows executives to do their job under the scrutiny of strong, independent and accountable boards in order to give stakeholders the confidence and certainty they need’ (Turley , 2004)

The growing importance of corporate governance in the business world has led to a saturation of academic research in this area. In particular the governance of the traditional public limited company (PLC) has been assessed from nearly every perceivable angle. So where does one go next? Academic interest has begun to spread to organisational structures which have been previously neglected. For example, organisations ranging from partnerships to non-profit organisations offer fresh new challenges for corporate governance. It is this relatively untouched field of corporate governance that this dissertation aims to tackle. It will move away from looking at PLCs and instead try to develop an understanding of the corporate governance regime of limited liability partnerships (LLPs). It will consider the corporate governance issues that LLPs have to deal with and the instruments that they have in place to overcome these challenges.

1.2 Choice of Sample

I have chosen the professional services industry as my sample group for a number of reasons. Firstly, the majority of companies within this industry are LLPs. This enables the researcher to consider the governance structure of LLPs in a sample where the variation between the companies under investigation is limited. Furthermore, recent corporate scandals such as Enron, Parmalat and Worldcom which have been directly linked to professional service firms have led to increased concern about the corporate governance measures in the industry. For example, the corporate scandal of Enron led to the collapse of Arthur Andersen, the largest firm within the professional service industry, due partly to failures in its governance structure. In addition many of the companies in this industry have law suits pending regarding their failure to stop large scandals occurring. For example, Deloitte and Grant Thornton are being sued by Parmalat for their role in its collapse whereas Ernst and Young defeated a litigation claim from Equitable Life for £2.6bn in 2005 (<http://news.bbc.co.uk>). Thus, an investigation into the professional services industry might reveal governance failures that help explain why so many law suits are brought against these firms. The final reason for the choice of the industry as my sample group was that firms within it are often employed to give advice on how other businesses' should implement their corporate governance regimes. They produce company specific governance reports and organise industry wide governance surveys and reviews. Therefore it will be interesting to see if they "practice what they preach."

1.3 Research Questions

1. Is there a lack of corporate governance in limited liability partnerships?

The objective here is to discover what corporate governance mechanisms are in place within LLPs, of the professional services industry. It will also compare the public and private promotion of corporate governance within the industry

2. Is there a generic corporate governance template for limited liability partnerships?

The aim here is to discover whether there is a common structure for corporate governance within LLPs of the professional services industry. It will discover what inter-firm differences exist between the LLPs and the reasons for these differences.

3. How does company structure affect corporate governance?

This question will compare and contrast the corporate governance regimes of PLCs with that of LLPs. The aim is to discover what differences are present and to see whether these reflect the theoretical views of academic literature.

4. What is the attitude of LLPs to Corporate Governance?

The objective here is to discover the attitude of LLPs to corporate governance. It aims to uncover the importance of corporate governance as an issue within the professional services industry and whether this differs at a private and public level.

5. How should corporate governance within LLPs be organised?

The aim here is to find out the views of LLPs towards the regulation of their corporate governance. It will review the current situation in terms of the rules that LLPs have to follow and discuss whether future regulation will take a self-regulatory or legislative approach.

6. What are the future concerns for corporate governance within LLPs?

The goal here is to look to the future of corporate governance within LLPs and see what problems and issues will need to be tackled in the years ahead.

1.4 Significance of the Research

A dissertation researching corporate governance in LLPs represents the first tentative steps in understanding governance within this organisational form. It will provide insight into understanding how governance differs in contrasting organisational structures. It is significant as it takes the governance debate into whole new arena of investigation where the focus is not on shareholders external to the firm, but on the internal partners who are also the owners of the firm. This limited divorce of ownership and control means that managers need not be concerned with outside control, but instead must be accountability to the partners of the firm. The dissertation's small sample size and limited scope within one industry will prohibit any definitive trend of results, however its work will provide an opportunity to understand what issues professional service firms are facing and how these relate to the academic literature in place.

Finally, the recent corporate scandals of Parmalat, Equitable Life and Enron have raised serious questions about the governance regimes of professional service companies. The events of recent years have not only brought about the demise of Arthur Andersen, but also resulted in over \$50bn of claims outstanding against the Big 4 firms in the industry (Economist, 2004). This research will therefore help determine whether these problems can be linked to weaknesses in the governance regimes of LLPs.

1.5 Reflexive Accounting

In order for this dissertation to be considered credible in the academic world it needs to take a reflexive approach towards its research. Reflexivity emphasises the importance of self-awareness, political/cultural consciousness and ownership of one's perspective (Patton, 2002). It involves self-questioning and self-understanding in order to explicitly recognise the effect that the researcher has on the research. A detailed discussion of reflexivity will be undertaken in the section 3.4 of the methodology chapter; however it was thought that it should be mentioned briefly here to show that researcher had considered the need for reflexivity from the start of the thesis.

1.6 Project Outline

While Chapter 1 has given a background to the issue of corporate governance in LLPs of the professional services industry and introduced the research questions to be answered, Chapter 2 reviews the existing literature in this field, and in particular, highlights the lack of academic research on the role of corporate governance in LLPs. Chapter 3 identifies the methodologies used for data collection and analysis as well as providing a brief background to the individuals and companies studied in the dissertation. Chapter 4 is the analysis section of the thesis which presents the qualitative findings from the websites and interviews and answers the objectives and aims set out in this introductory chapter. Chapter 5 forms the discussion part of this dissertation where key themes are drawn from the analysis and discussed in light of existing academic literature. Finally Chapter 6 concludes by reviewing the major sections of the dissertation, emphasising any important areas of discussion and making suggestions for future research within this academic area.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

This chapter is divided into four main parts. It begins by presenting a definition of corporate governance and outlining the competing theoretical perspectives that exist in the governance debate. It then moves on to consider corporate governance in its traditional setting of an open corporation. A review of corporate governance in PLCs allows a control group to be developed which can then be compared and contrasted with the findings of the dissertation. Once a sound background of corporate governance has been established a review of governance in less traditional business forms, particularly that of LLPs is undertaken. This chapter continues by highlighting the gap within existing academic work that the dissertation will fill emphasising the added value it will bring to the research community. The final section reviews the methods of past academic research in order to establish the most suitable methodology to be undertaken.

2.2 The Origins of Corporate Governance

Corporate governance, a term that scarcely existed before the 1990s, is now universally invoked wherever business and finance are discussed (Keasey et al, 2005). It is only since the 1980s that it has established an identity as fertile territory which straddles the academic domains of economics, management and law and which occupies the attention of executives, shareholders, employees and other corporate stakeholders. However despite its universal presence many academics draw different boundaries to its meaning. The term 'corporate governance' may just describe the formal system of accountability of senior management to their shareholders or it may delve deeper than this to include the entire network of formal and informal relations involving the corporate sector and their consequences for society in general (Keasey et al 1997). For example, Shleifer and Vishny (1997) believe that corporate governance deals with the 'ways in which the suppliers of finance to corporations assure themselves of getting a return on their investment' (p.373). This is in contrast to Turnbull (1997) who argues that corporate governance describes all the influences affecting the 'institutional processes, including those for appointing the controllers/regulators, involved in the production and sale of goods and services' (p.2).

Since corporate governance carries such a wide variety of interpretations, it seems appropriate to set out the approach that will be adopted in this dissertation. The one that seems most suitable is that of Keasey and Wright (1993) who define corporate governance to include ‘the structures, process, cultures and systems that engender the successful operation of the organisation’.

2.3 The Perspectives of Corporate Governance

There are four main theoretical perspectives on corporate governance: the principle agent model, the myopic market model, abuse of executive power and the stakeholder model. Even though not all of these models are directly relevant to an assessment of LLPs they will all be briefly reviewed in an effort to provide a detailed background analysis of corporate governance literature.

The principal agent/finance model is the dominant perspective of corporate governance. It is an essential element of the so-called contractual view of the firm developed by Coase (1937), Jensen and Meckling (1976) and Fama and Jensen (1983a,b). The essence of the agency model is the separation of ownership and control that occurs when a principal hires an agent to work on his behalf (Fitzroy et al, 1998). It is this delegation of decision making away from the principal and more specifically the moral hazard that accompanies this which leads to the principal-agent problem. This combined with the fact that in the real world it is impossible for the principal to observe completely the agent’s actions means, if both parties are rational utility maximisers, it is unlikely that the agent will always act in the best interests of the principal (Jensen 1986). The principal-agent perspective therefore sees governance arrangements as the devices that the suppliers of finance require to protect their interests in a world of imperfectly verifiable actions.

Secondly, adherents to the myopic model perspective argue that the Anglo-American model of corporate governance is “fundamentally flawed” (Keasey et al, 2000). They conclude that in the presence of a myopic capital market there is likely to be a failure of governance in that there will be systematic distortions of investment in the economy to the detriment of long-term growth. They argue that the finance model has an overemphasis on a company’s short-term interest including short-term investment, profits and share price driven by market pressures (Keasey et al, 1997). They see the challenges of corporate governance reform as one of providing an environment in which

managers and shareholders are encouraged to share long-term performance horizons rather than focus on short term gains.

Another view in contrast to the principal agent problem is that corporate elites tend to abuse their power. Hutton (1995) argues that the status quo bestows an excess of power with the senior management, and some of them abuse this to serve their own self-interest. This is because without effective monitoring senior managers may pursue their own interests to the detriment of firm performance (Keasey et al, 2005). Under this perspective corporate governance reforms should be used to restrict, if not prevent, the pathologies that arise from the abuse of executive power. Governance arrangements can therefore be created to reflect principles of transparency, representation and a division of responsibility (Kay and Silberston 1995).

Finally, the main challenge to the principal agent model is the stakeholder perspective of governance. It argues that company goals should be defined more widely than simply the maximisation of shareholder value (Keasey et al, 2000). In specific terms, there should be some explicit recognition of the views of other groups that have a 'stake' in the long-term success of the firm. The term stakeholder refers to the group of constituents who have a legitimate claim on the firm (Pearce, 1982) and include stockholders, creditors, employees, customers, suppliers and the general public (Hill and Jones, 1992). According to Simon and March (1958), each of these groups can be seen as providing the firm with critical resources in exchange for the promotion of their interests by the firm. For example, stockholders provide capital to the firm and expect the firm to maximise the return on their investment. Governance is therefore seen as the mechanisms in place to protect the interests of these stakeholders (Hill and Jones, 1992).

The perspective that is most relevant to an investigation into LLPs is the stakeholder model where the main focus is on the internal residual claimants of the partnership, but where there also exists other important stakeholder such as clients, creditors and regulators.

2.3 The Corporate Governance of Publicly Traded Companies

This section of the literature review will focus on the corporate governance of PLCs. This is because before one can study governance within LLPs a benchmark of governance in the traditional organisational form needs to be established. This will enable the researcher to determine whether or not this governance structure is an effective template for LLPs and to see if similar governance mechanisms are used under different organisational structures.

The majority of academic literature that deals with corporate governance focuses on PLCs where the agency problem is mostly readily encountered. Corporate governance issues arising from the agency problems engendered by this separation of ownership and control and the inability to write complete contracts (Hart, 1995; Shleifer and Vishny, 1997) have been recognised for many decades if not centuries (Marshall, 1920; Berle and Means, 1932). This research has not just considered the manager/shareholder relationship discussed by Jensen and Meckling (1976), but has been extended by academics such as Kay and Silberston (1995) to include other key stakeholders such as employees and creditors. This recognition that shareholders are not the sole residual claimants ‘suggests that a more explicitly “political” view of corporate objectives is appropriate since members of the firm besides shareholders are affected by executive decisions’ (Garvey and Swan, 1994, p148).

The substantial volume of research completed in this area has meant that a clear corporate governance framework for PLCs has been developed. It is based on the specialisation of decision management and residual risk which is a consequence of the unrestricted nature of residual claims of open corporations. This unrestricted nature of common stock residual claims leads not only to the agency problems discussed earlier, but also to special market and organizational mechanisms for controlling these problems (Fama and Jensen, 1983a).

The Stock Market

The unrestricted alienability of the residual claims of open corporations gives rise to an external monitoring device—a stock market that specializes in pricing common stocks and transferring them at low cost. Stock prices are visible signals that summarize the implications of internal decisions for current and future net cash flows. This external monitoring exerts pressure to orient a corporation's decision process toward the interests of residual claimants (Jensen, 1983b).

The Market for Takeovers

External monitoring from a takeover market is unique to the open corporation and is attributable to the unrestricted nature of its residual claims (Manne, 1965). Because the residual claims are freely alienable and separable from roles in the decision process, attacking managers can circumvent existing managers and the current board to gain control of the decision process, either by a direct offer to purchase stock (a tender offer) or by an appeal for stockholder votes for directors (a proxy fight) (Hughes, 1993).

Expert Boards

Internal control in the open corporation is delegated by residual claimants to a board of directors. Management are then made accountable to shareholders via this board. It is a separate legal entity which has the primary role of ensuring that shareholders have reliable information regarding corporate performance, risks and prospects and that the management take actions that further shareholders interests (Ezzamel and Watson, 2005). The traditional board of PLCs is made up of both executives from the firm and non-executives that are either affiliated to or independent from the company in question. These outside members act as arbiters in disagreements among internal managers and carry out tasks that involve serious agency problems between internal managers and residual claimants, for example, setting executive compensation. Thus board composition, in terms of who is represented on the board and how those represented get selected is a central issue in corporate governance. Board composition is likely to impact on how the board functions, how important investment and financing decisions are made and on how power and influence are allocated and become manifested within the board (Ezzamel and Watson, 2005).

In addition to the main board most PLCs have three subcommittees: the nomination committee (to advise on the appointment of new directors), the remuneration committee (to advise on directors' emoluments and service contracts) and the audit committee (to advise on the audit and to have free access to company financial information). These committees provide NEDs with greater scope to exercise their independent influence on the way executives manage the company's affairs (Ezzamel and Watson, 2005). For example, establishing a remuneration committee can in theory avoid the conflict of interest that inevitably exists when executives are permitted to determine their own rewards. Similarly, having an audit committee comprising solely of NEDs could improve financial disclosure practices and communications with shareholders.

Executive Remuneration

Executive remuneration is a key component of corporate governance within PLCs. As mentioned earlier the role of the remunerations committee is to determine the pay of the board of directors and to resolve the potential conflict between executives and the firm's owners (Conyon, 1997). Furthermore, the recent emergence of innovative instruments of executive pay such as Executive Share Options and Long Term Incentive Plans provoke particular interest in relation to their ability to either reinforce or compromise the robustness of corporate governance (Bruce and Buck, 2005).

Regulation

Regulation either in the form of industry reports or via codes of conduct has been an important part of the corporate governance landscape since the early 1990s. From the publication of the Cadbury Report in 1992 to the introduction of the combined code in 2003 the UK government has continually tried to improve corporate governance within PLCs (Keasey et al, 2005). The traditional format of UK legislation has been one of 'comply or explain'; that is companies are required either to comply with governance codes or explain why they do not. In contrast the recent introduction of the Modernising Company Law White Paper (2002) and the Director's Remuneration Regulations (2002) suggests a more compulsory approach is being adopted (Keasey et al, 2005).

An Alternative to the Governance Template

Allen and Gale (1998) argue that standard corporate governance mechanisms that are the focus of much of the existing literature do not appear to work very effectively in the real world. For example, Weisbach (1988) and Jensen (1989) document the weakness of the board of directors as a governance mechanism whilst Buck et al (2003) find evidence to suggest executive remuneration fails to align managers' and shareholders' interests.

Despite this lack of outside discipline and monitoring most firms seem to operate efficiently. For example, organisational structures that have no external governance mechanisms such as LLPs (Greenwood and Empson 2003) compete effectively with for-profit organisations. Allen and Gale (1998) explain this by arguing that a broader perspective than the standard agency view of governance is necessary. They believe, that in order for firms to survive in evolving environments, they must have entrepreneurial management teams that must do more than minimise cost. Instead they must make decisions about the direction of the firm in order to stay competitive. Rather than relying on the takeover or employment market to rectify an ineffective firm the most efficient firms will instead take over the market. This broader view can explain why firms with such different external and internal governance mechanisms are able to operate efficiently and provide a return to their stakeholders.

This argument is based around the idea that governance mechanisms do not create success for firms, but instead that this is driven by dynamic competition in the product market. This suggests that there is not one template for good governance and that efficiency can be achieved through a variety of measures, which should be tailored to the strategy of individual firms.

2.4 Corporate Governance in Alternative Organisational Structures

Much of the existing literature on corporate governance implicitly assumes that only PLCs are subject to analysis (Blair 1995). This would however, limit the topic to fewer than 40,000 firms world-wide and involve only a fraction of all economic activity (Economist, 1995:116). As a result of this academics such as Jensen and Meckling (1983), Fama and Jensen (1983a,b) and Greenwood and Empson (2005) have extended the corporate governance debate to alternative organisational structures ranging from mutual funds to partnerships. In particular Fama and Jensen (1983a,b) consider whether the model of governance for a PLC fits companies with alternative organisational structures. This therefore helps develop a picture of what theory predicts the governance regimes of LLPs should look like.

Partnerships may be defined as legal agreements in which: ‘Two or more persons... share risks and profits. Each partner is liable for the debts and business actions of the others, to the full extent of their own resources’ (Bannock and Manser 1989: p158). As this definition makes clear, ownership is not necessarily internal to the partnership, however in practice external ownership is virtually unknown in the field of professional services, though sometimes retired partners retain their investment in the firm (Wilhelm and Downing 2001). As such, there is no external agency problem equivalent to the shareholder-manager problem associated with the public corporation. Collectively, partners own and thus govern the partnership.

Another important characteristic of a partnership that separates it from an open corporation is the absence of asset partitioning, which creates greater risk for executives (Hansmann and Kraakman 2001). Asset partitioning defines which parties have claims over which assets and under which circumstances. Partnerships, do not separate the assets of the partnership from the personal assets of partners (that is, partners have unlimited personal liability). As a result of this the partnership does not exist independently of the partners themselves, therefore creditors making claims upon the partnership have full access to the personal assets of all partners. Partners are also liable for misconduct by fellow partners even if they themselves played no part in the misconduct or even had no knowledge of transgressions. Thus, not only are each partner’s personal assets at stake, but partners are also collectively accountable for the actions of colleagues. This research is, however

concerned with ‘limited liability partnerships’, which limit the personal liability of partners for the transgressions of fellow partners if they had neither knowledge of, nor involvement in, that work, while leaving the assets of the partnership fully exposed (Johnson 1995). Put simply a LLP is an ‘organisation in which the partner’s liability is limited to the amount he/she has invested in the company’ (www.investorwords.com). The individual partner is still however highly exposed as the risk to his personal assets is reduced, but not eliminated because partners remain fully liable for their own negligence. The central point is that LLPs are extremely vulnerable, as they significantly increase the risks to individual partners and so have the effect of heightening the deployment of ‘mutual monitoring systems’ (Greenwood and Empson 2005).

Fama and Jensen (1983b) have reassessed the governance debate through the perspective of a partnership highlighting its differences to that of a PLC. The next six paragraphs will review the main themes within their 1983b paper entitled ‘Agency Problems and Residual Claims’.

The major difference between partnerships and PLCs is that the residual claims of partnerships are restricted to the professional agents who produce the organization’s services. This restriction therefore increases the incentives of agents to monitor each others actions and to consult with each other to improve the quality of services provided. Such mutual monitoring and consulting are attractive to the professional agents in service activities where responsibility for variation in the quality of services is easily assigned and the value of professional human capital is sensitive to performance. The monitoring and consulting are likely to be effective when professional agents with similar specialized skills agree to share liability for the actions of colleagues.

In partnerships, individuals or small teams work on projects, audits and so forth. Because of the importance of specific knowledge about particular clients and circumstances, it is efficient for the teams to make most decisions locally. Thus, with respect to the services rendered to customers, decision control takes place within teams, where interaction and mutual monitoring are heaviest. At this level, however decision management (initiation and implementation) and decision control (ratification and monitoring) are not separate. To control the resulting agency problems, the residual

claims in partnerships, are restricted to professional agents who have the major decision making roles. Fama and Jensen (1983b) argue that this outcome is consistent with their hypothesis that the combination of the decision management and control function leads to a restriction of residual claims to the agents who both manage and control important decisions. Moreover, even in the largest partnerships services are rendered in individual cases by one or a few professionals. Responsibility for variation in the quality of services is easily assigned to individual agents, and the performance of agents is often well known to clients. In these circumstances, the value of human capital is sensitive to performance. In effect, unlimited liability is imposed on the human capital of professional agents by the market for their services. This gives the professional incentives to purchase monitoring and consulting to help limit loss in the value of human capital.

Professional services are also technical and so partners are efficiently monitored by others who provide valuable consulting services. Such mutual monitoring and consulting are encouraged when partners agree to pool net cash flows and to share liability for the actions of colleagues. Pooling of net cash flows and liability is attractive because it encourages mutual monitoring and consulting, which in turn improves the quality of services delivered, controls liability losses, and enhances the human capital of partners. Pooling of net cash flows and liability also has risk-sharing advantages.

Some partnerships have thousands of partners. The problem with such large organisations is that having obtained partner status, a professional may be tempted to free ride on the efforts of colleagues. The residual claims of large partnerships take a direct approach to this agency problem. The residual claim is not generally a fixed share of net cash flows; rather, a partner's share is renegotiated annually on the basis of past performance and estimates of likely contributions to future net cash flows. In these large partnerships service to a client is delivered by a small group of professionals who interact and monitor one another intensively. The composition of the teams changes, from case to case, to match specialized talents to specialized problems. As a result, the professionals develop knowledge of the talents and contributions of a range of colleagues. Flexible sharing rules add to partners' incentives to gather and communicate such knowledge to the renegotiation process. Given flexible sharing rules and the way payoffs are tied to performance, partnerships can be viewed as associations of proprietors who get together to obtain the benefits

from marketing a portfolio of specialized skills both to clients and to young professionals who purchase specific education.

The partners in large professional partnerships are diffused residual claimants whose welfare depends on the acts of agents they do not directly control. For example, residual claimants in partnerships delegate the ratification and monitoring of important decisions above the level of individual cases and audits. The boards of partnerships have special features that relate to the restriction of the residual claims to important internal agents. The residual claimants are experts on the organisation's activities, and they observe directly the effects of actions taken by the board of managing partners. Thus, unlike the stockholders of open corporations, the residual claimants in partnerships have little demand for outside experts to protect their interests, and their boards are composed entirely of partners.

The board is involved in decisions with respect to the management of the partnership, for example, where new offices should be opened, who should be admitted to the partnership, and who should be dismissed. The board is also involved in renegotiating the shares of the partners. Here, as in other decisions, the boards of large partnerships combine the valuable specific knowledge available at the top level with information from partner-residual claimants. The role of the board is to develop acceptable consensus decisions from this information. Thus, the boards of partnerships are generally called committees of managing partners rather than boards of directors. The idea is that such committees exist to manage agency problems among partners and to study and determine major policy issues in a manner that is less costly than when performed jointly by all partners. Since the residual claims in a partnership are not alienable, unfriendly outside takeovers are not possible. Inside takeovers by dissident partners are possible, however, because the managing boards of these organizations are elected by the partner-residual claimants they are unlikely to occur.

Greenwood and Empson (2005) develop a series of hypotheses highlighting the efficiency of the governance in partnerships relative to PLCs. They argue that the professional partnership agency minimises costs and ensures status-based efficiencies.

Greenwood and Empson (2003) propose that in the context of professional services, partnerships are more efficient than the public corporation partly because they incur no external agency costs. Ownership is typically contained within the firm: hence there is no external agency problem. However, professional partnerships and private corporations incur internal agency costs. As these entities reach a certain size, the responsibility for management is typically delegated to a small group of partners/owners. Often, those responsible for managing the firm are older partners, whose interests may not coincide with the interests of younger professionals (Ciancanelli 2002). Senior partners, for example, may resist longer-term investments because the returns are not immediately received and do not advantage those approaching retirement (Wilhelm and Downing 2001). Professional partnerships thus have the challenge (and bear the costs) of aligning the actions of those managing the firm with the interests of all owners. They conclude that internal agency costs incurred by partnerships are unlikely to be as severe as the external agency costs incurred by the public corporation, for three reasons. First, partners are more knowledgeable about the business of the firm than are investors in public corporations, enabling them to monitor more efficiently the behaviour of their agents (Fama and Jensen 1983). Second, the proximity of partners to managers provides opportunities to exercise influence in a way not available to more dispersed shareholders. Third, managers are likely to be aware of the scrutiny of their colleagues. In short, partnerships are more efficient than PLCs because their internal agency costs are lower than the external agency costs incurred by public corporations (Greenwood and Empson 2003).

2.6 Position in Literature

Over the last 20 years governance regimes of PLCs have been analysed from every perceivable angle. Academic research ranging from corporate boards to the takeover market has dominated academic journals. As a result of this a clear framework for good corporate governance within PLCs has been developed. The next logical step is therefore to extend this corporate governance debate into the relatively uncharted territories of other organisational forms, in particular that of the LLP. As discussed earlier some academic work has been carried out with respect to the theory behind governance in partnerships (Fama and Jensen 1983a,b; Greenwood and Empson 2003), however no

empirical assessment of these theories has been undertaken. As a result of this failure a number of interesting governance questions have emerged:

1. Is there a lack of corporate governance in limited liability partnerships?

The professional services industry has been hit with a number of corporate scandals in recent years and so there is a need to discover whether this is due to weak governance within the industry. This dissertation therefore aims to discover what governance mechanisms are in place within LLPs in the professional services industry. It will also compare the public and private promotion of corporate governance in the sample firms.

2. Is there a generic corporate governance template for limited liability partnerships?

The objective here is to discover whether or not there is a common structure for corporate governance within LLPs in the professional services industry. It will compare and contrast the corporate governance regimes of the sample firms.

3. How does company structure affect corporate governance?

This question will compare and contrast the corporate governance regimes of PLCs with that of LLPs. The aim is to discover what differences are present and to see whether these reflect the theoretical views of past academic literature.

4. What is the attitude of LLPs to Corporate Governance?

The objective here is to discover the attitude of LLPs to corporate governance. It aims to uncover the importance of corporate governance as an issue within the professional services industry and whether this differs at a public and private level. It is important as it will reveal whether or not governance is seen as a differentiating factor within the industry.

5. How should corporate governance within LLPs be organised?

The objective here is to find out the views of LLPs towards the regulation of their corporate governance. It will review the current situation in terms of the rules that LLPs have to follow and discuss whether future regulation will take a self-regulatory or legislative approach.

6. What are the future concerns for corporate governance within LLPs?

The aim here is to look to the future of corporate governance within LLPs and see what problems and issues may need to be tackled in the years ahead.

2.7 Methodology

There is little existing literature that researches the corporate governance of LLPs. A consequence of this is that no previous work can be analysed in order to determine the most suitable methodology choice for this dissertation. However, by considering research that has been carried out in other areas of corporate governance a sound research method should be able to be developed.

Past academic analysis of corporate governance has used both quantitative and qualitative methodology. For example Bonet and Conyon (2005) and Buck et al (2003) both used quantitative methodologies to analyse the relationship between compensation committees and executive compensation and the effect of LTIPs on company performance respectively. Furthermore, Agrawal and Chadha (2005) used statistical analysis to examine whether certain governance mechanisms are related to the probability of a company restating its earnings. Quantitative analysis has been the traditional dominant strategy for conducting social research; however qualitative analysis has become increasingly more influential since the 1970s. It is often more suitable when the research is concerned with words rather than numbers (Bryman, 2004). There are a wide variety of qualitative mediums that are used to research corporate governance ranging from corporate website analysis (Coupland, 2005) to ethnographies (Fredericks, 2000) and interviews (Roberts et al, 2005). The most widely employed method in corporate governance qualitative research is that of the interview

due mainly to the flexibility it provides researchers (Bryman, 2004). A good example, of this instrument is Bowman et al's 2001 paper which used 35 semi-structured interviews to analysis the contribution of NEDs to UK enterprises.

Corporate governance research uses a wide range of methodological analysis. As a consequence there is not one logical research methodology that this dissertation should follow, but instead the optimal method will be determined by the research questions posed, the data and sources available for analysis and the time constraints that are in place. The decision of what method to use and the justification for its choice will be explored in the methodology chapter of this dissertation.

3. METHODOLOGY

3.1 Introduction

This chapter seeks to outline the methodology of this study and to contextualise it within the aforementioned theoretical framework. It will begin by describing and justifying the nature of the research methodology chosen for this dissertation. This will involve finding the instrument that is best suited to reveal the corporate governance issues within LLPs. It will then move on to outline the practical applications of this methodology citing previous academic work as guides to its implementation. The final section will conclude by considering the limitations of the research methodology chosen.

3.2 Methodology

In order to answer the research questions that have been posed it was decided that a combination of research instruments should be used: website analysis and interviews. The idea behind this was that website analysis would provide the breadth to the research, highlighting the differences between the corporate governance regimes of professional service firms. This not only compares and contrasts the governance regimes of the sample firms, but also provides an opportunity to see how the companies publicly promote their governance structure. In contrast the interview medium was chosen in order to understand the reasons behind differences in corporate governance policy and to get a deeper insight into the corporate governance issues of professional service firms. It will enable the research to compare companies' public and private governance views and discover whether or not they are considered an important business issue.

Multiple sources can provide insight from a variety of different "angles", each yielding data that provide valuable information. By using a combination of sources (i.e. triangulation) the overall results show greater construct validity than could be achieved by any single source (Yin, 1989; Cook and Campbell 1979). Academic examples of the use of multiple qualitative sources include Poon and Swatman's (1999) use of surveys and interviews to help understand the adoption of the internet by small businesses and Mcdermott et al's (1997) combination of surveys, semi-structured interviews and plant tours to study the US power tool industry.

Epistemological Approach

A positivist epistemology, which emphasises validity, reliability, generalisation and methodological rigour has been rejected in this research. This is because the drawback of such an ideological framework is that it inhibits researchers from getting close enough to the phenomenon in order to understand the abstract, implicit and informal systems that have major implications on comprehending an organisational setting (Denzin & Lincoln, 2000). Instead this dissertation will take an interpretative approach. This school of thought conceives a world made up of a multiplicity of realities where each individual perceives, understands, experiences and makes meaning of that reality in a different way (Bryman, 2004). The foundation assumption for interpretive research is that knowledge is gained, or at least filtered, through social constructions such as language, consciousness, and shared meanings (Klein & Myers, 1999). Interpretive research also acknowledges the intimate relationship between the researcher and what is being explored, and the situational constraints shaping this process. In terms of methodology, interpretive research does not predefine dependent or independent variables nor sets out to test hypotheses, but aims instead to produce an understanding of the social context of the phenomenon and the process whereby the phenomenon influences and is influenced by the social context (Walsham, 1995). It is therefore a suitable epistemology as via the use of websites and interviews this dissertation is trying to understand others' experiences and relate them to one's own reality.

3.3 Credibility of Qualitative Research

Qualitative research has been exposed to considerable criticism since its origin. Denzin and Lincoln (2000: p7) argue that “qualitative researchers are often labelled ‘journalists’ or ‘soft scientists’ and that their work is termed unscientific”. It is often dismissed as loose, unspecified and of producing nothing more than anecdotal, subjective impressions that cannot provide a solid foundation for rigorous scientific analysis (Hammersley and Atkinson, 1995). However, such a perception is to ignore the strength of good qualitative research: as richly descriptive and deeply explanatory of processes and of cause and effect. Indeed proponents view qualitative research as “endlessly creative and interpretive” (Denzin and Lincoln, 1998: p291) and thus capable of generating “well grounded, rich descriptions and explanations of processes in identifiable contexts (Miles and

Huberman, 1994: p1). Further, unbounded by a rigid approach qualitative research possess a dynamism and holistic perspective that enables it to reflect and realise temporal and causal influences on consequences that make its conclusions even more “fruitful” (Miles and Huberman, 1994: p1). This is not to suggest however that the inherent subjectivity of qualitative research leads it to rely upon scant or tenuous links, but rather it allows the research the potential to be truly representative of the polyphony and multi-vocality of a case. This emphasises the credibility of qualitative research by effectively undermining potential accusations of anecdotalism and makes a mockery of any claims that qualitative research can in no way achieve the methodological rigour and consistency associated with quantitative research.

3.4 Reflexivity

There is a recognition by most academics that the compilation of their work is a process that is emergent, reflecting the choices made by the researcher. The process of academic writing is not part of the transmission of human culture, but the provision of an insight on its subject matter, in this case the corporate governance of LLPs.

In research reflexivity involves “thinking critically about what you are doing and why, confronting and challenging your own assumptions, and recognising the extent to which your thoughts, actions and decisions shape how you research and what you see” (Mason, 2002). It represents recognition of the researchers’ own position and a critique of the research itself. Russell (2005) recognised that the “interacting factors of age, gender, height and level of experience as an ethnographer influenced her research.” Thus, reflexivity is a strength of qualitative research as it looks beyond the face value of research and considers how the methodology, ideology and personal characteristics of researchers’ effect results. It allows the audience to ‘see the puppets strings as they watch the puppets show’ (Watson 1994).

Reflexivity is a corner stone of qualitative research and thus cannot be ignored when completing a research project. It is clear that my age, sex and my pre-determined view of the sample firms have affected my analysis of the data. In particular the fact that I am scheduled to begin work for Ernst & Young may have sub-consciously meant that I took a more positive analytical approach towards

their corporate governance regime than with other companies with which I have no affiliation. The key here is not that this occurs, but that it is acknowledged, so that the reader can relate to this appropriately.

3.5 Sampling methodology

Choice of the research sample appears to be one of the primary concerns of survey studies (Mouly, 1978). The issue arises from the fear that the data collected for the specific sample is not representative of the whole population. The sampling methodology depends on subject of interest, unit of enquiry and general scale of research (Moser and Kalton, 1971). Thus, the sample was identified with regard to the research focus on corporate governance within the LLPs of the professional services industry.

8 LLPs in the professional services industry were selected. These included 4 of the largest firms within the industry i.e. the Big 4 and 4 from the next tier down in terms of size and turnover:

The Big 4: Ernst & Young, KPMG, PricewaterhouseCoopers and Deloitte

Tier below: Grant Thornton, PKF, BDO Stoy Hayward and RM Robson Rhodes

The limited horizontal sample chosen for investigation means that qualitative research was the suitable methodology to be undertaken. It enabled the research to combine both breadth and depth without having the constraints of quantitative research. For example, qualitative methods permit “inquiry into selected issues in great depth with careful attention to detail, context and nuance as well as great breadth as the data collection need not be constrained by pre-determined analytical categories of quantitative research” (Patton, 2002: p227).

3.6 Research Design: Research Breadth

The aim of this part of the research was to assess what publicly available corporate governance information is available on the websites of professional service firms. 8 websites were selected for analysis:

Table 1

Company	Website Address	Year Became an LLP
BDO Stoy Hayward	www.bdo.co.uk	2004
Deloitte	www.deloitte.com	2003
Ernst & Young	www.ey.com/uk	2001
Grant Thornton	www.grant-thornton.co.uk	2004
KPMG	www.kpmg.co.uk	2002
PKF	www.pkf.co.uk	2005
PricewaterhouseCoopers	www.pwc.com/uk	2003
Robson Rhodes	www.rsmi.co.uk	2003

Research Method

While precise descriptions of how qualitative data should be collected, organised and presented remain elusive (McCracken, 1988; Wetz, 1983), the analysis followed steps suggested by Hill (1994) and Snider et al (2003). Firstly, the websites were scanned in their entirety for explicit or implicit statements regarding the firm's corporate governance regime. The websites were initially explored using the sites own search engines with reference to key words surrounding 'corporate governance' and variants thereof. These searches resulted in several hundred hits from the eight websites, however they often related to the corporate governance services that were provided by the firm rather than their own corporate governance regimes thus a more focus search had to be undertaken. This involved redefining the search criteria to specifically ask about the corporate governance of the firm in question. This resulted in two main patterns emerging. Firstly, none of the firms in the sample had a clear section on their website dedicated to their corporate governance regime. Secondly, the search results more often than not provided the researcher with a link to the firms' most recent annual report, which contained information regarding their corporate governance structure. The annual reports of 7 out of the 8 sample firms were available online through the firm's website, whereas PKF's annual report was requested online and sent in physical form to the researcher.

Once the relevant material was found a search for similarities within the information was undertaken resulting in the discovery of interrelated and expressive themes (Potter and Wetherell 1987). This step involved reading all data points several times, organising like information into separate grouping, and seeking appropriate identifying monikers. Themes in content were then highlighted using the table on the next page:

Table 2: An Assessment of Governance Structures

Subject	Company							
	BDO Stoy Hayward	Deloitte	Ernst & Young	Grant Thornton	KPMG	PricewaterhouseCoopers	PKF	RM Robson Rhodes
Management Executive	✓	✓	✓	✓	✓	✓	✗	✗
Board of Partners	✓	✓	✓	✓	✓	✓	✗	✗
Audit Committee	✗	✓	✗	✗	✓	✓	✗	✗
Nominations Committee	✗	✓	✗	✗	✓	✗	✗	✗
Remunerations Committee	✗	✓	✗	✗	✓	✓	✗	✗
Internal Audit/Control	✗	✓	✗	✗	✓	✓	✗	✗
Risk Management	✗	✗	✓	✓	✓	✓	✗	✗
Ethics and Independence	✗	✓	✗	✗	✓	✓	✗	✗
Regulation	✗	✗	✗	✓	✗	✓	✗	✗
Quality Assurance	✓	✗	✗	✓	✓	✓	✗	✗
Transparency	✗	✗	✗	✗	✓	✓	✗	✗

The table on the previous page allowed the researcher to devise four main groups to describe the corporate governance regimes of the LLPs in question. The groups were categorised in the following way:

Group 1: No information on corporate governance was provided by the website

Group 2: The website provided an overview of the main corporate governance mechanism used within the firm providing technical details of their design. No reference was made to minor governance committees, internal audit, ethics and independence policies or transparency.

Group 3: The website provided a technical overview of the corporate governance regime of the firm in question highlighting all of the major and minor committees in place. References were made to internal audit and ethics and independence, however risk management, regulation and quality assurance were not mentioned.

Group 4: The website provided a comprehensive summary of corporate governance. This included a detailed technical description of all governance mechanisms in place including governance committees, internal audit, risk control, quality control and ethics and independence. There was also a referral to governance regulation in place.

Table 3

Group 1 (No information)	Group 2 (Main Governance Instruments)	Group 3 (Majority of Governance Instruments)	Group 4 (Comprehensive Summary of all Governance Instruments)
PKF	Ernst & Young	Deloitte	KPMG
RM Robson Rhodes	BDO Stoy Hayward		PricewaterhouseCoopers
	Grant Thornton		

The Web Site as a Context

The web as a relatively new context of communication is still emerging as a variant of more established genres (Wynn and Katz, 1997). Commercial web sites are treated as public documents which render them available to scrutiny equal to or more stringent than the printed form (Winner, 1995). As a commercial venture it may be compared with journalistic representations in newspapers, magazines and some television documentaries, where, despite an even-handed description being espoused, a vested interest is understood to exist.

It is common for many researchers who use websites as their research subject to focus their work on textual/discourse analysis. For example Coupland's (2005) paper critically examines the language drawn on to describe socially responsible activities in the context of the corporate web page. Other commentators, who have explored computer-mediated identity, have proposed that, even in 'virtual' space, identities are constructed in relation to material and social factors (Livesey 2001). Furthermore, Alvesson, and Karreman (2000) emphasize the importance of considering the linguistic view in qualitative research. However, even though there are many issues surrounding identity in 'virtual space' (Winner, 1995) this research project does not focus on this debate. Instead it is concerned with the content of the websites themselves. It follows work such as Patten (2002) who focuses on the variation of the level of disclosure with respect to corporate social responsibility on websites of insurance firms. Snider et al (2003) also use websites in order to discover the content of what the top 50 non-US multinationals are communicating to their various stakeholders about their commitment to socially responsible behaviour.

3.7 Research Design: Research Depth

The second part of the research involves conducting semi-structured interviews with a number of firms within the sample in order to gain greater detail about corporate governance. In this light assessing which firms to contact was a critical choice in the research. In order to obtain an in depth assessment of the groups devised in the first part of the methodology one firm from each group was selected for interview:

Table 4

Company	Group
PKF	1 (No information)
Grant Thornton	2 (Main Governance Instruments)
Deloitte	3 (Majority of Governance Instruments)
KPMG	4 (Comprehensive Summary)

In an ideal world where unlimited resources exist and access to all required personnel is possible an interview would have been undertaken with every firm in the sample. However in reality this number of interviews was simply not practical. This is because identifying an appropriate sample to interview is a function of being able to identify willing participants who can reflect the diversity of activities in different-sized firms in each industry. Ultimately, it depends upon firms' willingness to co-operate, and in finding an individual who can respond to the questions raised by the enquiry. In particular I encountered problems with the large professional service firms where there was often a company policy of non-cooperation in 'surveys', issues with confidentiality and the lack of time available for research (Langlois and Lucas, 2003). For example, despite personal contacts within Ernst & Young and numerous emails and telephone conversations with staff members the company refused to be interviewed citing confidentiality concerns for their lack of co-operation.

Furthermore, the number of interviews that were feasibly possible to undertake was limited due to the costs of travelling to and accurately recording each observation, which according to Baker (2002) increases with the ability to check precisely what occurred. The 3 month time constraint of the dissertation also meant that potential interviewees did not have the time to fit interviews into their schedule. This was made worse by the fact that it was the summer holidays and that many partners were taking annual leave.

Even in light of these problems the researcher was able to organise interviews with 4 out of the initial sample of 8 companies. This number was considered appropriate because it provided the

opportunity for a detailed analysis of the four levels of corporate governance discovered by the website analysis. This number was also optimal as with the time constraints in place a small sample of interviews enabled the researcher to gain in depth knowledge on specific firms. The problem with trying to interview all eight firms would have been that only a superficial understanding of each firm would have been uncovered therefore limiting the level of detail analysis that this dissertation could undertake.

Interview Preparation

Yin (1989) contends that researchers utilizing fieldwork methods have to ensure that valid and reliable, yet flexible procedures are followed so that pre-determined goals can be achieved. These procedures include consideration of various design issues such as the setting of clearly defined goals, seeking co-operation from prospective subjects, designing and developing research instruments, and conducting pilot studies. McKinnon (1988) stresses that the researcher must expend considerable effort in designing and developing the questions which prospective subjects are to be asked. Thus, the development of the interview instrument involved an iterative process whereby questions were refined and revised following a review by an academic lecturer (Bruns, 1989; Denzin, 1978). The questions were also phrased in an open-ended rather than closed manner so that the maximum amount of information could be obtained from the interviewees.

The company's selected were each approach using a standardised email, see appendix 1, stating briefly the purpose of the research, the co-operation required and reassurances about confidentiality issues. In two cases the firms were approached through personal contacts whereas the other companies were contacted through the email addresses provided on their websites.

Each of the four companies that I contacted were asked to nominate the most appropriate individual to speak to on corporate governance issues, with the only stipulation being that the interviewee be a partner. This element of self selection may, of course, have biased our sample towards those individual most likely to attend to corporate governance issues however this ensured that the interviewee was extremely knowledgeable about the subject in question and best able to answer the researcher's questions. This referral approach has been use in other academic work such as Drake et

al's (2004) investigation to the environmental conditions in the UK's baking and refrigeration industry.

3.8 Interview Profiles

Defining the partners to contact

As suggested by Baker (2002) all the interviewees that were contacted were partners within their firm. The rationale of such approach is that these people are likely to have experience in the field, they should understand the overarching nature of the company/industry and they are also gatekeepers in the organisation so, can therefore deny or allow access.

It is important to provide a brief overview of the interviews and the companies studied in dissertation as a useful background to the responses generated in the research and to understand the contextual factors that may affect their motives. Below is a list of firms and interviewees in alphabetical order:

Interview 1 (Monday 24th July 2006)

Company: Deloitte

Company Turnover: £1,355.5m (2005)

Contact: Bob Warburton

Position: Audit Partner and Managing Partner Finance & Legal

Other Responsibilities: Member of the Executive Group and Secretary to the Board

Description of Business Operations: Their principal activity is the provision of audit, tax, consulting and corporate finance services in the UK.

Interview 2 (Monday 17th July 2006)

Company: Grant Thornton

Company Turnover: £255.82m (2005)

Contact: David Campbell

Position: Audit and Assurance partner

Other Responsibilities: N/A

Description of Business Operations: Grant Thornton is principally engaged in the provision of accounting, business assurance, insolvency and restructuring, transaction advisory and tax services in the UK.

Interview 3 (Monday 10th July 2006)

Company: KPMG

Company Turnover: £1,281m (2005)

Contact: Mel Egglenton

Position: Audit and Assurance partner

Other Responsibilities: Member of KPMG's Audit Committee

Description of Business Operations: The principal activities of the group are the provision of professional services through the functions of audit, tax and advisory. Advisory covers both risk advisory services and financial advisory services.

Interview 4 (Tuesday 1st August 2006)

Company: PKF

Company Turnover: £238.82m (2005)

Contact: Tom Morton

Position: Partner in Audit and Assurance

Other Responsibilities: Sits on the Management Board of PKF

Description of Business Operations: PKF's principal services include assurance & advisory; corporate finance; corporate recovery & insolvency; forensic; management consultancy and taxation.

3.9 Interview Structure, Layout and Content

Baker (2002: p167) notes that in the absence of “understanding and/or satisfactory explanation, we look for additional information to help us understand and interpret the phenomenon that has come to our attention.” In order to allow understanding to be improved, semi-structured interviews were conducted with the respondents in the selected firms. The structure of the interview, see appendix 2, was designed so as to allow the objectives of the research to be easily met. For example, a dedicated ‘website’ section was used as a response to one of the objectives of the research.

Furthermore, in order to create a rapport, which Trull (1964) notes is important in gaining access to information; the interview began with a brief introduction by the interviewer followed by simple questions that eased the respondent into the work. These were based on preliminary material relating to the background of the organisation. From these general questions the interview became firm specific as an affinity was developed between interviewer and interviewee.

All interviews were recorded using a digital voice recorder. The average time per interview was 35 minutes. The researcher took note to avoid some of the potential pitfalls of using a voice recorder highlighted by DiCicco-Bloom & Crabtree (2000) such as background noise, weak batteries, placement of the recorder and other issues that influence the quality of recorded interviews.

In terms of content the interview was designed primarily to obtain detailed information on the structure, concerns and motives of the corporate governance of the various firms. Since the aim was to provide some qualitative discussion of the views and motives of the firms with regard to corporate governance, the majority of questions were 'open-ended' in nature, allowing a high quantity of information to be obtained.

A final consideration was with regard to setting (Baker, 2002). The setting is important because it can affect the comfort and relaxation of respondents and subsequently their listening capability and communication. In reflection of this, the researcher met interviewees at their desired location, normally their office.

3.10 Interviews as a Research Method

“Interviewing is rather like a marriage: everyone knows what it is, an awful lot of people do it, but behind each closed door is a world of secrets” (Oakley, 1981: p41)

Snow and Thomas (1994) report that the use of interviews in field-based research enables researchers to appreciate the different meanings that people place on their experiences and thereby, achieve a more in-depth examination of the phenomena under investigation. In this regard, interviews are considered to be an integral part of the interpretative research tradition which has been particularly prevalent in the social sciences (Jick, 1979). Qualitative interviewing begins with the assumption that the perspective is meaningful, knowable and able to be made explicit. We interview to “find out what is on and on someone else’s mind, to gather their stories.”(Patton, 2002: p341). There is however, the possibility for great variation in the methodological features such as length, style of questioning, and participant numbers of interviews (King, 2004). In common with several previous studies employing interviews in the field (e.g. Innes and Mitchell, 1990 and Roberts et al, 2005) individual semi-structured interviews were used.

Patton (1990) argues that the semi-structured interview process not only allows information to be collected in a systematic manner, but facilitates probing and thus helps the researcher to add richness and delve deeply into the phenomenon under investigation. Semi-structured interviews were also considered desirable because of the nature of the interviewees. Schoenberger (1991) argues, the corporate interview is susceptible to problems of control because it is likely that respondents are accustomed to being in authority and pressing their own personal agenda. In order to prevent such an approach, whereby the respondent dominates the interview, a semi-structure interview layout was selected. This method helped to ensure a degree of comparability, which was beneficial for my research analysis. Moreover semi-structured interviews enabled issues that emerge during the interview process to be further explored without the apprehension that subject areas would be excluded completely. Its strength can be seen as an ability to “capture the multitude of subjects’ views of a theme and to picture a manifold and controversial human world” (Kvale, 1996, p7)

In addition to this Kvale (1996) claims that there is “no common procedure for interviews” (p13). So even though a semi-structured schedule was used to initiate each interview and keep it focussed on the research agenda, as far as possible the interview followed an informal conversation format, something that required a degree of crafting to each individual respondent. Indeed according to Douglas (1985) the employment of such creativity is vital:

“The structured interviewer is like the ignorant swimmer who fights against a powerful rip tides and finally succumbs to the tides because of exhaustion. Creative interviewers try to divine the flow of the rip and swim with it in order to eventually gain control of the outcome-saving themselves”

(Douglas, 1985: p22)

With this in mind the, interviews were steered somewhere between the free spontaneity of what Kvale (1996: p13) terms a “no method approach”, and the rigid structure of an “all method approach”. This allowed the course of the interviews to be iterative, flexible and follow conversational lines around those issues that the respondent focussed particularly strongly upon, yet

still bowing to the temporal constraints and the need to address the original broad motivations of the research project. Thus, the course of the interviews heeded very closely to the observation of Fetterman (1998, p39): that “an informal interview is different from a conversation, but it typically merges with one, forming a mixture of conversation and embedded questions.”

A final advantage of overt research was identified by Baker (2002) who argues that it allows two-way communication, which enables explanation of questions or concepts while providing an opportunity for respondents to mention issues that they feel have been neglected. This is supported by Silverman (1997), who notes that an interview provides an opportunity for respondents to raise issues that the interviewer may not have anticipated.

3.11 Analysis of Interviews

A common critique of researchers is that they are explicit about their research methods but less so regarding their data analysis. In reference to this the researcher provides a brief description of the data analysis process.

Heritage (1984) suggests that the procedure of recording and transcribing interviews has the following advantages. Firstly, it helps to correct the natural limitations of our memories and of the intuitive glosses that we might place on what people say in interviews. It also allows a more thorough and repetitive examination of the interviewees’ answers thus leading to better analysis. Finally, it opens up the data to public scrutiny by other researchers, who can evaluate the analysis that is carried out therefore helping counter accusations that the analysis might have been influenced by a researcher’s values or biases (Bryman, 2004). Thus, despite the time consuming nature of transcribing it adds considerable value to research.

After the interviews had been transcribed they were then coded. Initially this required detailed reading and re-reading of the scripts using an ‘open format’ with ideas noted beside various important segments of text. This refers to the process where the researcher seeks to derive structure

through the analysis of non-standardised text (Baker, 2002). This is an important stage in allowing the researcher to avoid missing elements of conversations, while getting as close to the material as possible (Bate, 1997). Crang (1997) also claims that this is an important task in filtering the voluminous collection of notes and tapes.

While ‘open coding’ generally reflected the actual language used by respondents, two other stages of coding took place. Firstly, ‘emic’ coding to divide main themes into smaller sections was undertaken. Secondly a more analytical ‘etic’ coding was used in an attempt to interpret exactly what was meant by the language used by respondents (Parker and Roffey, 1997). In this way, several overlapping themes emerged between the various interviews, and some major points of discussion reached. The technique of combining both open and emic coding can be seen through the work of both Wahl et al 2002 and Jones and McEwen (2000). In addition the use of ‘etic’ coding as part of qualitative analysis is outlined by Eaves (2001) in her synthesis technique for grounded theory analysis.

3.12 Methodology Limitations

There is an awareness that there a number of limitations associated with the research methodology used in this dissertation. By recognising such weaknesses it was hoped that their effects were minimised while providing caution for future research in this area. Some of the notable weaknesses of the research are general observations associated with interviews.

For example, there are academics that argue that the very popularity of interviewing may be its undoing as an inquiry method (Patton, 2002). In the contemporary “interview society” so much interviewing is being done so badly that its credibility is undermined (Fontana and Frey, 2000). Like with any research methodology interviews can be done well or poorly (Patton, 2002), however by following well respected research techniques, preparing clear and ethical questions and transcribing and analysing accurately my interviews this research should fall into the former rather than the later category.

A concern with interviews is that because of the active role of the researcher, there may be a subconscious leading of interviewees in attempt to gain findings that match preconceived ideas (Baker, 2002). As Crang (1997: p184) identifies “no researcher refuses to think about the interpretation and significance of their research while they are doing it”. In an attempt to minimise this affect the researcher tried to provide polar arguments and minimise his input into the interview process. However, counter to the notion of research independence, it was believed that a high degree of involvement would enable richer descriptions and allow a greater explanation of the respondent’s thought process.

Baker (2002) notes that another weakness of interviews, is the distortion that may arise when people are asked to report and detect actions that have become so integrated, that the individual is unaware of them and so does not report them. In an attempt to overcome this weakness projective and introjective (Peppas, 2003) interview techniques were used. There are however, still limitations associated with these techniques. For example, with projective techniques interviewees may provide a normative response that they hope to implement rather than ones that actually occur. This problem might be overcome with introjective techniques, but the reflection of previous experience may be selective and non-representative of normality.

Due to the reasons outlined in section 3.7 a limited number of interviews were obtained thereby narrowing the scope of the project. Martinsuo (2001, p539) argues that such an approach “may increase the depth of the topic, but at the same time lose touch with original problem or question and merely respond to a fraction of what was originally intended”. This over emphasis on narrow set of research explanations is referred to as the ‘problem of anecdotalism by Silvermann (2001). However on balance this seems not to be a significant problem for two main reasons. Firstly, this sample is not intended to be statistically representative, but instead represents a form of theoretical sampling (Glaser & Strauss, 1976). In addition it is not my intention for my findings to be generalizable across the industry, but instead the aim is to find an understanding of behaviour, values and beliefs in terms of the context in which the research is conducted. A limited sample is

therefore not a problem as the researcher's goal is not the representative capture of all possible variations, but to gain a deeper understanding of the cases in question.

Bate (1997: p1163) also argues that a "successful account drips with authenticity and plausibility" allowing the respondents to speak for themselves in research write up. He also suggests that the "text becomes a window rather than a page" allowing the reader to have contact and relate to the interviewee. It is light of this that the interviews were fully transcribed in order to allow direct quotations in the analysis. There was also an awareness of the limitations of interview recording. Due to practical considerations, scripts noted what people said and not, as Crang (1997) suggested, how and why people did things or made sense of them. Consequently, the tone of voice, hesitations and body language were ignored, which may affect the interpretations of primary data.

CHAPTER 4: ANALYSIS

4.1 Outline of the analysis

The analysis of this dissertation is based on two main types of comparison. It begins by comparing the data collected using the website and interview techniques highlighting the differences in the public and private approach of LLPs towards governance. It then moves on to consider the differences between the views of the interview respondents. This detailed analysis provides answers to the research questions set out in the earlier chapters of the thesis. Furthermore, due to the limited literature on corporate governance in LLPs, the analysis chapter will be based predominantly on primary findings, with academic literature being addressed in chapter 5. It should be noted that the presentation of qualitative data is important in the process of understanding. All quotes will therefore be presented as far as possible in their original form.

4.2 Setting the Scene

Interview Respondents

All of the interviewees were qualified to discuss the corporate governance of their respective companies. Each respondent was a partner within their organisation and thus had the authority and business knowledge to make educated statements about corporate governance. They also were involved with corporate governance within their organisation, be it through “informal channels” (Interview 2) or a more formal set up i.e. by “sitting on the national board” (Interviews 3 and 4) or being a “member of the audit committee” (Interview 1).

Definition of Corporate Governance

Corporate governance is a phrase that is used freely within the business world; however as shown by the literature review it has a wide number of definitions. All of the companies in the sample failed to provide a definition for corporate governance on their websites. Although defining this term may seem a sensible corporate policy the fact that corporate governance has been part of the business agenda for over 20 years implies that most business people understand it as a concept. This therefore

suggests that the ‘subject audience’ that these websites are designed for is a business one that already understands key business phrases. This concurs with the argument of Wynn and Katz (1997) who argue websites are designed ‘to sell to a particular audience’ (p2) and are not simply there to provide information to the public. This assumption of basic business knowledge was also reinforced when the researcher asked the interview respondents to define corporate governance. This is because they answered the question in a manner that suggested I should have already known the answer. For example the phrases such as ‘obviously’ (Interview 3) and ‘as you probably know’ (Interview 2) were used by the respondents.

Not surprisingly the definitions provide in the four interviews were similar to that of theoretical definitions developed by Keasey et al (1997) and Shleifer and Vishny (1997) who believe it represents the systems in place to make the management accountable to the owners of the partnership. The key phrase of “accountability” was found in each of the definitions provided and can be summed up best through a quote provided by Interview 3:

‘Well for us corporate governance means the procedures put in place in order to ensure transparency and accountability within the firm.’

The definitions provided by all the interviews did not mention any ‘informal or formal relations involved in the corporate sector’ (Keasey et al, 1997), nor an explicit statement about the relationship between the LLP and all its stakeholders (www.investorpedia.com). Thus, LLPs can be seen to look at governance from an internal viewpoint where they focus on ensuring that ‘there is a check on the running on the firm to guarantee that the strategy undertaken accurately represents the wishes of all partners in the LLP’ (Interview 3). The narrow focus to these definitions was to some extent off set by the fact that they all mentioned the word ‘transparency’. This suggests that there is some concern in ensuring that outside stakeholders such as clients and the government are provided with information regarding the corporate governance of LLPs.

In summary the definition of corporate governance for LLPs seems to be more internally focussed than with traditional theoretical definitions.

4.3 Research Questions

4.3.1 Is there a lack of corporate governance in LLPs?

The analysis of the corporate governance regimes of firms in the professional services industry can be looked at in two ways. Firstly, it can be considered through an analysis of the websites where the corporate governance information available to the public is assessed and secondly, a more private view of corporate governance can be reviewed using the data collected in the interviews.

Websites

The website analysis provided a wide spectrum of data concerning corporate governance. Two firms, RM Robson Rhodes and PKF, provided no information at all regarding their corporate governance structure. If we take this at face value this suggests that they have no governance in place within their organisation, however realistically this lack of governance may just be a public perception rather than a private reality.

The second group of firms had websites that provide a summary of the main governance measures that were in place, including a discussion of the executive board and partnership council or equivalent. For example, Ernst & Young's website talks about its 'Global Practice Council being their global governance body which provides input and insight into the Global Executive Board' (Ernst & Young Annual Report, 2005). Furthermore, BDO Stoy Hayward's website reveals the objectives of its Partnership Council including dealing with 'partner equity issues, the sharing of profits between partners and the admission to the partnership' (BDO Stoy Hayward Annual Report, 2005). Each website revealed the composition of these two main instruments highlighting the number of executives and non executive partners as well as outside advisors who sit on the Board and Partnership Committee respectively. For example, in Grant Thornton the Partnership Committee comprises of the national managing partner, 12 members elected by the LLP and one additional ex-officio member (Grant Thornton Annual Report, 2005). The websites of these three firms, however only focused on the largest two governance mechanisms available to them, the Executive Board and Partnership Council and do not refer to other corporate governance measures such as audit committees, internal audit and risk management. The websites therefore suggested that these three

LLPs have developed a sound broad governance structure, but that they have no specific governance mechanisms in place.

Deloitte fits into the third category for websites as it provided details on a wide range of corporate governance mechanisms. In particular it revealed the existence and composition of not only its Executive Committee and Board of Partners, but of specific governance instruments such as audit, remunerations and nominations committees. The information also contained reference to the development of a governance culture through the use of internal audit and ethics and independence guidelines. Furthermore, unlike any of the other websites in the sample Deloitte's website discussed the possibility of the setting up of a 'governance' committee purely to deal with governance issues in the firm.

The websites of KPMG and PwC provided a comprehensive and technical summary of all governance mechanisms. This suggests that any claims that the corporate governance of LLPs in the professional services industry is not comprehensive is misplaced. For example, these websites review governance mechanisms ranging from the partnership council and audit and remunerations committees to quality control procedures and a review of regulation compliance. In particular KPMG meets the standards of 'Article 38 of the European Union's 8th Company Law Directive although it has yet to have statutory force within the UK' (KPMG Annual Report, 2005). Their websites also allude to the formation of a corporate governance culture through the development of a code of conduct, which 'sets standards of professionalism and integrity' (PricewaterhouseCoopers Annual Report, 2005). Finally, there was also recognition that reputation was a key competitive advantage within the industry and that it needed to be maintained through quality control procedures. For example KPMG's website talks about compliance with the 'International Standard of Quality Control' (KPMG Annual Report, 2005).

In summary the websites of the sample firms presented a wide spectrum of corporate governance standards within LLPs of the professional services industry. They ranged from no reference of corporate governance to a comprehensive and technical summary of the corporate governance mechanisms present. These disparities are surprising as one would expect some form of conformity within an industry that relies on reputation as a competitive advantage. These differences may

however, just represent the public perception of these companies, rather than a true reflection of the actual governance regimes that exist.

Interviews

The varying levels of corporate governance information found through the website medium was not reflected in the private discussions undertaken with the four interviewed firms. All four of the interviewed firms had a comprehensive corporate governance regime in place. PKF who, provided no corporate governance information on their website, revealed that they had ‘a Board made up of both executives and non-executives’ as ‘well as audit, nominations and remunerations committees as subsets of this main board’ (Interview 4). Furthermore, Tom Morton mentioned the use of quality control procedures, particularly that of ‘internal audits’ as an integral part of their governance procedure. He however emphasised that they were not as a result of their organisational structure.

‘These types of internal governance mechanism are driven by our professional standards rather than our limited liability status’ (Interview 4)

A number of internal governance controls were also mentioned such as a specialised risk management department and a number of bottom-up governance controls such as whistleblowing hotlines. References were also made to external governance controls in particular the high level of regulation that LLPs had to conform to.

‘We are regulated by the FSA and the QED and various other provisions. So we are heavily regulated probably more so than PLCs’ (Interview 4)

The limited scope of Grant Thornton’s website was also shown to be misleading once an interview with the company had been completed. It was revealed that rather than just having a broad governance framework in place the regime also contained subcommittees such as audit, remunerations and ethic committees that deal with specific governance objectives.

‘there are subgroups of the Partnership Committee which are the audit committee who deal with all financial and accounting issues, the remunerations committee who are 4 senior members of the

Partnership Committee that sign off on the remuneration issues of the firm. There is also an ethics sub group which deals with ethical issues within the firm' (Interview 2)

Furthermore, a large section of the interview with David Campbell discussed the internal reviews that the company has in place which were not mentioned on the website:

'there are essentially two levels (to our internal control)...one is an assessment of the quality of the work we do.....and the other is to ensure compliance with things like ethical standards, judgement calls and so on' (Interview 2)

Finally, the interview revealed the existence of firm policies with regard to bottom-up governance measures including a 'direct route to the partnership committee through email and one to one access to partners on the committee' (Interview 2).

The website of Deloitte provided a substantial amount of information concerning the corporate governance regime of the firm. The interview undertaken with Bob Warburton reconfirmed this information and revealed a number of further corporate governance mechanisms that Deloitte had in place. In particular he discussed the 'delegation of responsibility and empowerment to local levels to help produce a mutual monitoring system where everyone is accountable to each other' (Interview 3). This expanded the information discussed on the website to provide an insight into how the day to day governance issues of the firm are solved. In particular he emphasised the inappropriateness of a flat tier system where each partner works independently.

'Everyone is managed and supervised in order to make sure no governance issues occur'
(Interview 3)

Finally, when the issue of a 'governance committee' was raised in the interview, the response received from Bob Warburton was in direct contrast to that expressed on the website. Rather than the setting up of a governance committee being in the discussion stages it was revealed that it had been decided that such a committee was redundant as the Board of Partners fulfils that role' (Interview 3).

KPMG was the only one of the four firms interviewed whose website appearance corresponded directly with its actual corporate governance regime. This is because all the different aspects of corporate governance mentioned in the interview ranging from internal controls, such as audit committees and internal review programs, to external controls, such as annual external reviews and regulation compliance, were present on the website. Thus, the private and public portrayal of KPMG's corporate governance regime is very similar. 'They are both driven by the attitude that 'transparency and openness is a key factor in corporate success' (Interview 1).

Summary

There is a stark contrast between the portrayal of corporate governance of LLPs at the public and private level. It seems that privately corporate governance is seen as a very serious issue with a large number of governance mechanisms in place to ensure accountability and transparency. This therefore dismisses any fears of governance failures within the industry. In contrast to this the evidence of the websites suggests that the importance of corporate governance varies between the firms within the professional service industry. There is a failure by the majority of interviewed firms to portray their governance structure to the public. Only KPMG can be seen as providing information on their website that accurately reflects the true state of their corporate governance regime. This lack of enthusiasm for promoting their governance structure publicly seems strange as reputation is a key competitive advantage within the professional services industry. Firms acquire new work and keep existing customers by promoting their reputation to clients. Thus, one would believe that any opportunity to enhance a firm's reputation by promoting a successful and effective corporate governance regime would be taken. However in reality this is not the case and the reasons for this will be discussed later in this chapter.

4.3.2 Is there a generic corporate governance template for LLPs?

There does seem to be a generic corporate governance template for LLPs in the professional services industry. This is because despite a few variations in the style and content of the governance mechanisms in place a number of key instruments can be identified:

Management Executive

All four of the interviewed companies mentioned the presence of a management executive group which is responsible for the operational management of the company. In the case of PKF this management board was made up of ‘both executives and non-executives’ (Interview 4). In contrast to this KPMG’s and Deloitte’s executive groups consisted solely of executives who are ‘actively engaged with clients’ (Deloitte Annual Report, 2005). The senior executive of KPMG, however also meets on an informal basis with chief executives of FTSE 100 companies to discuss strategic issues. Grant Thornton’s management board on the other hand consists of the senior partner, four experienced executive partners and two independent non-executive external advisors. These external ‘grey-hair advisors bring both expertise and experience to the management board’ (Interview 2). These external advisors are the equivalent to the non-executive directors found on the board of PLCs, however their role in LLPs is focussed on adding value to the company through experience and expertise rather than ensuring independence:

‘Both (external advisors) have been brought on board for their expertise to help Grant Thornton reach its objectives rather than for a specific governance purpose. They can tackle the problems and challenges we face from a different perspective.’ (Interview 3)

In contrast to the stance taken by Grant Thornton, neither Deloitte, KPMG nor PKF have any external non-executive advisors on their main board. Deloitte revealed that ‘they have the ability to take on NEDs and have done so in the past, but this is something that they do not think is necessary as part of their governance regime’ (Interview 3). Bob Warburton argued that ‘NEDs are not needed as unlike publicly limited companies the partners are the sole shareholders’. Mel Egglenton, of KPMG, also agreed with this stance arguing that it was ‘quite difficult for people outside the partnership to come effectively onto the board and to an extent it is not as relevant because we are not trading shares but ourselves’ (Interview 1). Tom Morton also argued that there was less need for external advisors in LLPs compared to PLCs, however he also revealed that PKF may consider this adoption in the future.

The management executive of Deloitte, KPMG and Grant Thornton do not ‘get involved in governance per se’ (Interview 1), but their actions are accountable to the rest of the partners within the LLP. In contrast to this PKFs management board are also involved in the governance side of the organisation. Rather than having a separate committee which deals with governance issues PKF consists solely of an executive board through which both strategy and governance policies are set.

‘I personally don’t see the need for or the theory behind separating the strategy and management of a company from its corporate governance’. They don’t have a separate board and governance committee in PLCs do they?’ (Interview 4).

In summary the management executive forms the centre piece of company structure within all four of the firms interviewed. The main differences that do exist between the firms is the composition of the boards and the role of this instrument i.e. is it there simply to implement strategy or does it have a governance role as well? The differences found suggest that there are conflicting opinions on the usefulness of NEDs in LLPs, however even when they are present there is a suggestion that they are in place more for their expertise rather than to fulfil a governance role. The key point that was stressed by all the respondents was that the partners are also the owners of the company so governance issues are primarily internal rather than external to the firm.

The Board of Partners

The fact that the management board does not tackle governance issues in 3 of the 4 interviewed LLPs can be explained by the presence of a separate governance committee within their structure. Deloitte, Grant Thornton and KPMG all have a structure separate to their main executive through which decisions are made concerning governance issues such as partner nominations, equity and remuneration.

For example in Deloitte the ‘Board of Partners is responsible for the promotion and protection of partner’s interest and for the oversight of management’ (Deloitte Annual Report, 2005). The board is composed of ‘the Chairman, the Senior Partner, ten elected partners and five of the Executive Group proposed by the Senior Partner and affirmed by the partners’ (Interview 3). Grant Thornton has an equivalent of this called the Partnership Committee whose role is to monitor the national

managing partner's stewardship of the firm and is made up of 12 members elected by the partners of the LLP together with an ex-officio member (Grant Thornton, Annual Report, 2005).

In contrast to the two other firms, the structure that deals with governance issues within KPMG is the national board which is responsible for the group's strategy and overseeing its implementation. On the board only 10 out of the 22 board positions may be filled by those members in executive roles; the remaining 12 board members are considered to be non-executives within the UK firm' (KPMG Annual Report, 2005). Mel Egglenton justified the use of the board as the firm's main governance device claiming that 'all of our governance procedures are interwoven with our strategic aims and objectives and so this is why the board is in the best position to deal with corporate governance' (Interview 1)

Governance Committees

All four firms that were interviewed had both audit and remunerations committees as subsets of either their main management group or their separate governance committee/board.

The audit committee takes on the role of monitoring all 'reporting, accounting, financial and control aspects of the executive management's activities' (Interview 3). All of the audit committees in place consist of 3 or 4 members who are either all non-executives (PKF, Grant Thornton and KPMG) or a mixture of executive and non-executives (Deloitte). Even in the case of Deloitte the only executive that sits on the audit committee is the Senior Partner. The remuneration committee is a similar specific governance mechanism which deals with the distribution of equity amongst partners. It is also dominated by non-executive partners and is in place to ensure that 'the whole reward mechanism is balanced and seen to be fair amongst the partnership' (Interview 1).

Some variation in the interview sample was found with the existence of one off committees. For example only Deloitte and PKF had a nominations committee that dealt with partnership and board elections. Furthermore Grant Thornton also had an ethics committee that 'deals with any ethical issues within the firm' (Interview 2). There was a recognition by all of the LLPs that a number of 'ad hoc committees might be set up during the year to deal with any issues that the firm might face' (Interview 3).

Internal Control

Dialogue from the four interviews revealed a number of internal mechanisms that the LLPs use as part of their governance regimes. These range from internal reviews and audits to quality control measures and risk assessments. The most common of these was the internal review where systems are in place to continuously ‘review the effectiveness of our system of internal control’ (Deloitte Annual Report, 2005). In particular David Campbell, of Grant Thornton, discussed his firm’s internal quality review forum where self-monitoring takes between office locations.

‘For example the audit work of the Sheffield office is independently examined by a team from our office in Milton Keynes’ (Interview 2)

Furthermore Mel Egglenton, of KPMG, cited the ‘huge internal review programs including quality and risk control that exist through all our various functions whether it is audit, tax, or corporate finance’ (Interview 1).

There was also a recognition by respondents that “bottom-up governance” was important within their organisations. In particular all interviewees discussed the existence of ‘whistleblowing lines’ as a formal way in which employees could highlight governance problems to their organisation.

‘Well we have a number of different channels ranging from whistleblowing hotlines to bi-annual feedback meetings with staff members in order to make sure there is a direct line up to the board and the managing partners’ (Interview 4).

All of the firms have formal reporting procedures and each respondent emphasised the importance of creating an ethical and open working environment.

‘The whole issue about being open, about integrity and ethical values is something we take very seriously. It is a culture that permeates all the way down through the firm’ (Interview 2).

External Control

All of the external governance controls in place can be linked back to the regulation that LLPs as professional service companies have to adhere to. All of the four respondents cited the high level of regulation that they have to follow through organisations such as the ‘Audit Inspection Group’ (Interview 3), the ‘Financial Service Authority’ (Interview 4) and the Institute of Chartered Accountants (Interview 2). Most of this regulation is as a consequence of the work that these LLPs undertake in particular that of audit. References were also made to the Department of Trade and Industry’s recent campaign of trying to increase transparency within the large accountancy firms through the opening up of their governance structure.

In contrast to the other LLPs, KPMG also undertakes an annual private independent review of the processes that the firm has in place for identifying and managing corporate governance issues. This involves an ‘independent ombudsman reviewing complaints within the organisation and assessing whether they are dealt with properly or not. He then reports his findings back to the board’ (Interview 1).

Personal Comparisons

Respondents from each firm were asked to voice their opinion on any differences in governance structure that they thought existed between the firms in the professional services industry. Despite the direct questioning approach taken no significant differentiating factor could be named by any of the respondents. There also seemed to be a lack of knowledge of the corporate governance regimes of competitors with most of the interviewed firms assuming that they all had similar governance structures:

‘I am not a great studier of the opposition accounts’ (Interview 1) and ‘I don’t know to be honest, but I doubt it (the governance structure) is very different’ (Interview 4)

Respondents that could make an educated discussion of differences between the corporate governance regimes in place used this as an opportunity to promote the advantages of their system compared to their competitors. For example Tom Morton of PKF discussed the development of a governance culture where partners cannot simply be expected to follow orders but must be ‘herded like cats’ (Interview 4). He argued that PKF was different from other firms as it adopted an open communication and monitoring system that ensured that all partners were actively involved in the running of the firm. In addition Mel Eggleton argued that KPMG was ‘definitely leading the profession by forming the Audit Committee Institute, a body set up to provide audit committee members with information to enhance the audit committee process’ (Interview 1). Thus, these statements don’t signify significant differences in governance structure, but are an attempt by the firms to portray their governance procedures in a positive light.

Summary

There is a consensus, that apart from small deviations in terms of the actual governance mechanisms in place, all of the firms that were interviewed had a similar governance structure. It was put most aptly by David Campbell:

‘there is a fairly standardised approach across most of the firms and that is simply because common sense dictates that kind of structures we are coming up with are the kind of structures that you would come up with if you were starting from a clean slate. So having come up with them I don’t think anyone will go out and seriously re-invent the wheel’ (Interview 2)

4.3.3 How does company structure affect corporate governance?

Now that a clear template for governance in LLPs has been developed a comparison can be made with the governance structure of PLCs.

Management Executive/Board

All of the LLPs interviewed have a management executive through which the policies, direction and management of the firm are controlled. For 3 of the 4 firms this is an entity that is completely

separate from the governance structure within the company. On the other hand the structure of PKF is similar to that of a PLC with the operational management and the corporate governance of the firm being controlled through the same board.

The governance structures of Deloitte, Grant Thornton and KPMG are controlled through a separate committee or board. It is similar to the two tier board that is used within the German corporate governance model where the management and governance of a company is separated. The separation takes place in order to ensure that ‘they can independently scrutinise the work of the national management board’ (Interview 2) and ‘that the promotion and protection of partner’s interests’ (Interview 3) occurs.

Another stark contrast between the governance regime of LLPs and PLCs is the presence of Non Executive Directors on the board. Only Grant Thornton has any form of external advisor on the board, whereas NEDs are an integral part of the governance system of PLCs. The LLPs cite the fact that ‘the shareholders are our partners’ (Interview 1) and so their ‘interests will be represented by the partners themselves’ (Interview 3) as the reason for the lack of independent external advisors within this organisational structure.

Governance Committees

The audit and remunerations committee form an integral part of the governance regimes of both LLPs and PLCs. Furthermore, the role that they play seems to be the same within both organisational structures. For example, Mel Egglenton argued that from ‘an audit point, that piece of governance (the audit committee) is taken care of, very much in the traditional listed company way’ (Interview 1). The remunerations committee also fulfils the same role for both organisations by ‘signing off on the remuneration issues within the firm’ (Interview 2). The only difference being that it deals with dissimilar remuneration issues within each organisational structure. For example, a PLC’s remuneration committee decides on the salary, bonus and share option structure of management pay whereas remuneration committees in LLPs ‘deal with equity and profit sharing’ (Interview 1) between partners.

The nominations committee which is also a common instrument within PLC is only present in a half of the LLPs interviewed. The nomination committees that do exist in LLPS have the same role as in PLCs as they deal with board and partner elections. The LLPs that do not have a nomination committee in place deal with these issues as part of their main board function.

Internal Controls

The internal governance controls that are present in LLPs are very similar to that used within PLCs. The use of internal audits, quality control systems, whistleblowing hotlines and internal reviews are all mechanisms that PLCs use to ensure effective governance. For example Unilever PLC discusses the use of internal reviews and the existence of a 'code of business principles' in their annual report (www.unilever.com) Furthermore companies such as BP PLC have a set of ethics principles (www.bp.com) that are present in most of the LLPs interviewed. The reason for the similarities within these internal controls can be seen as a result of both of these organisational forms having to make sure that the management of the firm is working in the interest of the owners whether that means other partners or shareholders. Thus, a number of internal instruments are developed to ensure that employees and the management are working in the interests of these owners.

External Controls

External control is the area in which the governance structure of PLCs and LLPs differ the most. This is because the residual owners of PLCs are shareholders who are external to the firm. This brings with it a number of external controls ranging from the role of institutional shareholders and the stock market to the existence of the takeover market. In contrast to this the divorce of ownership and control that is common to a PLC only occurs to a certain extent within a LLP. In a LLP managers are also some of the owners and so they are accountable to themselves and the other partners within the organisation' (Interview 4). The fact that no external owners exist means that the only governance issues that need to be considered outside the LLP concern stakeholders such as clients and creditors etc. As a result of this the only external control that is used in LLPs is via regulators such as the FSA and DTI who lay down guidelines to ensure the completion of honest and ethical work for clients.

Regulation

The formal governance regulation that is in place for PLCs is substantial compared to that of LLPs. The PLCs have to follow a comply or explain policy in order to meet the governance standards put forward in the 2003 Combined Code. In contrast to this LLPs have no formal governance regulation to follow as there is 'no public money involved' (Interview 3) so there is little justification for government interference. The audit work that is carried out by LLPs in the professional service industry means, however that the guidelines of regulators such as the FSA and the DTI have to be followed, but this compliance is a result of the nature of the work undertaken rather than the structure of the business itself. This lack of formal legislature concerning corporate governance in LLPs is expected to continue if companies are 'open and deal with governance in the correct manner' (Interview 1), however the stance of the government may change if governance failures in this industry cause future corporate scandals that damage the public as whole.

Summary

The organisational structure of firms has an important impact on their governance regime. The governance template for PLCs discussed in chapter 2 would provide a misaligned and ineffective structure for LLPs to follow. The key difference between PLCs and LLPs is that the divorcement of ownership and control is not only much greater in the former compared to the latter, but in LLPs the owners and the managers are both internal to the firm. The result of this is that there is less focus on external control mechanisms and regulation and greater concern in ensuring that internally those elected to represent the owners follow the objectives of the partnership as a whole. It is these internal mechanisms such as audit committees, internal reviews and risk and quality assurance programs which are the key governance instruments within LLPs. Thus, the focus here is on internal rather than external governance.

4.3.4 What is the attitude of LLPs to Corporate Governance?

There is a clear divide between the public and private attitude of professional service firms towards corporate governance. From a private perspective the wide variety of governance mechanisms in place, the reliance on reputation as a key competitive advantage and attitude of the interviewed

respondents towards corporate governance all suggest it is a serious issue within LLPs. For example, corporate governance was described as an ‘extremely important’ issue by PKF and Mel Egglenton, from KPMG, also stressed its importance ‘both internally with our own people and externally to make sure we continue to recruit the best talent’ (Interview 1). In contrast to this however, the public perception of governance within these organisations is very different. This because, as discussed earlier, the websites of the vast majority of firms within the industry do not present an accurate picture of the actual governance regimes in place. This lack of public publicity is not however seen as a major concern for the industry.

None of respondents that were interviewed were aware that their firm’s website contained none or a limited amount of governance information. Deloitte, Grant Thornton and PKF all put forward the view that they believed there was no need for a corporate governance section on their website and that this was something that they were not going change in the future.

‘I don’t think we have considered or will consider in the future putting a section discussing our corporate governance regime on our website’ (Interview 4)

The major reason for this lack of interest in promoting corporate governance on a public setting can be linked to the belief by all the firms that clients were not concerned with the governance of their firm. In particular there seems to be a consensus that it was not ‘a differentiating factor’ (Interview 4) in terms of competition within the industry. Furthermore these three respondents suggested that the information provided on their annual report, even if not a perfect reflection of their actual governance regime, would satisfy any client enquiries they received.

‘I expect if clients wanted to know more about our corporate governance regime they would obtain our annual report and get the information from there’ (Interview 3).

Grant Thornton and Deloitte also cited the fact that they did not wish their corporate governance regimes to be used as a ‘template for others to follow’ (Interview 3) as a reason why they only provided limited information for the public. David Campbell also argued that clients don’t ‘need to know precisely what our structure is or what our methodology for governance is, but instead need to

know that we have got the competence, expertise and knowledge to provide them with advice’
(Interview 2)

This suggests that promoting corporate governance externally is not a key issue for LLPs who instead believe that their website should focus on other issues such as the types of services that they offer. Some readers might conclude that this suggests an arrogance within the industry as firms believe that their ethics and independence do not need to be promoted, but instead are taken for granted.

‘Frankly I doubt many clients are concerned with our governance regime. They already assume we are honest and independent....it is a given’ (Interview 4).

In contrast to the other three firms KPMG was concerned that the lack of public awareness of corporate governance should be improved. This is because despite a comprehensive discussion of its governance regime in its annual report there was a recognition by Mel Eggleton that there was a need for a governance section on their website:

‘I am not quite sure what our objectives are on the website but it ought to be dealt with on their’
(Interview 1)

Furthermore KPMG argued that even though corporate governance was not a decisive factor in the competition for work it was an issue that ‘sometimes comes up when we quote for work’ (Interview 1). As a result of this KPMG believed it was something that was worth tackling at both the private and public level.

Summary

It seems that the majority of the professional service firms are not particularly concerned with public perception of their corporate governance regimes. This is because they do not believe that governance is a ‘differentiating factor’ within the industry and so think it is something they do not need to promote to their clients or the public. They believe that any inquiries they have concerning governance can be dealt with through the information they provide in their annual reports despite the

fact that most do not accurately reflect the governance structures they have in place. KPMG seem to be the only firm out of the four interviewed that recognise that public promotion of governance shouldn't be ignored, but they are still a long way from flagging it up as a top promotion priority. There seems to be an over confidence from all the firms within the industry that their reputation as ethical, independent and honest companies is set in stone and thus the promotion of governance to the public is not necessary or a 'waste of resources' (Interview 4). The gulf between the private and public picture of corporate governance within LLPs in the professional service industry is therefore large with little evidence of it getting smaller in the future.

4.3.5 How should governance regulation in LLPs be organised?

Current Situation

The current state of legislation in the UK means that LLPs are not subjected to any of the legal corporate governance requirements that PLCs face. In particular they do not have to follow the comply or explain approach put forward by the 2003 Combined Code. The only formal governance regulation that the firms have to adhere to is the guidelines of regulators such as the FSA, DTI and ICA who govern the work that the professional service firms carry out.

Furthermore LLPs as an organisational structure do not face any formal corporate governance disclosure requirements in the UK. However due to the nature of the audit work that LLPs in the professional service industry undertake they are required to comply with the European Transparency Directive:

‘Audit firms have to publish an annual transparency report. This report should cover among other things a governance statement, a description of the internal quality control system and a confirmation of its effectiveness by the management of the audit firm’ (<http://europa.eu>).

The main consequence of this directive is that it is not legally binding and so leaves room for interpretation. The result of this is that there is scope for varying disclosure levels within the industry.

Affect of Corporate Scandals

Recent corporate governance developments in professional services industry relate to the large corporate scandals that have occurred over the past ten years. In particular the failure of Enron led to large scale changes within the industry including the decline of Arthur Andersen.

All of the interviewed firms, unsurprisingly, described the major consequence of these corporate scandals was 'to provide a greater level of emphasis on corporate governance, not just in our industry, but in business as a whole' (Interview 2). However, despite an increased focus of governance within the industry it has not 'caused any real issues as despite a lot of speculation about increased litigation this has not occurred' (Interview 3). Tom Morton, at PKF, argued that the key consequence of these scandals was to 'remind some of the clever clogs in the city that independence and ethical behaviour is extremely important' (Interview 4). He was however keen to emphasis that despite these scandals creating a greater focus on ethical rules, 'at the end of the day it is down to individual people' (Interview 4) to behave in the correct and proper way. The key point here is that there has been recognition by all the interviewed firms that such scandals can occur and so firms have become more proactive within their governance structure to 'prevent the same sort of thing befalling our own firm and our own business' (Interview 2)

The Future

There is a comprehensive view from all of the interviewed firms that future regulation within the professional industry will take a self-regulatory approach rather than a legislative one. Firms believe that if they 'are open and deal with it (governance) in the correct manner then there won't be any appetite for formal legislation' (Interview 1). There was also a feeling that the most of 'professional service companies are doing a good job in promoting their accountability and transparency' (Interview 3) and so it would be hard to justify an increase in formal legislation. The fact that there is 'no public money involved' (Interview 4) or 'shareholders to protect' (Interview 3) in a LLP means that the government would find it difficult to defend further legislation. There was also a concern raised by Tom Morton at PKF that too much regulation could restrict professional service firms and reduced their ability to run profitable innovating businesses:

‘The whole industry is like a big ship with the regulation being the weed attached to its hull which slows it down’ (Interview 4)

This brings in to light the common debate on whether too much governance legislation can restrict entrepreneurial growth.

Finally Grant Thornton approached the self-regulatory versus legislative debate from a different angle than the other firms. They argued that legislative change within LLPs is unlikely and that the bigger concern is that the ‘legal entity through which Grant Thornton do business may change’ (Interview 2). David Campbell went on to discuss the recent developments of UK division of RM Robson Rhodes which has been acquired by its US parent. This not only means that RM Robson Rhodes will have to comply with Sarbanes-Oxley legislation, but the fact that the US company is owned by a PLC means that its whole structure might change. This brought into light the issue of LLPs becoming PLCs and the changes that this would entail:

‘it would give rise to a more refined framework of regulation and governance, which would then obviously be akin to those applied by listed companies’ (Interview 2)

4.3.6 What are the future concerns for governance within LLPs?

The concept of corporate governance is one that is constantly evolving and offering new challenges to companies in the business world. From developments in regulation to conflicts of interest in client work, the LLPs of the professional service industry need to have an adaptable corporate governance strategy to deal with the changing environment they face.

One of the main issues that was raised by the interviews was the fear of ‘another corporate scandal’ (Interview 1) occurring within the industry. In particular Mel Egglenton believed that the danger of a global scandal is that it would ‘create more pressure for the government to directly intervene and possibly break up the Big 4’ (Interview 1). This may be a worst case scenario for most of the firms within the industry, however it is clear that there is recognition that everything possible must be done to prevent any chance of this occurring. In particular there was consensus that firms have to work closely with the government and regulators to ensure this never happens.

Another concern highlighted by PKF is the fear that corporate governance regimes within LLPs will become set in stone and fail to adapt to the changing environment that they face. Tom Morton emphasised the importance of continuing to ‘review our governance regime in order to make sure it is effective and to make changes when they are called for’ (Interview 4). If a governance regime does not move with the times it can be left behind and become ineffective. This creates the opportunity for unethical and dishonest practices to occur as the mechanisms are not in place to stop this. In addition David Campbell, of Grant Thornton, believes the key problem that LLPs face is to ensure that ‘the committees established by all different firms can actually change and influence things....being for substance rather than show’. It may all be well and good that structures such as a ‘governance committee’ are in place, but the need to effectively carry out the role they were designed for.

‘Do they (governance controls) genuinely have teeth? Have they genuinely got the ability to influence and enact things when governance is in conflict with the management?’ (Interview 2)

The key here is that the instruments that are in place actually prove their worth and effectively tackle the governance issues that occur whether they are in conflict with the management executive or not. If the effectiveness of the governance instruments discussed are called into question then the whole credibility of LLPs will be undermined. If the trust and reputation of professional service companies are stained this could cause irrevocable damage to the industry with clients no longer taking the ethical stature of the firms for granted.

In contrast to this however Bob Warburton argued that the effectiveness of corporate governance instruments was not an issue for Deloitte as the firm has sufficient evaluation processes in place for this not to be a problem.

‘We have a board evaluation process...it challenges the board against its objectives and assesses its effectiveness on both an individual and board level’ (Interview 3).

Although Deloitte may have a number of evaluation procedures in place I believe Bob Warburton's response to this issue was driven more by a desire to paint Deloitte in a favourable light rather than to reveal the company's real concerns.

'Ours does a great job. It was designed to deal with corporate governance and it does this effectively and efficiently' (Interview 3)

Summary

A number of governance concerns were raised in the interviews. In particular the danger of another corporate failure and concerns over the effectiveness of corporate governance instruments were the main issues discussed. It must also be noted that some respondents either believe that they have no concerns in this area or are afraid that any issues they raised would suggest weaknesses in their governance regime-a situation which they would not allow. Thus answers have to be viewed in light of the fact that the companies are trying to portray themselves in a good light.

4.4 Discussion Points

The above analysis has brought to the fore a number of clear issues that need to be tackled in chapter 5:

1. The research medium undertaken affects the results that are obtained
2. The PLC governance template is not suitable for LLPs
3. There are large differences between the public and private attitudes of LLPs toward corporate governance.
4. Corporate governance is not a differentiating factor in the professional services industry..

CHAPTER 5: DISCUSSION

5.1 Outline of Discussion

The discussion will provide an overview of the implications of the research upon the corporate governance field. It will consider the main issues raised in the analysis chapter and discuss them in relation to corporate governance literature.

5.2 Discussion of Issues

5.2.1 Research medium

The main methodological finding of this dissertation is that the choice of research instrument used affects the results that are obtained. This is because the websites and interviews produced contrasting views of governance regimes within the LLPs of the professional services industry. For example, if a researcher was to only use websites as a research instrument conclusions made be drawn that some of the LLPs had no information on their website and misinformed assumptions could be made. This is not however a true reflection of reality, as the interviews showed that even firms who provided no information on their website had a number of governance instruments in place. It must therefore be recognised that in order to make accurate conclusions from a study into governance in private corporations, such as LLPs, the researcher must use a research instrument that delves deeper than simply assessing the public perception of such companies. LLPs have a limited need to promote governance to the public as the residual claimants are internal to the partnership. As a result they are very private organisations where levels of confidentiality and secrecy are high. Methodological points of this research must be considered. If a credible research project is to be undertaken into corporate governance in LLPs then the research instrument or instruments chosen must reflect the fact that these firms are private organisations. The researcher must not solely analyse publicly available information, but instead use instruments that allow a breakdown of the private barrier of LLPs and obtain an accurate and realistic picture of governance within these organisations. A failure to use such techniques brings into question the credibility of work, such as Perry and Bodkin (2000), who used solely web based research as the instrument for their investigation into the Fortune 100 companies. In contrast academics such as, Coupland (2005) and

Snider et al (2003), overcame these concerns by explicitly stating that they were analysing data in light of the fact that websites are designed to provide publicly available information. Their intentions were not to interpret this information as an accurate portrayal of firms, but instead recognised that websites only provide information that firms want the public to see.

5.2.2 The PLC Governance Template

It is clear from the website and interview analysis that the PLC governance structure outlined in chapter 2 is not a suitable template for corporate governance within LLPs. The analysis reveals that although a number of the PLC governance mechanisms are present in LLPs there is a greater internal governance focus in the latter rather than the former. This outcome is in line with the academic literature of Fama and Jensen (1983a,b) and Greenwood and Empson (2003). Both of these papers argue that residual claimants are internal to the LLPs and that the decision management (initiation and implementation) and decision control (ratification and monitoring) are not separate. This is agreed with by the interview respondents who argue that ‘ownership and control in LLPs is much closer than that of PLCs’ (Interview 4).

The hypothesis that residual claimants delegate ratification and monitoring to a level above that ‘of individual cases and audits’ (Fama and Jensen, 1983b) is also shown to be valid due to the existence of partnership boards within LLPs. However, the interviews also revealed that although residual claimants delegate power to a management executive, governance issues are often dealt with by a separate instrument. For example, 3 out of the 4 interviewed firms have some form of “governance” committee/board which is separate to the main management executive of the companies. This separate governance mechanism provides the LLPs with an opportunity to split the decision management and decision control of the firm. By having a separate committee that consists of both executive and non-executives it enables the LLPs to ensure that the strategic decisions made by the management executive are monitored by a body not directly involved in the running of the firm. This therefore contradicts the theory of Fama and Jensen (1983a), who argue that decision management and decision control, should be conducted jointly within LLPs. This is because despite the fact that decisions are monitored and ratified by partners within the firm these partners are non executives and so do not play a direct role in the strategic running of the company. These separate

entities are in place to help prevent a conflict of interest arising at the top level of management and to ensure that the top executive of LLPs are making decisions in the best interests of the partnership as a whole. It ensures that individual partners cannot fulfil their personal objectives at the expense of the company (Greenwood and Empson, 2003).

Another issue raised by academic literature is the importance of mutual monitoring in LLPs. In particular, Fama and Jensen (1983a,b) argue that mutual monitoring is driven by the delegation of control and the sharing of liability and residual cash flows among the important decision makers of the partnership. This hypothesis is supported by the research analysis which found that internal governance mechanisms such as mutual monitoring are central to the governance structure of LLPs. For example, all the interview respondents discuss the existence of governance committees, internal audits and internal reviews. In particular David Campbell, of Grant Thornton, detailed the use of quality internal reviews as a method of mutual monitoring between the various audit locations of the firm:

‘For example the audit work of the Sheffield office has been independently examined by a team from our office in Milton Keynes’ (Interview 2)

Mutual monitoring also takes place in a less formal manner through the development of a governance culture within LLPs. For example, Tom Morton, of PKF, discussed the opening up of communication channels and the development of a culture that promotes governance. In particular, he cited the use of ‘regular partner meetings and an exchange of information’ (Interview 4) to help put in place a culture that ensures monitoring, without the negative stigma attached to more formal procedures.

Fama and Jensen’s (1983b) proposition that ‘the boards of LLPs are composed entirely of partners’ also comes to fruition in the research. This because 3 out of 4 of the interviewed firms do not have external executives present within their organisation. The interview respondents cited the fact that the ‘shareholders are the partners and so non-executives will struggle to represent them’ (Interview 1) as the reason for this decision. Thus the residual claimant status of partners means, that compared to external executives, they have greater expertise and are better positioned to deal with governance issues in an efficient and effective way (Fama and Jensen, 1983b). Grant Thornton are the only firm

to have external directors on their board, however there is a recognition by the firm that the reason for their presence is to bring strategic and market expertise rather than to specifically deal with corporate governance issues:

‘Both have been brought on board for their expertise to help Grant Thornton reach its objectives rather than for a specific governance purpose’ (Interview 2)

The issue of free riding that is discussed by Fama and Jensen (1983b) is also overcome within LLPs. In order to prevent partners free riding on the efforts of their colleagues remuneration committees renegotiate the partners’ residual claims annually on the basis of past performance and estimates of likely contributions to future net cash flows. This is an attempt to ensure that the partners’ rewards reflect their contribution to the overall success of the partnership.

Greenwood and Empson’s (2003) claim that partnerships suffer no external agency problems finds some support in this dissertation. This because even though external stakeholders do exist in form of clients and creditors, governance is generally considered an ‘internal issue’ (Interview 3) by LLPs. Furthermore, any external controls that are in place are a result of the nature of work that the professional services firms carry out rather than of the LLP structure itself. Finally, the argument that the internal agency costs incurred by LLPs are unlikely to be as severe as the external agency costs bore by public corporations (Greenwood and Empson, 2003) is a hypothesis that was not tested in this dissertation. The broader business knowledge partners possess, their closer proximity to the business and a greater awareness of scrutiny that they are under are all viable reasons to suggest that this cost reduction occurs. However, unless the sample is extended to incorporate PLCs it is impossible to make a direct comparison in terms of agency costs between these two organisational structures.

5.2.3 Public and Private Attitude

There is a distinct contrast between the public perception and the private reality of corporate governance in the LLPs of the professional services industry. This is because despite governance being a strong private priority there seems to be little evidence to suggest that the LLPs, in the sample, think that they should promote their corporate governance regime to external clients. On the

contrary it seems that most of the LLPs seem to think it is not a ‘differentiating factor’ (Interview 4) and that it is something they do not need to promote to their clients or the public. This is a surprising result as the competitiveness of firms within the professional services industry relies heavily on the reputation that they have with external stakeholders. For example, Dowling (1986) argues that corporate audiences routinely rely on reputations of firms in making investment decisions, career choices and product decisions. In particular reputation can be seen as signals to the public about how a firm’s products, jobs, strategies and prospects compare to those of competing firms. Favourable reputations can therefore create excess returns for firms by inhibiting the mobility of rivals in the industry (Caves and Porter, 1977). This suggests that the LLPs should focus on their public governance image in order to create a favourable reputation which will allow them to charge premium prices, attract the top applicants, enhance their access to capital markets and attract investors (Fombrun and Shanley, 1990). In particular a LLP with an effective and efficient governance reputation would be able to improve relationships with key external stakeholders such as clients and banks.

Steps to help develop a governance reputation were however dismissed for two main reasons. Firstly a number of the LLPs believe that their sound governance structure is already known by external clients and so they do not actively promote it:

‘They already assume we are honest and independent....it is a given’ (Interview 4).

This is an easy argument to understand as, if clients are concerned about the reputation of the LLPs, then they simply would not do business with them. The success of the Big 4 in terms of turnover and profits means this is obviously not the case. Secondly, both Deloitte and Grant Thornton cited the fact they do not wish their governance regimes to be used as a template for clients as the reason for the lack of public promotion. This is sensible in that every governance regime should be unique and therefore tailored to the needs of one company only. The objective of the public promotion of corporate governance should not however be about putting forward a “perfect” governance template. Instead steps should be undertaken to show clients that the LLPs have the mechanisms in place to deal effectively with any governance issues that occur. In particular they need to be reassured that the governance failures that brought about the downfall of companies such as Enron are no longer present within the industry. This type of reputation building must however be credible if it is going

to have the desired effect of improving a firm's position in the market (Kreps and Wilson, 1982). For example, if websites are seen as an ineffective way of promoting governance in the professional services industry then it makes little economic sense for LLPs to 'waste resources' (Interview 4) developing them. Benefits of reputation enhancement will only occur if the signals delivered to the market are considered credible.

The current reputation of LLPs in the professional services industry may be secure; however it is no longer untarnished. The \$50bn of claims outstanding against the Big 4 firms (Economist, 2004), the recent collapse of Arthur Andersen and the existence of other corporate scandals such as Parmalat and WorldCom has meant that the independent and ethical culture of LLPs is no longer taken for granted. Any future corporate scandals could not only create drastic changes to the structure of the professional services industry through the direct intervention of the government (Interview 1), but may also have irreversible effects on the reputations of these LLPs. Thus, if these companies lose integrity and trust with external clients then their very existence in the industry may be at risk.

Reputation is a key factor in business as it can create competitive barriers in that clients will only select from the most reputable professional firms in order to signal their own worth and rationality (Galaskiewicz 1985, Podolny, 1993). Therefore even though it may not be considered a current priority within the professional services industry if the LLPs continue to rest on their laurels and don't promote their effective governance regimes publicly it could prove extremely costly in the long run.

5.2.4 Governance as a Differentiating Factor

It is clear from the analysis that there is a governance template that all of the interviewed firms follow. In particular David Campbell of Grant Thornton believes that there is 'a standardised approach across most of the firms' (Interview 2). This is not surprising as their LLP structure means that they all face similar governance issues. What is of more interest is the fact that there is an acknowledgement by some of the interview respondents that they are not aware of the governance structures of their competitors:

‘I am not a great studier of the opposition accounts’ (Interview 1) and ‘I don’t know to be honest, but I doubt it (the governance structure) is very different’ (Interview 4)

This lack of competitive knowledge seems quite surprising as it contradicts the basic economic concept that market knowledge is a strategic asset that can form a core organizational competence for a firm (Glazer, 1991; Hamel and Prahalad, 1994). In particular being knowledgeable about competitors’ behaviour will enable the firm in question to adapt their strategy in order to maximise their return in the market. The lack of competitor knowledge within LLPs of the professional service industry can however be explained by a number of reasons.

Firstly, as discussed earlier, corporate governance is not considered a differentiating factor in the professional services industry, thus it is not something that LLPs compete on. As long as individual corporate governance regimes are effective and efficient then firms will not be concerned about what mechanisms are in place in other firms in the industry. Secondly, corporate governance structures have to be tailored to individual firms and so although LLPs in the professional services industry face similar governance issues the mechanisms in place have to match a firm’s unique culture, organisational structure and relationships with stakeholders. For example, just because a nominations committee exists in one LLP does not mean it must be adopted by another. A counter to this is put forward by Cohen and Levinthal (1990) who argue that companies should be aware of their rivals’ structure not so that they can copy it, but so that they can they can adopt a strategy that exploits any weaknesses that they uncover. In this case LLPs may not need to know their rivals governance regime, but by having this knowledge they will be better able to compete within the industry. Furthermore, competition within the professional services industry appears to be quite low due to the fact there is a wide client base, conflicts of interest that reduce the work that can be taken on and revolving auditor selection by some firms. The result of this is that the cut throat competition seen in other industries is not present in the professional services market and instead it could be argued that a form of tacit collusion is in operation (Brander and Spencer, 1985). This lack of formal bidding for clients therefore means that there is little incentive for a comparison of governance structures within the industry. Finally, it must be remembered that the interviewed respondents are just one employee within their organisation and so even if they do not know about the oppositions governance structure somebody else in the organisation may do. The interview respondents may be

the spokesman for the company they represent, but they will not necessarily have universal knowledge about the governance systems and policies in place.

CHAPTER 6: CONCLUSIONS

6.1 Overview

This thesis provides an empirical investigation in corporate governance within the LLPs of the professional services industry. It began with a chapter that set the scene for the project by introducing the topic of corporate governance in LLPs and outlining its interest to the academic world. More importantly it set out a number of research questions that formed the basis for the rest of the research. The literature review provided a detailed summary of existing governance literature in both the traditional PLC and the less common LLP setting. More importantly it highlighted the gap in the existing academic world that this dissertation was attempting to fill. The methodology chapter considered the practical issues of carrying out the project. It outlined and grounded the research method chosen, it considered with practical problems encountered when gathering the data and reviewed the limitations and reflexivity issues that accompanied such research. The aim of this chapter was to present to the reader the methodology by which the research questions developed earlier would be answered. Chapter 5 carried out a detailed analysis of information from both the websites and the interviews so that the research questions could be answered. From this detailed analysis a number of interesting findings were highlighted for further discussion. Chapter 6 then discussed these issues in greater depth with reference to previous academic theories and literature. The thesis was concluded with an analysis of the major findings of the research, a discussion of the limitations of the dissertation and suggestions of future areas of research.

6.2 Contributions to the Field

Corporate governance is a business issue that is relevant to all organisational forms. As academic work within the traditional listed corporation environment becomes saturated, research will move into the relatively uncharted territories of alternative organisational structures. This dissertation represents one of the first empirical studies into corporate governance within LLPs of the professional services industry. It has revealed that the corporate governance structure of PLCs is not a suitable template for LLPs. The fact that differing governance issues exist, in particular the presence of internal rather than external residual claimants (Fama and Jensen, 1983b), means that an alternative set of effective governance mechanisms are employed. A stark contrast between the

public and private portrayal of corporate governance was also discovered. The lack of interest and investment in developing a positive public governance image, despite recent corporate scandals and pending law suits, is driven by the fact that governance is not considered a ‘differentiating factor’ within the industry and by an over confidence in reputation. Governance may not been seen by LLPs as a public problem, however these firms need to remember that reputations may take years to be established, but they can be destroyed in the blink of an eye.

Therefore this thesis has provided an explorative study into the governance of LLPs. Whilst no definitive conclusions can be drawn from its results it has developed integral hypotheses and highlighted areas of interests that should form the basis for further research.

6.3 Limitations of the Thesis

It is necessary for researchers to be critical advocates. As a result it is inevitable that there are a number of limitations regarding the research and its presentation. The most notable limitation of this dissertation was the inability to interview a wider population of LLPs. This would have provided greater credibility to the research and allowed some more concrete conclusions to be drawn. The limited sample size of this dissertation means that any of the conclusions made, while suggestive of how the governance regimes of all LLPs are structured, cannot necessarily be seen as representative of firms across the business sphere. It is acknowledged, that to have interviewed more than one partner from each sample firm, to make sure that an accurate picture of governance was developed, would have been desirable. This would have ensured that any conclusions made were more representative of the firms under investigation rather than just the view of one partner within the organisation. So extending the interviews to include more firms and a greater number of employees would have been desirable, however time and financial constraints meant that this was not possible.

The interviews were also too detailed for the scope of the research, which created wasted data and provided an overemphasis on ‘emic’ rather than ‘etic’ codes. This concentration on ‘emic’ codes was believed to be legitimate because of the immaturity of the field and the lack of previous research. Nevertheless, there is a recommendation that future research in this area concentrates on the ‘etic’ aspects of interview responses while considering a wider array of interviewees. Using

interviews as a research medium also requires a recognition that respondents may have used such opportunities to show their firm in a positive light. Despite the fact confidentiality reassurances were made, the results obtained should be viewed with this limitation in mind.

6.4 Future Research

The relative new topic of governance in LLPs means that there is a large scope for future academic research in this area. For example, future researchers may wish to conduct research using a larger sample within the professional services industry in order to test the findings of the thesis. Umbrella organisations, such as the DTI and ICA, could also be contacted in order to get an independent perspective on the governance structure of LLPs in the professional services. A further development of this will be to introduce the LLPs of alternative industries into the sample group. For example, incorporating LLPs from the legal industry, would provide governance information from an alternative set of firms that could be used in comparison with this existing thesis. This would not only provide an opportunity to assess how the governance of LLPs changes under different circumstances, but would enhance the development of a formal governance template for LLPs. There is also scope for more detailed analysis of corporate governance within individual LLPs. An interesting research project would involve a detailed analysis of the corporate governance regime of a particular LLP. This could involve assessing the governance mechanisms in place, reviewing the governance culture that exists, and discussing governance with all levels of management. Researchers may however find the same limitations that were faced in this thesis, that of distrust and confidentiality, that are common in most private corporations.

Finally this dissertation marks one of the first steps in a movement towards looking at corporate governance in organisation forms, other than the traditional PLC. This dissertation has proved that corporate governance in LLPs may not have the visible residual claimants of PLCs, but it still plays an essential role in their business strategy. Therefore future research should not just consider governance within LLPs, but look at corporate governance issues and mechanisms in normal partnerships, non-profit firms, and private organisations.

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CHAPTER 8: APPENDICES

Appendix 1: Letter of Contact

Dear Sir/Madam,

My name is Simon Cooper and I am currently undertaking a Masters in Corporate Strategy and Governance at Nottingham University. As part of our course we are required to write a dissertation on a topic area of our choice. I have chosen the topical subject of corporate governance and am interested in discovering the role it plays within professional service companies such as PKF.

To date I have looked at the publicly available information on your website and in your recent annual reports concerning PKF's corporate governance regime. I was wondering if you could refer me to a member of staff that would be willing to discuss your corporate governance regime in more detail. It would only involve discussing the publicly available information I have obtained in the form of a 20 to 25 minute interview. Furthermore arrangements can made regarding confidentiality if you have concerns about the discussing sensitive information.

I would be very grateful for any help you could provide me in respect to this request.

Thank you for your time.

Kind regards

Simon Cooper

Phone: 07769905171

Email: simon_cooper2@hotmail.com

Appendix 2: Interview Structure, Layout and Content

Section 1: Background Information

- 1.1 What is your role in the organisation?
- 1.2 How many years have you been working for KPMG?

Section 2: Corporate Governance

- 2.1 What do you understand by the term corporate governance?

Section 3: Corporate Governance Regime

- 3.1 Could you briefly describe your CG regime?
- 3.2 What internal and external governance controls do you have in place?
- 3.3 Do you believe your company takes the form of a more hierarchical or collegial approach towards corporate governance?
- 3.4 Do you think that your CG regime is more proactive or reactive?
- 3.5 Have you ever thought about setting up a “governance committee” that deals solely with governance issues independently from the other objectives of the firm?

Section 4: Website

- 4.1 Why is there no section on your website outlining Deloitte’s CG regime?
- 4.2 How do you present your corporate governance status to potential clients?

4.3 Do you think your clients are concerned with Deloitte's corporate governance structure?

4.4 Do you not think such a section would help create greater confidence in the company from the business world?

Section 5: Corporate Scandals and Regulation

5.1 How do you think large corporate scandals such as Enron and Worldcom have affected your corporate governance regime?

5.2 Do you think such high profile failures have undermined the public's trust in professional services companies?

5.3 Do you think corporate governance regulation for professional service firms goes far enough

5.4 Do you think that the corporate governance of LLP should take a more legislative or self-regulated approach?

Section 6: Comparisons

6.1 Do you believe that your governance structure is different/similar to other professional service companies i.e. the Big 4 or the tier below?

Section 7: The Future

7.1 What corporate governance issues do you think will be most important in the future?

Appendix 3: Interview Transcripts

Interview 1-KPMG

S.C = Simon Cooper (Interviewer)

M.E. = Mel Egglenton (Interviewee)

S.C: I think its best to begin with a brief history of my University career and an outline of my dissertation.

M.E: That sounds fine-please proceed.

S.C: I did my undergraduate degree at Nottingham University in Economics, which I finished last year and this year I have started my Masters in Corporate Strategy and Governance and as part of that I have to write a dissertation, which I am doing at the moment. One of the topical issues at the moment is corporate governance and a lot has been done in the past on corporate governance in Public Limited Companies (PLCs). Now I think there is a movement to looking at governance in other organisational forms like Limited Liability Partnerships (LLPs) such as KPMG. I am basically trying to test the waters because there is not much previous work done already into where companies such as Deloitte and KPGM feel their governance lies, if they think it is an issue? If their clients are concerned about it and what the next steps in this direction are?

S.C: I think the best way for us to start is by you discussing your position in KPMG.

M.E: I am one of the senior partners in the Audit and Assurance division of KPMG. I have worked for the company for over 15 years and so I know the ins and outs of it better than most. Of more relevance to you is that fact that I have a position on the Audit Committee within the organisation so I play an integral part in our governance regime.

S.C: That's great. Could you now define what you understand by the concept of corporate governance?

M.E: Well corporate governance is an interesting phrase. It is a combination of all the mechanisms and policies within a business that not only makes it accountable and transparent, but also ensures it achieves its aims and objectives. Transparency and openness is a key factor in corporate success

S.C: Please could you continue by outlining the corporate governance regime of KPMG including what procedures you have in place to deal with governance?

M.E: We feel we, as part of the big four, we led the public company debate on governance from the profession side with the formation of the Audit Committee Institute. We felt it was an important subject-it is an area we feel we have a lot of expertise in and so we think we led the pack through that and it is really one of our ongoing commitments. We organise a lot of non-exec forums as part of the Audit Committee Institute which we feel helps shape best practice and is giving people very practical guides as to what they can do, as to whether they are a FTSE 100 or a global or even a low CAP or even a name company that doesn't have quite the same requirements. Therefore from our

own governance point of view it would not be consistent if we didn't have governance at the heart of what we are doing. Obviously we have slightly different interest groups to satisfy, the principle one is instead of shareholders we have partners. We have a real difficulty in having non-KPMG partners involved in the management of our business that would be difficult because we wouldn't be able to give them any real authority. To have true non-execs would be very difficult for a professional firm. We do it two ways, in terms of where the business is going we have the Senior Partners Advisory Board made up of a Chairman, Chief Executives of FTSE 100s who meet with our senior partners to discuss the strategy and where we are going but don't get involved in the governance side per se. With regards to the governance side of the firm it is headed by the national board which contains both executives and non executives. As a subset of the main boards we have formal committee formed with partners that are independent of the decision making process in the firm. They are non-executives, which is a difficult concept to understand. If you actually looked at our management structure no one on the audit committee would have a job within formal running of the firm. I chair it and I'm the working partner and the other two partners on it are both operational partners as well. We go through the same routines as a FTSE 100 Audit Committee. From an accountants point of view we meet with the external auditors, we agree their fee, go through their findings at the end of the audit, we follow what our own internal auditors are doing, we help shape their work program to make sure that the cheques and balances are looked after. The only slight difference is that our external audit only covers up to the amount of profit available for distribution so we do some additional work internally to make sure we are satisfied with the way that is then distributed among the partners. So from an accounting audit committee point of view that piece of governance is taken care of, very much in the traditional listed company way.

Other governance we have in place is that we have a remuneration committee chaired by independent partners, independent of the decision making process again and their task is to ensure equity amongst the partners and the way that our profit distribution are decided to make sure that the right checks and balances are in place and to make sure enough weight is given towards financial and some of the other operational performance indicators like development of people etc. All the things that we think are important so that the whole reward mechanism is balanced and seen to be fair amongst the partnership. Those are both sub-committees of our main UK board

The other governance we charge ourselves with is a responsibility to the communities that we serve. We are very keen on equal opportunities, diversity and we have quite a large corporate station responsibility program. We give a specified amount of income each year to the KPMG foundation and other charitable causes and we encourage our people to participate and those who want to can take up to 2.5 hours a week to do recognised social activities e.g. mentoring or reading schemes with local schools etc. We also do larger one off projects e.g. this office went and redecorated the paediatric ward at the Queens Medical Centre and we also do projects in deprived areas.

S.C: Have you ever thought about setting up a "governance committee" that deals solely with governance issues independently from the other objectives of the firm?

M.E: I don't really see the purpose of setting up a corporate governance committee as such. All of our governance procedures are interwoven with our strategic aims and objectives and so this why the Board is in the best position to deal with corporate governance. I am not sure what a governance committee, as you called it, would bring to our organisation. I don't think corporate governance issues can be separated from the rest of the organisation. The Board does a tremendous job for in ensuring that we deal with corporate governance in both an effective and efficient manner.

S.C: Is this type of separate “governance committee” something you would consider starting in the future?

M.E: I don’t think this is something we would consider in the future...I just don’t think there is a place or need for such committee in KPMG.

S.C: So far they all sound very internal controls which is probably the main difference between PICs and LLPs because you don’t have the shareholders or the takeover market to check you. Do you feel that you have any external controls?

M.E: Yes, for example when you write this dissertation in September, we know that our accounts will be examined and obviously we are in the business of giving accounting advice so our own accounts will be highly examined by regulators and therefore we feel they have obviously got to be best practice and best of house. So I am almost certain we will adopt IRS this year and the pressure on us to adopt it fully and be beyond criticism is probably even greater than the listed companies because someone will look at us and make hay and political capital out of non-compliance so we will fully comply and go for IRS. We strongly believe in it as measure for international comparability. The other thing worth remembering is that we were the first firm to publish our accounts before there was any requirements and before we were an LLP which was felt within the partnership to be a very bold move about 8 years ago. Now all 4 are publishing and we still get headlines about it as everyone still takes the profit, divides it by the number of partners and says that they are earning too much money. But there is a lot more information in our accounts about what the firm is about and what we set out to do and we did set out to lead and say we shouldn’t be a secret organisation, if we are dealing with public companies and large privately owned companies we should have the same level of disclosure as them and that’s what we do. So we do feel that pressure and we think it is important.

S.C: With the partners and audit committees/remunerations committee you have a top down structure to make sure things go well. Is there a horizontal structure monitor partners and make sure nothing goes wrong?

M.E: There are huge internal review programs, quality and risk control programs through all our various functions whether it be audit, tax, transactions or financial deals we are working on. Then of course we have the external regulators who come in, the PCAAB, the American oversight body who can now come in and inspect us and Audit Inspection Unit is a big one for our institute. There is still a lot of self-regulation within the profession but there is now increasingly external oversight and the pressure of this is greater so you will see the US publishing results of the big 4 in America and that is coming more and more over here. So there is all the external review on that and the FSA do independent examinations. If you are interested in bottom up we also have our employee forums which have been pretty successful because we have just won the Times Best Big Company to work for which we probably wouldn’t have won a few years ago.

S.C: I read in your annual report that Richard Prack completed the annual review of KPMG in 2004 and his recommendations were taken on board

M.E: Yes he is our independent ombudsman, he does an annual report for us and looks at the complaints that come in and examines them and reports back to the board independently as to

whether we dealt with it properly or not. Most times we get a positive report but sometimes we don't and have to act on what it says. Employees like to ask the senior partners about things they are not happy with- generally speaking it is normally on corporate governance issues.

S.C: A lot so far seems your policy is more proactive rather than reactive i.e. trying to get reviews out there, being the first to start new governance procedures. Is that something you consider when doing it?

M.E: Yes I'm sure all the big 4 would like to say that they lead the profession. We certainly feel we do in terms of openness on how we operate and on how our profits work and are derived. Equally in the modern day people like students have probably a very different outlook to maybe the values that we brought to the firm when I joined 30 years ago. We do have a values charter and its not just something that we nail up on the wall. We do carry out an annual value survey with the whole of the UK staff and we do worldwide ones as well. We benchmark that each year, see where we have improved, sometimes we will have fallen or where we have improved from the previous year. We compare it amongst various parts of the business to see if one part is happier or unhappier than others. We look at it regionally, look at it within London and split it down within the various departments. We try and learn from parts of the business that are doing things better than the others i.e. why is it that maybe audit has come out very well on managing people's careers in one year but another part of the firm might not have done? The key is that we can learn from these weaknesses in order to improve the organisation as a whole. It is important to us both internally with our own people and externally to make sure we continue to recruit the best talent.

S.C: I read in your annual report that your chairman does meet the external advisors but it is not on a formal basis. Do you think that is going to change?

M.E: The problem for us is around the partnership, the shareholders are our partners therefore it is difficult we think to bring a non-exec in to represent them. We are trying to say who amongst the partners are independent and in terms of our nominations panel for who can be on the board. The way our board is constituted is that it is made up of senior partner and a number of people who are in what we call our prime decision-making executive positions As a result there is a balance with partners who are drawn from the partnership at large, which is done through a nominations process. We feel we can balance it within the fact that we have a partnership and the partnership ethos is still very important to us, which is why we look at the way we share profits and its not totally about individual performance but about how you help parts of the firm etc. So it is quite difficult for people outside the partnership to come effectively onto the board and to an extent it is not as relevant because we are not trading shares but ourselves

S.C: You seem to take corporate governance very seriously but when I searched your Internet website there seemed to be nothing on the website regarding your own corporate governance. Is that something you feel you need to let the clients know or do you think that by your reputation alone that is something they know?

M.E: I have no idea why that is not on, it ought to be on. We do make sure that it is given the right prominence in the annual report. You can pull the annual report off the web and I'm not quite sure what our objectives are on the website but it ought to be dealt with on there.

S.C: Do you think that you should get this message across about your corporate governance more to clients?

M.E: Yes it sometimes comes up when we quote for work. Other areas of quasi-governance, what do external people look at, come into our work, diversity comes up probably more often than governance in that people will ask us what our policies are on diversity, by gender, by race and we do have strong policy on that. That again is dealt with in the annual report. That is increasingly important not just in local authorities, but you will see a lot of public companies now that have corporate social policies and diversity programs as well.

S.C: There have been a number of scandals in the last 10 years such as ENRON, World.com. How has that affected your governance regime? Has there been increased emphasis to make sure it is a lot tighter?

M.E: Yes there is no doubt about that. The UK corporate governance side was developing anyway and it is still principles based rather than rules based i.e. its about best practice not hard rigid set rules that say actually you should have 6 independent non-executives and if there not then you are not complying and we will fine you. But the American system is much more draconian and exceedingly difficult for them to deal with in some ways and if you read about capital markets you see that all the listings are taking place in London, listings in New York are drying up. Have they overdone it? Possibly. Will it stop another ENRON? Possibly not. So will do believe in that. It has actually generated a number of additional work streams for us and a lot of the external oversight is driven out of that. We would argue that we already have internal policies so the next step of people coming externally to us is not a problem, it is part of the price we pay for self-regulation.

S.C: Do you think it is going to continue under self-regulation or do you think it is going to become a more legislative approach like in America?

M.E: I think provided we are open and deal with it in the correct manner then yes I don't think there is any appetite for legislation. I think it would be very difficult to nationalise the profession, there is this argument of should it all be done in a different way but would that actually aid it? I don't know. How would we look after a global business if one part was controlled via the DTI for instance? It would be very difficult. Generally speaking it working pretty well so our view is that we think independence is the correct way but we fully cooperate with all the regulators and more than that we work with the regulator to make sure that both sides of the equation are balanced up. We have a need and a desire for the way we want to run our business but obviously with respect and adhere to the regulation side. The regulator must work closely with the professions to frame the regulation and that way you will get regulation that works and we don't want it tipped to far in the regulators way and it wouldn't make sense to have it tipped too far in the professions way either.

S.C: PLC corporate governance has been tackled by a lot of legislative, codes of conduct etc. do you think the next stage will be for the government to look in your direction or the direction of other organisation structures? There seems to be growing interest in this area

M.E: I think we are already quite heavily regulated. We have a huge amount of regulation over every stream of our business so I think we are possibly as heavily regulated as a public company anyway in terms of what the institutes, oversight boards and tax authorities can do. I don't think that is something that is likely to change greatly.

S.C: Do you think the focus of the government will switch even more from a governance angle because a lot of legislation just applies to PLCs rather than private?

M.E: I suppose the issue is that it is not just the shareholders who are seen as the stakeholders nowadays and that again is already leading to regulation. We run a defined benefit pension scheme so the pension regulator looks at us. I suppose individual stakeholders who are using pension accounts or any private companies accounts for that matter then there are more stakeholders than just shareholders and I think the interpretation of the companies act is getting wider. When I started the Director's responsibility was to the shareholders. I have seen in many recent public documents where that is being expanded out to other stakeholders and so those have to be taken into account. For example we did a deal last week where a client was going to take on more debt to buy a company because they had a pension fund that was in deficit so they had to go to the pension regulator and say that's where we are going, this is the level of gearing that will be in the company and the pension regulator will ask for something in return, which is fine. So I think that there is legislation coming in, whether they will try and apply corporate governance legislation to private companies I think that will be difficult. Some of the larger private companies do to an extent comply with it but it is equally one of the things that is driving people out of the public arena. And that is quite dangerous in itself because you still want the best people to aspire to work in public companies with the growth of venture capital and less intrusive reporting that goes with it a lot of good people are now not entering the public arena and some good people in the public arena are now switching over to venture capitalist firms.

S.C: That's the balance they have to strike isn't it. Do you think you differ from any of the big four or smaller tier firms such as Grant Thornton in the way you look at corporate governance?

M.E: I think we definitely led the profession by the forming of the Audit Committee Institute. It was set up to provide audit committee members with information to enhance the audit committee process and feedback on the issues they are facing. Not only does it build up relationships, but it keeps these audit committee members up to date with changing legislation, new governance initiatives and so on. This is mainly for our clients, however the principles we employ are same principles that we use. Apart from this may difference I am not a great student of the opposition's accounts but you probably know if we are all the same. Are they similar to ours?

S.C: Generally the big four are quite similar but the smaller ones are not. I've got an interview with a partner at Grant Thornton next week.

M.E: I think personally it is very difficult for the mid tier, they keep saying they want to compete with us, they want a level playing field and they think that we are too difficult to break into for big audits. But the reality is we invest a lot of money in the developing areas so IFRS currently have millions of pounds training time and investment has gone into that and I think it is very difficult for them to make those investment decisions, we make those internationally and I think is difficult for them. I don't know why they don't publish their governance procedures.

S.C: Finally what do you think is going to be the greatest corporate governance issue that professional service firms will face in the next few years?

M.E: I think the danger of another corporate scandal could be very serious. If there is other large corporate scandals the danger is, particularly if the scandal is global, in the US or possibly UK, then there will be more pressure for the government to directly intervene and possibly try to break up the big 4. Our view is that we work with the regulator to make sure that there is that right balance because we actually think the market works pretty well and most of the external studies will support that. There is still freedom of choice, there are still four. The regulator himself allowed PricewaterHouse to move to Cooper. They knew it was going to go down to five. In terms of audit practice that was very small anyway. Four is from an audit perspective, there is choice and there is choice beyond that if they want to go to the mid-tier.

S.C: Thank you for your time. Your discussion has been very helpful.

M.E: No problem...good luck with the rest of the dissertation.

Interview 2-Grant Thornton

S.C = Simon Cooper (Interviewer)

D.C = David Campbell (Interviewee)

S.C: I think its best to begin with a brief history of my University career and an outline of my study

D.C: That sounds sensible

S.C: I did my undergraduate degree at Nottingham University in Economics, which I finished last year and this year I have started my Masters in Corporate Strategy and Governance and as part of that I have to write a dissertation, which I am doing at the moment. One of the topical issues at the moment is corporate governance and a lot has been done in the past on Public Limited Companies (PLCs) and the issues surrounding them . I think now there is a movement to looking at governance in other organisational forms like Limited Liability Partnerships (LLPs) such as Grant Thornton. I am basically trying to test the waters because there is not much work done already into where companies such as Grant Thornton feel their governance lies? If they think it is an issue? If their clients are concerned about it and what the next step is in this direction? However before we move onto discuss Grant Thornton's corporate governance regime please could you give me some background on your position within the firm?

D.C: Ok...I have been at Grant Thornton for over 30 years now and am a Partner in our Audit and Assurance division. I do not sit on any of the governance boards within our organisation, but I work closely with the partnership committee at a divisional level in developing our governance structure.

S.C: That's great. Please could you go on to define what you understand by the concept of corporate governance?

D.C: As you probably know corporate governance is about promoting corporate fairness, transparency and accountability. It is the range of mechanisms such as our Partner Committee, internal reviews and much more that are used to help direct and control our organisation. It involves the supervision of our executives to ensure that they are accountable to all the partners' as a whole and that they follow any regulation in place.

S.C: Now we have covered these basic questions I thought the best place to start would be for you to describe Grant Thornton's corporate governance regime

D.C: Ok, we became a limited liability partnership a couple of years ago and so in a sense some of what we are doing is groundbreaking as far as we are concerned, however the model we have of the moment may not be the framework that we will follow in the future. Well...partnerships that have converted into limited liability partnerships have actually come down quite a long journey because the concept of a partnership where effectively a number of people, well a large number of people in the case of a firm like ours, are enfranchised, with an actual say in the running of a firm, is all very nice and democratic and equitable, but it is incredible cumbersome when actually comes down to doing business. This is because businesses have to be capable of making decisions relatively quickly, implementing those decisions, and taking the steps leading on from this. The problem with this is that we have 220 partners and the idea of consulting everyone for every decision is just not practical.... therefore something had to give here.

The first thing that gave, and this was before we became a limited liability partnership, was that we structured ourselves into something that was more akin to a normal publicly limited company. We remained a partnership with the relevant advantages that this brings, including tax and financial reporting benefits, but we wanted to be managed more like a traditional company. As a result of this we appointed or we devised a structure for the firm, which took the form of a command and control management structure and delegated a whole range of responsibilities that the partners held individually to management board within the firm. We ended up with a fairly classical board running the firm in a managerial sense and that board was, before we became a limited liability partnership, accountable to the partnership as a whole. We still had mass part meetings, which were incredibly infrequent-on an annual basis and at those we would endorse both the plans and decide on the implementation decisions and schedule. There was a form of checks, balances or whatever you want to call it in that structure, but errm we were essentially still a partnership.

We then went down the route of limited liability partnerships and with that then comes another set of tensions and dynamics that are established in the firm because of the structure you are taking on board. So in order to quell any concerns that individual partners may have in terms of what they were giving up which was effectively their rights and responsibilities, ermm. we devised our governance structure, which was then designed to put in place the checks and balances that we had previously as a partnership, probably in a fairly crude way, in, if I can use this word, a more appropriate way. So what we have done is to retain a management structure in the firm and that management structure has a small management board who have the overall management responsibilities for the firm as a whole. They then delegate those responsibilities to operating boards at what we call functional levels, so the service lines and so forth that we provide are managed by sub units who are accountable to the national management board. The national management board is then accountable to the limited liability partnership as a whole

S.C: Ok

D.C: And the way in which we have done this is what we call a partnership committee. The partnership committee is a dimension which I think has 12 or 15 members

S.C: It is twelve as I read it in your annual report

D.C: Thank you. It is a number of people drawn from members of the limited liability partnership who are not in any form of management role. They are completely independent of management and sit on a committee after being elected by the members of the LLP. I think that they serve three years with the opportunity of serving another term. Their job is to scrutinise the work of national management board as well as to function as an audit committee....there are sub groups of the partnership committee which are the audit committee who deal with all financial and accounting issues, the remunerations committee who are 4 senior members of the partnership committee that sign off on the remuneration issues of the firm. There is also an ethics sub group which deals with ethical issues within the firm. The partnership committee have these responsibilities and a few less significant specific tasks, but their primary role is to ensure that there are checks and balances on behalf of the LLP to oversee the actions of the national management board. The way that they do this, the practical application of this, is that the national management board meet with the partnership committee on fairly frequent, if not completely set in calendar terms, basis. On the basis of need, but there would be no less than three or four meetings annually or there might actually be more. In these meetings the national management board present short term and medium term business plans, aspirations and so forth to the partnership committee. It is for the partnership

committee to query, question and/or possibly modify or be it that the relationship of the national management board and partnership committee is one that actually should errrm be harmonize and not confrontational. The idea is that they are there to make sure that planning of the national management board is sense checked rather than them being left to their own devices. The members of the partnership committee are elected by the LLP members and therefore are giving the consent of the company as a whole and so after this is achieved the management board goes on to implement the plans in question. That is the over arching role of the partnership committee, however I have made reference, as we now have to have our accountants audited, so we have an audit and remunerations committee.

S.C: Do you have any external advisors on these committees? An equivalent to the non-executive directors of publicly limited companies?

D.C: Yes we do-thus far we have two non executive members. One of them is a former national managing partner of a firm called Eversheds...a national legal firm. He brings to bear quite a lot of expertise and experience..Eversheds was a firm that brought together a number of regional practices and so he has done a lot of good work in bringing people and work together and sorting out the difficulties in doing this. So he had the experience of that sort of work behind him. I suppose you can put him in the category of being a “grey hair advisor” as it were, to the committee.

The other non-executive director, there are only two, is a former Andersen’s partner who was either the global or European head of corporate finance and after the demise of Andersen he set up his own corporate finance practice in London and remains successful business person in his own right. errrm he joined us as a non-executive and he brings to bear a considerable international experience given that he was involved in the development of Andersen’s certainly on a European if not a Global scale. I am sure he was on the global board of Andersen as well. So he has a considerable international dimension to what he brings as well as knowledge of the UK private equity market. So he is probably more in tune with what one might call the current developments in the profession that we work in.

Both have been brought on board for their expertise to help Grant Thornton reach its objectives rather than for a specific governance purpose. They can tackle the problems and challenges we face from a different perspective. There has also been some consideration, if not yet any application, of whether there ought to be further non executives involved at certain levels. As yet that has not happened.

S.C: Ok. So far you have talked a lot about internal controls such as the partnership committee and sub committees, but do you have external controls to help keep an efficient corporate governance regime? For example PLC’s have the takeover market and institutional shareholders as their external control mechanisms.

D.C: Very much so in the sense that we are audited. This is completed new for us and so we are having to deal with this and all of the transparency that this affords to the goings on of Grant Thornton. Now in actual fact the whole issue of transparency was something led by, I think, the DTI who began a transparency campaign with the major accountancy firms and some two or three years prior to the time that we embraced the LLP framework. So transparency was a thing that we were having to get use to, but not the transparency that was driven by the regulatory requirements which audit imposes. It was different kind of transparency...it was transparency from the idea that we wanted to be transparent, but now we are driven by the transparency that comes as a results of the

completion of an annual audit, companies acts and so forth. We are probably, but some might argue, one of the most highly regulated businesses in certainly the UK and that might even go internationally. errr there are various regulators who have a look into the activities of Grant Thornton including things such as the Financial Services Authority, which is the over arching regulatory body that we are again answerable to. The Institute of Chartered Accountants who again we are answerable to and there is something called the Audit Inspection Unit, the AIU in short, which is involved in the monitoring of the quality of the audit work undertaken by the largest firms on public interest audit assignments. So there is a whole host of different regulators, and I am just giving you a flavour and so there are a whole host of others, who in some shape or form bring regulatory pressure or disclosure pressure...or maybe influence rather than pressure to bear on a firm like us. This therefore causes us to take note as they can in effect take our license to operate.

S.C: They of course do reviews, but do you undertake any internal reviews into your governance regime? Maybe highlighting areas to improve for example?

D.C: Absolutely we do. There are essentially two levels- one is an assessment of the quality of the work we do. We have on all parts of our practice and ours is quite a complicated business-if we break it down there is probably about 15 different streams of business that we are involved in. These are substantial but significantly different business streams that we are involved in so when I talk about for example, audit and tax, they are only a part of what the firm is involved with. I will not bother listing all the activities, but it is apparent from the annual report what all the different areas we are involved are. For each of the different activities that we are involved in we have our own internal quality review forum that we have established. They are not something that are in response to the LLP, but they have been going on for years. This is where the work of different locations, for example we are sitting in Sheffield, is reviewed by other office locations. For example the audit work of the Sheffield office has been independently examined by a team from our office in Milton Keynes

S.C: Ok

D.C: We have sent a team from Sheffield to go and review work that we have done in Norwich and so on and so forth. So every year a different team will come to visit to examine the audit quality and reports to the firm's head of audit who pursues the issues that come out of that. We have similar processes in our tax practice, in our corporate finance services, in our insolvency practice and so on. They cover not just the execution of the work, but also our compliance with things like ethical standards, judgement calls and so on. Typical areas that we are involved with in our work is evaluated and reported on. If necessary action is taken to sanction people or learn from the experience.

S.C: It sounds like that you have not only a top down monitoring process, but also a collegial approach towards corporate governance?

D.C: Yes that is indeed the case and in some ways the results of our own internal review processes are made available to the regulators who do the top down reviews on us. They take some comfort from the rigour of the reviews that we are involved with internally.

S.C: Do you also have a bottom up approach? For example if employees have suggestions for the corporate governance regime do they have avenues to express this?

D.C: Absolutely they do. The whole issue about being open, about integrity and ethical values is something we take very seriously. It is a culture that permeates all the way down through the firm. The firm has very clear policies with regard to reporting. Well it is really formal reporting as there is no such thing as informal reporting whether it moral or not. A lot of that is related to the client work we do and the work that you are involved in if I understand it right is more to do with internal governance proceedings within the firm. I suppose in answer to that in theory everyone has a direct route through to the partnership committee-the thing that has been set up to provide the governance structure within the firm. Well I say in theory, but I do me in practice as well because the partners on the committee are distributed around the firm and they are accessible via email or one to one access if people have concerns or issues.

S.C: I carried out some research into Grant Thornton through your website before today, however I was not able to find any section on it that outlined the corporate governance regime of the company. Do you think you should have a section? As you know you carry out audit to you think that promoting your good governance regime will reassure your clients?

D.C: It is very kind of you to say it is a good governance regime

Laughter by both parties

D.C: Two things really. The website is not as advanced as errr the firm is so it is a valid criticism of the website that there is not something on there-it probably tells you something more about the website than our business. I don't think there is anything...because we publish in the transparency reports and the accounts our approach to governance if someone was particularly interested in the Grant Thornton approach, which I don't think is uniquely different to any of the other large LLPs, then it is there for them to see if they wish to dig deep enough. I wouldn't say that ours should in anyway be described as a template for others to follow. With regard to corporate governance generally, I don't know if you have picked this up, but we do other people's governance and we provide thought leadership in report form of corporate governance trends in the PLC arena. So we do publish these reports for those interested in corporate governance frameworks.

S.C: Do you think those kinds of firms looking for a company such Grant Thornton to come in and assess their corporate governance regime are interested in your corporate governance regime? Do you think that promoting your own corporate governance to the client and making them more aware of your situation will promote your position in the market or do you think clients already respect and know about Grant Thornton and so don't need that reassurance?

D.C: Again I don't think that they need to know precisely what our structure is or what our methodology for governance is. But what they do need to know is that we have got the competence, expertise and knowledge to provide them with the advice on their structures and their implementation. This is frankly why we do the thought leadership stuff rather than relying on what we are doing ourselves. I think the fact that we are having to run a corporate governance structure framework with Grant Thornton itself is a matter for us. Well you can seek some solace with clients on the basis that we are all cursed by the same set of circumstances or blessed perhaps by the set of same circumstances, but errr this is not a question of us saying that you have to do it because we say it, you have to do it and we have to do it as well. So lets all do it in the most effective and efficient way.

S.C: How do you think recent scandals such as Enron and Worldcom have affected your governance regime? What changes have you had to make and is governance more of an issue than in the past?

D.C: Quite simply the answer yes it is. What a surprise! Scandals have sought really only to provide a much greater level of emphasis on corporate governance, not just of in our industry, but in business as a whole. I suppose that from the point of view of our business we are simply caught up in the same global tide to hit the times that everyone else is. errmm what particularly Enron did was to give us a sneak insight into actually how fallible and how frail some of the businesses that have come up over the last decade are to accounting issues and reporting that are frankly little understood by the majority of people who are involved in sophisticated business. They have demonstrated the frailty of those and there is the related issue which is then the collapse of Andersens. Andersens should not be related directly to Enron-Enron was just one of many things that had come along and tarred Andersens, but that was the one that sparked their collapse. The speed of collapse of Andersens and the fact that it was a global collapse was frankly quite astonishing for all of us involved in the professional services business. It was quite astonishing. So I guess what those scandal did was that to both corporate companies and then to an extent to ourselves gave us the impetus to ensure or take measures that would help to prevent the same sort of thing befalling our own firm and our own business.

One would argue that corporate governance is one of the means by which you bring about some greater solidity in your organisation. So obviously it has to be considered a good thing albeit coming out of a set of unfortunate circumstances. Quite frankly I should not under state the importance in terms of global capital markets because frankly the functioning and policing of global capital markets has increased significantly.

S.C: Do you think future corporate governance within LLPs will take a more self-regulated or legislative approach?

D.C: Errr.. that is an interesting question. I think what is more likely is that the legal entity through which we do our business could change. So the LLP framework that we operate with at the moment may just be a stepping stone along the way. If you take for example the firm in the UK, Robson Rhodes, who are probably aware of?

S.C: Yes I have done some research into them

D.C: Well they are in serious financial difficulty and so their UK firm have just been acquired by, this might sound a bit bizarre, by their US firm. The US firm is owned by a large quoted financial services group in the US called H&R Block who are known for doing mass tax returns and so forth in the US. It is a large quoted company in its own right and so all of a sudden the individual entity that was Robson Rhodes LLP in the UK now becomes a subsidiary of a major US corporation, which means that they for example will have Sarbanes-Oxley to take in account when they are completing their financial reports next year. So that is an example of a changing structure that gives rise to a different form of management and corporate governance within the entity that is involved. It has been much mooted that firms like ours could decide, with enabling legislation of course along the way, to become public companies in our own right. Instead of being a LLP we would become a publicly limited company and we would float our equity on a capital market for whatever purpose. This would then give rise to a more refined framework of regulation and governance, which would then obviously be akin to those applied by listed companies. So it is quite possible that we will go down that route. I don't think as I sit here now that there is any real impetus for there to be a stricter framework or a more regulated framework for corporate governance within LLPs because at the present time I don't think there is any evidence that there is any failure or market failure in that

sense. Because of the sorts of organisations that we are errr, we are, as you have already hinted at, going along somewhere at the fore front of corporate governance best practice because we are in the business of dispensing advice with regard to corporate governance structure and so forth. So I think that the peer pressure of being in that type of environment brings about refinements where refinements are required in corporate governance structures... hmmm... and I think the other aspect that could give rise to change is a change in the status of the organisation.

S.C: Something that you touched on earlier....do you think that your governance regime is similar or different to that of the Big 4 and/or the other lower tier firms? Or is there just one single template that all professional service firms follow?

D.C: I have not researched it in any detail, but I do read the annual reports of other firms when I have some spare time to do so. My take on it would be that there is a fairly sort of standardised approach across most of the firms and that is simply because common sense dictates that the kind of structures that we are coming up with are the kind of structures that you would come up with if you were starting from a clean slate. So having come up with them I don't think anyone will go out and seriously re-invent the wheel. I think that they will all have aspects of representation, of committee work and sub committee work within the overall functioning of the partnership committee in our terms or whatever other companies might refer to it as. Who then have a link through to the management structure of the firm and place checks and balances on their work and activities.

S.C: That sounds great. Finally what do you think is going to be the greatest corporate governance issue that Grant Thornton will face in the next few years?

D.C: That could affect a firm like ours?

S.C: Yes. That is correct

D.C: If you were privy to the terms of reference of the partnership committee in our firm or a governance committee more generally if you need a more generic term, then the question would be what do they do in the event of something going wrong? And actually have they genuinely got teeth? Have they genuinely got the ability to influence and enact things when things are going against us or one of the other firms? That would be a true test of their metal and their value. Because certainly over the last 5 years or so while the whole conversion to LLPs has take place, it has been a fairly if not benign then favourable economy and as firms, grow, develop and expand, make money and make profits people are generally happy. It is where things go against us that management could become either more bold or daring or more abrasive or whatever in what they propose is the means of making the firm grow and develop. It will be at that point where a governance committee, actually in conflict with its management, could either prove its worth or prove futile and prevent the committee from carrying out the job it was designed for and doing what is ultimately right.

S.C: So what you are saying it is all well good having the governance structure in place, but this means nothing if it is not used properly?

D.C: Exactly. As I have mentioned before the firm Robson Rhodes will make a good case study at one point, but whether you would actually be allowed into the detail of exactly what happened there is another story. They were a firm with a turnover of £70-80 million who set out a couple of years ago to become a £200 million turnover company by 2007. They had very distinct stated policies about how they were going to get there, which included going into big consultancy projects and into areas of the market where they didn't really have any traction at all...where they didn't even have

the experience and what they proposed to do was to buy in all of that experience. I know from a personal association with people within Robson Rhodes that the Chief Executive who was implementing that policy was not well liked, trusted or anything of that nature within the firm. Well in fact many Robson Rhodes partners openly disagreed with him and so it is difficult to see that the corporate governance process within Robson Rhodes was a bit thin in the fact that it was enable to subdue the actions of this Chief Executive. This as I have said before, it is breaking news that has only happened in the last week, has led to the UK business being acquired by their American holding company and now they are effectively no more than a subsidiary. Maybe fortuitously it may be the right thing to be at this time, but I don't see many of the rest of us going down that route. So really the point is can the committees that have been established by all the different firms, can they actually change and influence things or are they for show rather than substance.

S.C: Well thank you very much for your time you have been very helpful.

D.C: That is ok. All the best with the dissertation

Interview 3-Deloitte

S.C = Simon Cooper (Interviewer)

B.W = Bob Warburton (Interviewee)

S.C: I think its best to begin with a brief history of my University career and an outline of my study. I will then start with a few introductory questions before going onto to ask you to discuss the corporate governance regime of Deloitte.

B.W: By all means.....go ahead.

S.C: I did my undergraduate degree at Nottingham University in Economics, which I finished last year and this year I have started my Masters in Corporate Strategy and Governance and as part of that I have to write a dissertation, which I am doing at the moment. One of the topical issues at the moment is corporate governance and a lot has been done in the past on Public Limited Companies and the issues surrounding this. I think now there is a movement to looking at governance in other organisational forms like Limited Liability Partnerships such as Deloitte. I am basically trying to test the waters because there is not much work done already into where companies such as Deloitte feel there governance lies, if they think it is an issue? And if their clients are concerned about it and what the next step in this direction is?

S.C: I think the best way for us to start is by you discussing your position in Deloitte.

B.W: I am the managing partner responsible for the finance and legal part of Deloitte's business. This involves making sure we meet accounting and financial reporting standards as well as overseeing internal governance controls within the organisation. I am also the secretary to the management board. In essence my job involves overseeing all commercial and legal aspects that the firm encounters.

S.C: That's great. Please could you go on to define what you understand by the concept of corporate governance?

B.W: Well for us corporate governance means the procedures put in place by Deloitte in order to ensure transparency and accountability within the firm. It is there as a check on the running on the firm to ensure that the strategy undertaken accurately represents the wishes of all partners in the LLP.

S.C: Please could you go on by briefly describing the corporate governance regime of Deloitte including what procedures you have in place to deal with governance?

B.W: We have two main groups involved in the running of Deloitte. The first is the Executive Group which is managed by the Senior Partner and contains executive partners from the company. Its role is to set and implement the strategy for the company, but is not directly involved in corporate governance. The principle body this is responsible for corporate governance within the firm is the Board of Partners. It is responsible for the promotion and protection of partner interests and for the oversight of management. In particular it approves Deloitte's long term strategies and has specific oversight of risk. It provides an oversight of the management and is responsible for dealing with all partner's affairs. The board is composed of the Chairman, the Senior Partner, both of who are

elected by the partners a further errrm 9, no I think 10 elected partners and five Executive Group partners proposed by the Senior Partner and affirmed by the partners.

S.C: You also have smaller committees don't you? I think I read in you annual report that you have audit, nominations and remuneration committees. Is that part of your board of partners?

B.W: Yes it is. The board operates on its own and through a number of subcommittees. For example the audit committee monitors all reporting, accounting, financial and control aspects of the executive management's activities. It reviews the policies and overall process for identifying and assessing business risks and managing their impact on Deloitte.....it also liaises closely with external auditors regarding the results of the audit. It comprises of non executive partners and the senior partner. The remuneration and nominations are similar committees who deal with pay and partner nominations respectively. There are also a number of ad hoc committees set up during the year to deal with certain issues. This delegates the responsibility down to a smaller number of partners which makes this process more manageable.

S.C: You also have a management executive that deals with overall running and strategy of Deloitte's business don't you?

B.W: Yes we do

S.C: Are the members of this executive also present on the board of partners?

B.W: Yeah they are, but the board of partners is made up of a majority of non-executives. That is partners not on the executive board. The Board of Partners comprises, as I have mentioned briefly before, of 17 partners. The Senior Partner is the Chief Executive and the Chairman is a non-executive. There are 15 other partners of which 5 are nominated by the Senior Partner

S.C: How long is each term for the partners and can they serve more than one term each?

B.W: The board members serve a two year term and can be re-elected whereas Senior Partners and the Chairman serve 4 year terms before they can go up for re-election if they so want.

S.C: Do you have an equivalent of Non Executive Directors on the Board? Do you think this is important?

B.W: We don't have any NEDs on the board.

S.C: What are your reasons for this decision?

B.W: We have the ability to take on NEDs and have done so in the past, but it is something that we think is not necessary as part of our governance regime. We have recruited outside members in the past, but this is something that we do not favour in the future. We have seen it work, but it is difficult to make it work effectively. In addition the Board of Partners deals prominently with Partner issues so outside influences would be of limited help. For example a lot of it deals with profit sharing, retirement and nomination issues and with over 600 partners this obviously takes time. As this board's role is quite different to that of a public limited company board it would be quite boring for non-executive directors (laughter)

What I am trying to say is that NEDs are not needed as unlike publicly limited companies the partners are the sole shareholders. Thus their interests will be represented by the partners themselves and so external controls of this sort are needed.

S.C: I read in your annual report about the ethical principles that you adopt within the firm. I was wondering you think these fit within your corporate governance regime?

B.W: Well it is an important part of our corporate governance procedures. We place a huge amount importance in proper behaviour in terms of the adoption of the ethical guidelines and code that we have in place. It is important as if we can get these established as second nature in the firm then it prevents some corporate governance issues appearing altogether.

S.C: To date we have just talked about the internal controls that you have within Deloitte, such as the audit committee etc., but do face any external corporate governance controls?

B.W: External controls...do you mean with regulators?

S.C: Indeed anything that helps control your governance from outside the firm. For example the takeover market within publicly limited companies.

B.W: Indeed we have to meet the guidelines and recommendations of a lot of different regulators within the industry. For example we have to meet the standards required with the Audit Inspection, with the FSA and many other regulators. Each section of our business has to meet some kind of regulation-if anything we are properly more regulated than publicly limited companies.

S.C: It is mentioned in your 2005 annual report that a governance committee was being considered for adoption? Has this occurred?

B.W: This was under discussion, but it was decided it was not needed. We believe that our Board of Partners fulfils this role. The Board as we would have, was reconstituted three years ago, and it became more of a governance committee at this time. It has been reshaped to be dominated by non-executives-what I mean here is those partners that are not directly involved in the strategic running of the board. As a result of this non-executive dominance it has become very corporate governance focuses making the board accountable for their actions. They do a great job in developing a quality debate and discussion with the executive in order to keep them in check. This involves review the executives work, making suggestions and questioning future strategies.

S.C: We have talked about the external regulation that you face from government bodies such as the FSA etc, but does the firm undertake any internal reviews itself?

B.W: Errr yes we do. We have our own internal audit department which carries out reviews within the firm. It is a key element of the continuous review of effectiveness of our system of internal control. It comprises of permanent staff and client serving secondees from our internal audit service line. The team provides both financial and non-financial processes and works closely with our external auditors. Thus internal and external reviews are closely linked. We also have a compliance department which considers all aspects of compliance within the firm ranging from FSA regulations to that of the ethical codes.

S.C: Those two seem top down monitoring techniques that you use within the firm. Do you also have bottom up procedures in place? For example if a staff member has governance concerns are

their clear passages they can take to communicate them to the Management Executive or the Board of Partners?

B.W: errr we have a local intranet where there are methods of communication with board members and the executives within Deloitte. In particular we have anonymous whistleblowing lines where any issues, corporate governance or others can be raised by employees, without the feel of reprisal.

S.C: Is there also a lot of delegation of control to local levels within the organisation?

B.W: The key thing for Deloitte is transparency in the operation of everything it does. We delegate responsibility and empowerment to local levels, but our very structure puts forward a mutual monitoring system where everyone is accountable to each other. Everyone is managed and supervised in order to make sure no governance issues occur. It is not a flat tier system, like in some traditional law firms, where each partner works separately with their own clients. Deloitte takes on the modern definition of a partnership where the structure emphasises accountability and transparency. To carry on as individuals, independent of each other, is a very risky approach which is simply not a sustainable or sensible strategy in today's business environment.

S.C: The way I started this whole project was to look at the websites of the main players in the professional services industry and although you do provide some clarification of your corporate governance stance in your annual report there is not actually a section on corporate governance on your website. Do you think this is important and is it something you need to promote to you clients or is it more an internal policy?

B.W: Well we set out in our annual reports how we govern ourselves. So I don't think we need to include anymore information on our website. I expect if clients wanted to know more about our corporate governance regime they would obtain our annual report and get the information from their.

S.C: Do you think promoting your successful governance regime would attract more clients or make the more confident in your ability to advise them?

B.W: ermmm...yeah I think we are always a bit wary of promoting our governance regime to other companies. This is because we recognise that different business entities have different structures ranging from partnerships to public limited companies and so on. These different structures have different governance risks associated with them...for example banks have the responsibility of looking after other people's money whereas the governance regime of partnerships is concerned with providing a check on the management of the company. It would be inappropriate for us to say our corporate governance regime was a template for others to follow. We would not want to say that-it has been designed solely for Deloitte and not for any other company.

S.C: How do you think large corporate scandals of recent years such as Enron and Worldcom have affected you and your governance regime?

B.W: It has undoubtedly made us more proactive towards our governance structure. You can see that there has been a huge amount of additional focus on the regulation in place. However I think that the impact has been more in the corporate arena where the incident actually occurred. I don't think it caused any real issues within the professional services sector as despite a lot of speculation about increase litigation against Deloitte and the other Big 4 this did not actually occur.

S.C: One of the major issues resulting from Enron was the conflicts of interests that Andersen had while working for the company. Has the fallout from Enron had an affect on this?

B.W: I don't think it sparked the issue of conflict of interest as this had been a concern for a long time, but it did highlight the massive consequences of not being vigilant in this area. This is why Deloitte is extremely cautious in ensuring that we avoid any conflicts of interest when they take on work. This great caution has led us to turn down work in the past, but has also provided new opportunities where other firms have had to turn down the work of a particular client. There has been no question that this has improved in recent years...there was a time where professional service firms accepted engagements that would be simply unworkable nowadays. The corporate governance environment has changed and become stricter...Enron and other scandals are probably a factor in this, but just one of many

S.C: Do you think future governance arrangements within limited liability partnerships will take a self-regulation form or become more formalised through laws and legislation such as Sarbox in the US?

B.W: errrm I think that corporate firms have shareholders to protect whereas we are both the owners and managers of our company. As a result of this I don't think there is so much pressure for the government to take steps to put more formalised regulation in place....there will not be a mad rush to improve corporate governance within limited liability partnerships. I don't think there is a need for much more regulation as I think that most of the professional service companies are doing a good job in promoting their transparency and accountability. There is a fine line between too much legislation to ensure strict corporate governance regimes and a stifling of the growth of companies by having too many boxes to tick so to speak. I think the government will be concerned that even though a good corporate governance regime should be in place Deloitte and the other professional service companies should not be bogged down in achieving this.

S.C: Do you believe that your corporate governance structure is different to the other professional services companies, including both the Big 4 and the tier below? Is so how are you different?

B.W: Well I believe that we are more advanced than the other Big 4 companies in terms of corporate governance. Not only do we have the Board of Partners, but I think I am right in saying we are the only one of Big 4 that has a separate chairman and senior partner. Furthermore I think the size of our Board of Partners is greater in numbers than most of the other professional service companies especially the number of non-executives present on it. I know less about the corporate governance regimes of the smaller firms like Grant Thornton, but I pretty sure we are leading the way in this field. The good corporate governance regime that we have in place is important as it reassures the partners we have in the firm. It makes them more comfortable and confident in Deloitte.

S.C: Finally what corporate governance issues do you think that you will face in the future is any at all?

B.W: errrrmm..I am not sure that there are many potential challenges within our corporate governance regime. Instead I believe the challenges will stem from the regulation we have to adhere to rather than the governance itself. As regulation changes we have to make sure we are at the fore front of our industry anticipating and dealing with these change as they occur.

S.C: Speaking to other companies in the industry the concern seems to be that even though you have corporate governance measures in place does this guarantee their effectiveness?

B.W: Ours does a great job. It was designed to deal with corporate governance and it does this effectively and efficiently.

S.C: How do you ensure that it maintains its effectiveness?

B.W: We have a board evaluation process in the firm that looks at the effectiveness of the board as a corporate governance instrument. It challenges the board against its objectives and assesses its effectiveness at both an individual and board level. On the board each member knows the responsibility that they have and so board members are accountable and at both a group and individual level. This makes sure the Board of Partners works effectively and provides the opportunity to put forward new ideas and improve areas of governance where weaknesses have been found. It is a continuous learning process that must adapt over time to ensure successful governance for Deloitte now and in the future.

S.C: Well thank you very much for your time. You have been very helpful.

B.W: No problem at all. Best of luck with the rest of the dissertation

Interview 4-PKF

S.C = Simon Cooper (Interviewer)

T.M = Tom Morton (Interviewee)

S.C: I think its best to begin with a brief history of my University career and an outline of my study

T.M: Fine please proceed

S.C: I did my undergraduate degree at Nottingham University in Economics, which I finished last year. After completing this I began a Masters in Corporate Strategy and Governance again at Nottingham. As part of this Masters I have to write a 20,000 word dissertation, which I am doing at the moment. One of the topical issues at the moment is corporate governance and a lot has been done in the past on Public Limited Companies (PLCs) and now I think there is a movement to looking at governance in other organisational forms like Limited Liability Partnerships (LLPs) such as PKF. I am basically trying to test the waters because there is not much previous work done into LLPs and see where companies such as PKF and KPMG feel their governance lies.

S.C: I think the best way for us to start is by you discussing your position in PKF?

T.M: I started off at PKF in our audit and assurance division and eventually made partner about 11 years ago. I am now one of the elected members of the national board of the LLP. Our structure obviously changed when we became a LLP so we have a board errrr made up of both executives and non-executives, largely made up of the former. We are in LLP terminology known as the elected management so to speak. I am sure you know by now, if you have visited other people, a partnership works differently from a company. We have a different mentality to that of a publicly limited company for example.

S.C: Could you please continue by explaining to me what you understand by the term corporate governance?

T.M: Well it's the whole system and structure in place to ensure companies adhere to regulations and that they are transparent in and accountable for all the work that they carry out. It also involves putting in place measures which overcome any conflict within the firm

S.C: You briefly mentioned that you have an equivalent of a board, but what other internal corporate governance mechanism does PKF have?

T.M: Well it is effectively all done through the board because we have an Audit Committee, a nominations committee and a remunerations committee. These are all subset of the main board.

S.C: Who sits on these various committees-execs or non-executives?

T.M: Well the audit committee consists of 3 non-executives and non-executives are the majority in the other sub committees. The divorce between ownership and management that is common to a PLC only occurs to a certain extent within a LLP. So in a LLP the managers are also some of the owners so they are accountable to their fellow owners. So whilst there is a clear distinction between the two it is all linked together. The ownership and control is much closer than that of a publicly

limited company. The purpose of good corporate governance within an LLP is effectively to look out for the interest of its members. It is designed to keep the executive directors, in particular, in check. It is as one colleague put it 'like being married to a 100 people without the fringe benefits' (laughter).

This was what the essence of Smith and Higgs etc intended. That ought to be second nature to a limited liability partnership who wishes to conduct their business in good faith and so therefore behaving ethical as a member of this business should come naturally. I think that the Big 4 in particular are so large that some governance procedures need to place to ensure that a fair representation of all partners' views are made within the respective firms.

S.C: Do you have the equivalent of non-executive directors in PLCs from outside the firm within the PKF governance set-up?

T.M: We don't have outside non-executives. Grant Thornton do don't they?...we are Grant Thornton's auditors by the way.

S.C: Yes I discovered that in an earlier interview. Would you consider having non-executive director equivalents in the firm in the future?

T.M: It is not something that we have considered so far.

S.C: Is there any reason for this?

T.M: I personally do not think it would be bad idea and so it may happen in due course. Partnerships tend to be a very secretive culture. I think it is probably fair to say that errr that the majority of firms within the industry do not have non-executive directors from outside the firm. I think to some extent the fact that we are the managers and owners and so are looking after our own interests' means that there is less need for an impartial independent executive. On the other arguably the value of an external non-executive is that they are more effective as they do not know your business. Thus they can not only bring expertise to the firm, but also a fresh opinion to board room. Well it will be interesting to see if that practice spreads out through the whole of the professional services industry.

S.C: To date you have mentioned the board and the audit committee and so forth which are top down approaches towards governance. Do you have any other governance mechanisms at lower levels such as internal views or monitoring of work that different partner's undertake?

T.M: Oh yeah we have all sorts of procedures in place ranging from internal reviews, quality audits and so forth that are there to make sure standards are met within the firm. We also have a dedicated risk management department and encourage mutual monitoring within the organisation.

S.C: Are these new procedures since becoming a LLP?

T.M: No...these types of internal governance mechanisms are driven by professional standards rather than our limited liability status. We need make sure we have these procedures in place to meet the standards that clients expect of us...it is part and parcel of ensuring our competitiveness within the professional service industry rather than being solely a governance issue.

S.C: So do these internal controls for governance link in with the external measures, if any, that are in place to ensure an effective governance regime?

T.M: Errr..yeah we are regulated by the FSA and the QED and various other provisions. So we are heavily regulated probably more so than PLCs. The DTI have also recently released a working paper encouraging greater openness and transparency in the professional service industry.

S.C: Do you have any mechanisms in place that promote bottom up governance so employees can suggest improvements within your governance structure.

T.M: Well we have a number of different channels ranging from whistleblowing hotlines to bi-annual feedback meetings with staff members in order to make sure there is a direct line up to the board and managing partners. We try and make sure that there is a collective responsibility for our corporate governance regime and in light of this encourage discussion within this area. We believe that every idea and criticism should be listened to so that improvements can be made within PKF- you have to recognise that there is always room for improvement.

S.C: When I started this investigation I began by searching your Internet website to see what information there was on your corporate governance regime. However there seemed to be nothing on the website regarding your own corporate governance. Is that something you feel you need to let the clients know or do you think that by your reputation alone that is something they already know?

T.M: Firstly I am not surprise that we do not have a section of our website. Information will be available in our annual report when we file it later this year. I don't think we have considered or will consider in the future putting a section discussing our corporate governance regime on our website.

S.C: Do you think your clients want or need to know about your corporate governance regime? Do you think that by you showing your good corporate regime that they will be more confident in employing you as someone to help them with their governance or in other lines of work?

T.M: It certainly can't help.....errr I mean hurt. Frankly I doubt many clients are concerned with our governance regime. They already assume that we are honest and independent..it is a given and in the same way they automatically assume, as a result of external regulation and quality control, that we are good at what we do otherwise they would not employ us.

S.C: Do you think it could gain potential new clients, by differentiating yourself from the rest of the professional service firms through corporate governance?

T.M: I can't see why...you are trying to demonstrate that you are more ethical than the next firm aren't you? But if they assume that you are all ethical anyway it seems a waste of resources. I cannot remember what the marketing people call it exactly, but it is not a differentiating factor within our business. That is not to say it is not important...it is extremely important, but the clients have seen this anyway. You can argue the same for the banks and the building societies as they are required to demonstrate and disclose their governance mechanisms. That is because they are dealing with the public's money you see. I am the auditor of a building society and so know the ins and outs of how the work. The key difference between them and us is that we don't have any outside investment.

S.C: So you are looking at representing the public's interest in the case of a building society for example?

T.M: Yes...the public has an indirect interest in all business organisations, but it has no direct interest in LLPs. We have no outside public investment so governance does not need to be promoted as much as in PLCs. This may change as I believe that under current LLP law we are allowed outside investors, however I don't see this happening as there is little incentive for entrepreneurs to invest in a secretive entity that they will know little about and have little effect on its running. If this external investment did occur however, the whole way we promote our governance to the rest of the world would have to change drastically. Our transparency we have to reach a new level be this through self-regulation or legislation.

S.C: A number of other professional service companies have introduced a separate entity to deal with their governance concerns-a "governance committee" if you will. Is that something you would think about?

T.M: We might...but I don't think it is necessary at the moment. I personally don't see the need for or the theory behind separating the strategy and management of a company from its corporate governance. They don't have a separate board and governance committee in PLCs do they? I don't think it is healthy for governance to be so over bearing that it stops companies performing their primary task of running their business...not that I think it is in this country. It is probably about right in terms of the level of governance regulation, codes etc. that you have to meet. This obviously affects what directors or managers of companies are allowed to do.

I think the whole concept of non-executive directors for public companies is a very interesting subject. They are suppose to have the same role and responsibilities of executive directors, but yet they are not permitted to have the same information, privileges as executive directors. They also often face the time constraints of being part time members of the board. This puts these non-executive directors in a difficult position. Lord Wakeham, a non-executive director of Enron, is now facing financial difficulties as a consequence of the role he played within the company despite the lack of resources he had available to him.

S.C: Do you think in the future any corporate governance regulation for LLPs will take a more self-regulatory or legislative form such as Sarbanes-Oxley in the US?

T.M: I can't see why it should take a legislative form if there is no public money involved. There is a trade off to having a limited status which is that, you know, that you have make your accounts publicly available etc. and become transparent, but you no longer face liable action for other partners' actions. The whole industry is like a big ship with the regulation being the weed attached to its hull which slows it down. Maybe there needs to be a streamlining of what regulation we have to obey. For example in the public domain if you read any annual accounts they are getting longer and longer and harder and harder to understand. There is therefore a query over whether the shareholders actually read them? Is there simply too much information?

That is not to say that any individual part of that information should be removed...it is very hard balance to decide what should or shouldn't be kept in. What then tends to happen is that you next step will be that in addition to this wealth of information a PLC overview will be included which

highlights the main issues for those stakeholders that have interests in the company. This is what most of the public look at.....and so may be suitable for LLPs.

However as it is in the nature of governments to pass legislation, which itself is not a healthy thing, one cannot rule out future corporate governance laws within the LLP framework.

S.C: There have been a number of scandals in the last 10 years such as Enron, Worldcom. How has that affected your governance regime? Has there been a call for more stricter governance rules or more pressure from clients to adhere to greater governance levels?

T.M: I am tempted to say that some of us have always behaved properly. Well I hope that these scandals have reminded some of the clever clogs in the city that independence and ethical behaviour is extremely important. There may have been a greater focus on ethical rules since these scandals, but at the end of the day it is down to individual people...I may be easy for me to say, but that is what I believe.

I think it wasn't good for the profession in the short run, but these things happen within the economic cycle.

S.C: How do you think your governance structure is different from any of the big four or smaller tier firms such as Grant Thornton?

T.M: I don't know to be honest. I doubt it is very different...it is designed to balance the interests of PKF and is fairly straight forward and simple, but it seems to work well. I think the key to our corporate governance system, which is different to public companies and may be different to other LLPs is that we have recognised that governance is not simply mechanisms in place, but has to be a culture that transcends the whole of an organisation. For example unlike PLCs where directors, within the rules of Law, can direct all employees to carry out their strategy we cannot simply order our partners about. We can't tell them what to do as if they don't like our policies they simply won't do it. It is quite like "herding cats". What we therefore do is open up communication channels and develop a culture where partners are not ordered in a direction, but are convinced that the best way forward for PKF is being taken. Regular partner meetings, exchanging of information and mutual monitoring help encourage a culture that promotes effective governance. It is difficult to explain, but if you ever become an employee here you will know what I mean.

S.C: Finally what do you think is going to be the greatest corporate governance issue that professional service firms will face in the next few years?

T.M: I think succession is going to be an issue; however this is not really to do with governance. I would like to think that our structure will be a success in promoting effective and efficient governance within PKF. The only issue that could be a problem is that we become stagnant in the governance regime and don't continue to change in light of the evolving business world. It is important to continue to review our corporate governance regime in order to make sure it is effective and make changes to it when they are called for. For example we may adopt a governance committee in the future if circumstances make it appropriate. Furthermore we need to ensure that not only are our governance mechanisms in place, but that they are also effective. So in essence we need to continue to reassess and review our corporate governance structure in order to keep it at a high and effective level.

S.C: Is there a fear that another Big 4 failure may occur and what effects this might have for the rest of the industry?

T.M: Well we can't do anything about that errrr... the gap in size between us and the Big 4 means that we are effectively in a different market place with some overlap. It all goes back to our sphere of influence and our sphere of concern. We are concerned about a lot of things including a Big 4 failure, however there is nothing we can do about it so we have to concentrate on running our own corporate governance regime.

We think continuing our independent and ethical reputation within the professional service industry is our key governance goal in the years ahead.

S.C: What do you think your biggest change in governance terms, if any, that has been made since you became a limited liability partnership?

T.M: Well I guess the most obvious is the publishing of our accounts, which I welcome. Without being unkind to my fellow professionals at other firms it good thing that accounts are being independently checked and prepared on the same basis. I think it is a very healthy development really. I think increased transparency is a good thing. In these accounts we are not legally bound to make information concerning our corporate governance publicly available, but I think the DTI have just published a report that encourages firms that are LLPs to disclose their governance arrangements. So in the future this may be something we are legally bound to or just be part of voluntary disclosure....only time will tell.

S.C: Well thank you very much for your time...you have been very helpful.

T.M: No problem at all. It is a very interesting topic and I have enjoyed talking about it. The best of luck in your write up.