

Research Specification: Understanding barriers to entry, exit and changes to the structure of regulated legal firms

Purpose

The purpose of this research is to explore the barriers to the effective operation of the market(s) in which legal firms operate and identify ways in which regulators or representative bodies could improve market(s) functioning.

Background

The LSB has been set up to reform and modernise the legal services market in the interests of consumers, enhancing quality, ensuring value for money and improving access to justice across England and Wales. The LSB will achieve this pursuing its regulatory objectives¹ and providing regulatory oversight for the eight approved frontline regulators². All approved regulators share these regulatory objectives. The ability of new firms to enter the market and other firms to leave the market with no unnecessary barriers is crucial to the operation of the market and directly relevant to our regulatory objectives e.g. promoting competition in the provision of services; encouraging an independent, strong, diverse and effective legal profession.

The Law Society is the independent professional body, established for solicitors in 1825, that works globally to support and represent its members, promoting the highest professional standards and the rule of law. The Society has 160,000 individual members in England, Wales and around the world and 11,000 member firms operating in domestic and overseas markets.

One of the main aims of the Society is to support solicitors. This is a time of major turbulence and it is likely that many solicitors will find their business models under pressure and some may seek to leave practice or establish new practices. It is important that the Society should be able to understand in more detail the nature of the barriers faced by such firms, their purposes and possible alternatives. This will put us in a better position to support voluntary orderly exit by members while ensuring proper protection of the public.

This research is particularly concerned about small solicitors', firms with significant concentration of Personal Injury work and conveyancers' practices; by this we mean solicitors' or conveyancers' practices with fewer than 25 partners (around 98% of solicitor practices according to latest Law Society figures – see Table 1 below). Though the research (particularly the recent high-street research) may identify particular sizes of solicitors practices where problems are more prevalent.

¹ <http://www.legislation.gov.uk/ukpga/2007/29/section/1>

² The Law Society, General Council of the Bar, Council for Licensed Conveyancers, The Institute of Legal Executives, The Chartered Institute of Patent Attorneys, The Institute of Trade Mark Attorneys, Association of Cost Lawyers, Master of the Faculties.

Table 1: Solicitors private practice firms 2011

Number of Partners	Number of firms	As a %age of all Legal Practices	Number of Solicitors	As a %age of all Solicitors at Legal Practices
Sole Practitioner	4,599	45%	7,549	9%
2-4 partners	4,199	41%	19,178	23%
5-10 partners	895	9%	13,132	15%
11-25 partners	323	3%	11,591	13%
26-80 partners	135	1%	15,315	18%
81+ partners	50	0%	21,208	23%
All firms	10,202	100%	87,973	100%

Source: Trends in the Solicitors Profession, Annual Statistical report 2011, The Law Society

Recent events, including (among others) the contraction in the housing market (halving the number conveyancing transactions, while the number of firms undertaking conveyancing has remained constant), improved information available online in legal services such as probate, the planned reduction in legal aid funding, etc. have all increased financial pressures on legal businesses. At the same time the introduction of Alternative Business Structures has provided new competition and opportunities for firms seeking alternative sources of finance or market opportunities.

The ability of firms in any market to open, close or change structure or change regulator is of vital importance to the health and competitiveness of the market. Market flexibility allows successful firms and business models to grow and innovate, while unsuccessful firms leave the market. This supports the efficient allocation of capital, ensuring that consumers can get the legal services they need, in the way that they need, at a fair price. Market flexibility entails both removing unnecessary barriers to firms entering the market and ensuring that those firms looking to exit do not face unnecessary barriers. This flexibility both supports the wider government growth agenda and allows for greater choice for consumers. As the market for legal services is facing a multitude of new challenges the ability of market to react and allow firms to open, close or change structure becomes paramount to the success of the legal sector. Changes in legal firms may have significantly different impacts in different areas of the market, research the LSB published by OXERA³ gives a guide to the type of segmentation needed in any analysis.

It is likely that many of the barriers to exits provide clear benefits to consumers who might otherwise be disadvantaged by firms exiting the market without first ensuring adequate protections are put in place. Indeed, the balance between protection of consumers and avoiding placing unnecessary burdens on the profession is at the heart of the challenge of regulation.

Firm responses to the challenges they face will vary significantly: recent research with solicitor firms⁴ found 6% of firms were intending to seek external investment and 31% of firms were considering withdrawing from one or more areas of legal aid work in the next three years. Inevitably already significant churn in legal businesses will increase. In the 12 months to July 2012, 1,006 solicitors firms opened, while 380 firms closed⁵. In response to strategic or economic changes

³ <https://research.legalservicesboard.org.uk/wp-content/media/A-framework-to-monitor-the-legal-services-sector.pdf>

⁴ <https://research.legalservicesboard.org.uk/wp-content/media/time-of-change-report.pdf>

⁵ http://www.sra.org.uk/sra/how-we-work/reports/data/firms_opened_closed.page

a firm may choose to close, restructure (including demerging some departments), merge or be taken over. A potential concern for solicitors is that significant costs are imposed on individuals wishing to close their businesses, at a time when many are shutting because of a lack of profitability within the firms. Such barriers may prevent firms from closing and lead to the continued operation of unprofitable firms or firms where the owners wish to retire, within the market. This in turn may increase regulatory risks.

In a market with so many changes occurring simultaneously, barriers to entry, exit and changing structures of firm could present a significant impediment to the efficient allocation of capital. This in turn could have a significant detrimental impact on the Regulatory Objectives given to the LSB, most obviously “improving access to justice”, “promoting competition in the provision of services” and “encouraging an independent strong, diverse and effective legal profession”.

Aims and Objectives

This research aims to explore the regulatory and other barriers in the legal market(s) to solicitor practices closing, merging or otherwise changing their legal structure. Building on this the report should consider ways in which regulators or others could support improved market flexibility.

The research should:

- Identify barriers to market flexibility in the entry, exit, merger or other changes in business structure (e.g. mergers between solicitor and conveyancer firm), ownership or finance.
- Identify the specified or implicit aims of barriers and their cost/benefits
- Assess the extent to which the barriers protect consumers or meet other intended aims
- Assess alternative options to meet intended aims and assess their efficacy and their cost/benefits
- Consider any additional measures, whether regulatory or from The Law Society or Government, that could be introduced to enhance market operation

The objective of the research is to identify where regulators could seek to reduce or change regulation with the aim of better meeting the Regulatory Objectives. Equally the report should consider whether other measures could be considered regulatory or professional bodies or Government (e.g. potentially subsidising firms seeking to close, tax incentives) could help enhance market efficiency. The report should provide a clear analysis of the barriers and options for change.

Issues and scope

The research should use a combination of desk research and interviews, including with regulators, professional bodies, insurers, providers of business capital, and potentially those who are regulated, to provide a detailed and robust analysis of the barriers to entry, exit, merger or other changes in business structure, culture, ownership or finance. It should analyse the source of the barrier (regulatory, statute etc.), the detail of its impact including how this impact might vary across different firms e.g. sole practitioners, partnerships, other corporate structures. The research should also identify which types of structural change are most impacted by specific barriers. Barriers identified might fall into one of the following four categories:

- Those not focused on a clear objective and so largely unnecessary

- Those focused on a clear objective but the objective could be achieved in a more proportionate alternative way
- Those focused on a clear objective, well designed, but through poor delivery prove disproportionate
- Those that are both focused on a clear objective, proportionate and well delivered

The research should cover all solicitors firms, but with a particular focus on small solicitor practices as this is the area where we believe barriers are likely to be most significant. It may be that using the results from our high-street research the researcher will be able to target analysis at those firms most likely to be affected. Equally the OXERA segmentation model may help segment further the market for analysis.

There are a range of current requirements on firms seeking to exit the market, there are summarised in the SRA practise note⁶, though broadly summarised as ensuring “close down in an orderly and transparent manner”. Particular issues that the research should seek to cover include:

- Required run-off insurance cover
- Duties to clients in the event of close down
- Retention of records after firm closed
- Requirements on firms to ensure the suitability of buyer
- Market for individuals or firms looking to purchase solicitor firms
- Legal requirements on dissolving partnerships
- Tax liabilities on firms seeking to close or dissolve partnerships
- Run off requirements where firms are transitioning to a new business form e.g. solicitor firm to conveyancing firm

Some of the barriers to the efficient operation of the market will be based on sound logic and necessary consumer protections, therefore it will be important for the research to take a robust, and where possible empirical, approach to understand and challenge the benefit of having such barriers. The research, in looking at the aims of barriers, should consider the extent to which barriers support valid consumer protections, and the extent to which these consumer protections in practice are effective.

The research should consider options to offset the barriers and increase the efficiency of the market in allowing changes in firm structure. Options that may be considered include changes to regulatory requirements e.g. changing minimum insurance requirements; subsidies from The Law Society to support firms looking to close down; changes to tax law, etc.

The researcher should consider both how it will engage with the professions to understand the barriers, but also how to engage with those with experience of the impact of disorderly firm closure.

Tender Evaluation Criteria

All projects commissioned by the LSB are subject to our standard terms of contract. Tenders will be evaluated on best value for money and will be assessed on the basis of:

⁶ <http://www.sra.org.uk/solicitors/code-of-conduct/guidance/Closing-down-your-practice.page>

1. Overall cost. Please include appropriate breakdowns
2. The extent to which tenders are clearly written and meet the specified objectives, present a sound methodology, identifying any potential problems, and proposing suitable solutions
3. Address outputs and ensure these are in line with requirements and the required timing of the project
4. Proposed team composition, expertise and management and the organisation's diversity policy
5. The ability of the research team to write about complex technical issues in clear accessible language
6. How diversity issues would be addressed in the research.

Deliverables

Output

The output for this research should be a report with executive summary, suitable for publication, summarising:

- Barriers to market flexibility in the entry, exit, merger or other changes in business structure (e.g. mergers between solicitor and conveyancer firm), ownership or finance.
- The specified or implicit aims of barriers and their cost/benefits
- The extent to which the barriers protect consumers or meet other intended aims
- Alternative options to meet intended aims and assess their efficacy and their cost/benefits
- Any additional measures, whether regulatory or from The Law Society or Government, that could be introduced to enhance market operation

Project plan

Tenders should include a project plan and time schedule for the work that identifies the main task and key milestones that will be used to monitor progress. The plan should be accompanied by a resource profile, giving a breakdown of the resources in person days allocated to each task. We would also expect the tenders to include a clear analysis of the potential risks and how they propose to mitigate them during the project. We value tenders that are short and concise.

Duration

The research should commence in April 2013. Tenders should set out dates for completing key milestones such as information gathering, analysis, synthesis and report writing. The report should be finalised by 28 October 2013.

Legal Services Board Contact Details

Tenders with any queries about the research specification should contact:

Alex Roy 020 7271 0060

Tenders must be submitted by 5pm on Thursday 28 March 2013