THE BENEFITS OF MULTIPLE OWNERSHIP MODELS IN LAW SERVICES

JULY 2005

James Dow[1]
Carlos Lapuerta[2]

[1] Professor of Finance, London Business School, Sussex Place, London NW1 4SA, 0207-262-5050, jdow@london.edu

[2] Director, The Brattle Group Ltd., 198 High Holborn, London WC1V 7BD, 0207-406-1700, Fax: 0207-406-1701, carlosl@brattle.co.uk

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Introduction and Executive Summary

The Department of Constitutional Affairs has asked us to assess the potential benefits and costs of permitting legal service providers to fund their practices with outside equity. We first discuss the relevant conditions that might justify the prohibition of certain ownership structures. Concerns over service quality justify government intervention in many industries. Members of the legal professions have cited quality concerns in the debate over outside equity. However, government intervention can be costly to society. The government should intervene the minimum amount that is consistent with the protection of the public interest. In most cases the appropriate level of intervention involves direct regulation of conduct rather than prohibiting particular ownership structures.

Restricting the type of ownership structure is a blunt instrument for ensuring service quality. Government restrictions may not be justified even if a particular structure tends to reduce the level of service quality. The particular structure may enjoy commercial success if it offers sufficiently lower prices to consumers, and if consumers prefer to sacrifice some quality in exchange for the lower prices. Alternatively, a government restriction may be unnecessary if a particular ownership structure might fail in the market independently, for failure to offer consumers a sufficiently attractive combination of price and quality. To justify the prohibition of a particular ownership structure, the government should anticipate that it would degrade service quality to unacceptable levels, while simultaneously flourishing in the market over a sustained period. We find no reason to believe that outside equity might degrade service quality unacceptably while simultaneously flourishing in the market.

In the existing debate over service quality, we see insufficient appreciation of the conflicts of interest that currently confront both limited partnerships and sole practitioners. Lawyers today have direct financial incentives to sacrifice service quality and ethics for the sake of significant short-term financial gains. The introduction of outside equity could mitigate such problems, as the separation between ownership and management reduces the incentives of the manager to maximise profits. Temptation abates when our own investments are not at stake. Also, large corporations can have especially strong incentives to prevent or discipline the misconduct of individuals, because one scandal can harm an entire corporation’s reputation and business.

The legal profession is crucial to society, but its importance and conflicts are not unique. Many industries face conflicts between the ethical obligations of service providers and their short-term commercial interests. In many cases the conflicts have serious implications for society as a whole. Ensuring safe air travel is an important ethical obligation of a commercial airline. Short-term commercial interests may favour curtailing maintenance and safety expenses. In many cases we place greater trust in the largest airline to exceed minimum safety regulations, and we have greatest concern with the little-known operations of the small company. Such examples suggest that natural consumer preferences can incentivise large profit-maximising corporations to exceed minimum quality standards.

Permitting outside equity should not imply the relaxation of rules concerning conflicts of interest. In our consultations we have heard concerns that inappropriate owners might purchase

equity in law firms. Such concerns could justify screening applicants who propose to invest equity in law firms. Experience indicates that regulators can perform such checks adequately.

Economic theory indicates that partnerships may provide an inefficient mix of high quality at excessive prices for certain types of services, while providing more efficient service than corporations for others. A key factor is the difficulty that consumers face in evaluating service quality. Corporations may be superior for those aspects of the law where quality is relatively easy to evaluate, and partnerships may dominate for more complex and customised legal services. We explore but reject the possibility that partnerships might face extinction despite superior performance to corporations, as senior partners "sell-out" their firms to large corporations. If partnerships are efficient, they would be likely to persist despite the possibility of outside equity ownership. Economic theory suggests that a new type of ownership structure might evolve, which resembles a partnership with the lawyers owning the majority of stock, but where a minority of shares trade on a stock exchange. Such a structure could be as consistent with high service quality as existing partnership, while proving more efficient and stable. Since the optimal ownership structure may differ for different types of legal services, blanket prohibitions on particular structures would be mistaken.

The most significant benefit of outside equity would involve the ability to fund the introduction of more information technology to reduce the costs of personal legal services that involve relatively small but numerous transactions of a similar nature. Conveyancing provides an example. Some corporations like the RAC enjoy strong brand names among consumers, have expertise in information technology targeted to serving individual consumers, and have sufficient capital to invest in the transformation of personal legal services. Similar transformations have occurred in parts of other service industries such as accounting and banking, and have coincided with shifts from partnership structures to corporations. Under the current rules governing the legal profession, similar transformations are unlikely for a variety of reasons. The large law firms with access to capital do not specialise in personal legal services, and do not have the brand names or expertise in information technology that would help transform personal legal services. Lawyers who specialise in personal legal services cannot co-operate efficiently with large companies like the RAC simply by signing contracts that fall short of full ownership integration. The only alternative would be for the providers of personal legal services to raise debt, but debt faces several restrictions relative to equity. Permitting outside equity would be key to the introduction of more information technology.

1 Why should government regulate ownership structure?

There are several possible "structures" for delivering goods and services: a limited company, a partnership (limited or unlimited), a sole proprietorship and others. In any given market, one structure may emerge as more suitable and may come to dominate the market: newsagents are often sole traders and airlines are usually plc.'s. Different structures may sometimes co-exist, perhaps in different niches within a broader market. In a capitalist economy, it is not normally necessary or desirable for the government to determine the optimal structure in each market, and then to mandate the optimal structure through regulation. We simply expect suitable ownership structures to emerge as a result of market forces.

Intervention is justified in several industries to ensure service quality, because individuals have difficulty evaluating quality before purchasing a particular good or service. Examples include regulations to ensure safe air travel and regulations imposing certain hygiene standards on food vendors. Service quality has emerged as a key theme in our consultations with representatives of the legal services industry. We explore whether alternative ownership structures would provide a more or less efficient level of service quality.

Mandating a particular ownership structure is a blunt tool for promoting service quality. Such intervention is likely to be costly because it may be based on inaccurate hypotheses, it may have side effects, and cannot adapt quickly to economic change. The costs of regulation support adopting the least interventionist approach consistent with the protection of the public interest. In many industries, the government minimises intervention by permitting flexibility in ownership structures while regulating service quality directly.

The government should only prohibit specific ownership structures that can be reasonably anticipated to persist in the market profitably, while simultaneously degrading the quality of legal services below acceptable levels. Even if one form of ownership structure leads to inferior quality service, this certainly does *not* imply that government should prohibit that structure. Two possibilities exist. First, the lower quality service might be more efficient, desired by consumers because of its lower price. Some people are willing to pay extraordinary prices for the highest quality car, while others prefer lower quality at a lower price. Second, if a particular ownership structure provides undesirably low service levels, natural market forces may suffice to prevent it from succeeding in the market. Government prohibitions make sense only if particular ownership structures would thrive in the market place over time despite degrading service quality to unacceptable levels.

All change risks benefits and costs. In our consultations we heard that errors in the provision of legal services have particularly grave consequences. However, the prospect of errors is not sufficient to resist change. The existing legal system also produces errors. It would be a mistake to focus on the potential errors caused by change, when the existing system also makes errors. A proper analysis should consider the totality of benefits and drawbacks of the proposed system relative to the existing system.

2 Service quality

2.1 The Role of Commercial Pressures

Almost all of the argument we have read and heard concerns the conflict between service quality, ethics and commercial motives. An extreme point of view is that liberalising ownership structures would introduce powerful commercial temptations to degrade the quality of legal services.

Some of the existing debate seems to ignore that sole traders and partnerships face conflicts between short-term commercial gain and quality. The responses to the Clementi report include some specific instances of unethical behaviour such as stealing from clients. Such behaviour would seem less likely, not more, if a plc provided legal services. A key strand of economic thought is called “principal/agent theory”. The shareholder of a corporation is a “principal”, and

the “agent” is a manager whose behaviour affects profitability. Economic theory and evidence indicate that the agent is less likely to maximise profits when someone else’s investment is at stake. If commercial interests corrupt, they are more likely to do so when a solicitor’s own investment is involved.

We consulted the Law Society in connection with this report, and learned that sole practitioners commit a disproportionate of the crimes against consumers. The disproportionate number of crimes is consistent with our intuition that corruption is greatest when the agent and the principal are the same person.

Conflict between quality, ethics and short-term commercial gain confront other industries than the law. Similar arguments can be (and have been) made relating to the liberalisation of all kinds of other markets – the private finance initiative, privatisation of electricity, water, gas, telecoms, airlines, etc. However, service providers can find it effective to compete by offering high quality. Reputation, brand names, and legal responsibility for negligence help to uphold quality. Capitalism does not lead inexorably to low quality, unsafe goods and services, and poor ethics. Cars made behind the iron curtain were not of better quality than western cars. State-owned airlines are not safer than private airlines.

Larger institutions are more likely to be concerned with the effect that an individual transaction can have on other transactions. If someone tells colleagues that an independent café in his neighbourhod served cold coffee, the information is likely to be of interest only to those who frequent that particular neighbourhood. If a Starbucks in any part of London serves cold coffee, the information could affect perceptions of the entire Starbucks chain throughout London. Starbucks has a particularly powerful incentive to maintain quality, because a mistake at one café can affect all the others.

In many areas of economic activity, buyers trust that sellers will provide services well above the minimum standards set down by regulation. For example, a passenger might prefer to travel on British Airways rather than a small charter airline, believing BA to be safer despite the application of the same stringent safety regulations to both carriers. These and similar examples suggest that the stakes of large plcs in protecting their reputations can prompt service quality that exceeds minimum acceptable levels.

In our consultations we heard the view that the law was distinguished by the unique ethical obligations of lawyers and by the critical importance of legal services to society. However, legal services are not unique in their social importance or in their conflicts between short-term commercial gain, quality and ethics. Lives could be at risk when doctors who provide services on a fixed fee basis (such as the NHS in the UK or a Health Maintenance Organisation in the US) face commercial pressure to choose low-cost treatment. Conversely, those providing services on cost-plus reimbursement may come under commercial pressure to over-provide. Other examples include a supermarket’s incentive to sell low-quality food, and a minicab operator’s incentive to skip maintenance on vehicles, or to avoid checking drivers for criminal records.

Conflicts of interest arise in almost every part of the economy. Regulations and professional codes address these problems, and can work effectively in companies financed with outside equity. Permitting outside equity does not equate to a relaxation of regulations, professional

codes, or rules concerning conflicts of interest. For example, if the RAC buys a law firm, and someone contacts the firm to initiate a lawsuit against the RAC, the firm should decline to act. The RAC's purchase of a law firm should not imply a relaxation of current conflict-of-interest rules.

2.2 Undesirable Owners

Our document review and our consultations have revealed concerns that undesirable owners such as criminal organisations might buy equity stakes in law firms. Similar concerns prompt the Financial Services Authority to screen potential acquisitions of large equity stakes in financial services companies. However, an individual's purchase of BAE Systems stock does not typically trigger a bureaucratic process. The government should limit screening to only those purchases of stakes that raise the prospect for investor influence over management. It should be possible to establish an objective threshold of equity purchases of sufficient magnitude to raise concerns, and to screen potential purchasers effectively.

2.3 The Optimal Quality of Legal Services

As early as 1958, an economist noted that partnerships were less inclined to hire new staff than corporations.[3] Partnerships only want to add staff if it increases the average profits per partner, while corporations have an incentive to add all profitable staff, even if the marginal profits from new staff are less than the existing average. In a field where quality depends significantly on expertise and intellect that vary among potential staff, partnerships will have incentives to limit their size and recruit only the most profitable people.

This early economic literature suggested that partnerships would be simultaneously attractive to professionals but less efficient than a corporation. A standard economic assumption is that the expenditures on professional services will reflect their value. Any new, profitable lawyer would therefore be valuable to society, since society's willingness to spend money on the lawyer's services would exceed the lawyer's costs to the firm. Society will only lose if a partnership rejects the opportunity to hire profitable staff out of a concern to maintain the average profits per partner.

More recent literature hypothesises that partnerships may actually be more efficient than corporations, if service quality is difficult for the client to assess.[4] If the public does not know better, then partnerships and corporations will both have incentives to shirk on quality. Incentives to shirk on quality could in theory offset a partnership's other incentives to pursue a business model that involves potentially excessive quality and insufficient staff. The end result of conflicting incentives remains an empirical matter. Within the legal profession, partnerships might be more efficient than corporations in the provision of those services that are most difficult to value, and less efficient for services that are relatively straightforward. Perhaps corporations

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[3] Ward, Benjamin, "The Firm in Illyria: Market Syndicalism," *American Economic Review*, 48 (1958), 566-589.

[4] Levin, Jonathan and Steven Tadelis. "A Theory of Partnerships." *The Quarterly Journal of Economics*, February 2005.

would provide conveyancing services more efficiently, while partnership structures would be best for more complex, diverse and relatively infrequent transactions such as major corporate takeovers. Mandating a particular ownership structure makes little sense if the optimal outcome is likely to differ within branches of the law. The argument for liberalisation is strongest where the government cannot predict the optimal outcome.

2.4 The Potential Survival and Evolution of Partnerships

One interesting argument is that partnerships may not survive in the market despite offering the most efficient level of service quality. A partner receives a share of the profits generated by the partnership until he or she retires. Immediately prior to retirement, the senior partners could gain a share of the present value of all future profits by selling the partnership to a large corporation. Younger or incoming partners could, in principle, compete with corporations to buy the shares, but in practice may face financial constraints. Such constraints could cause the partnership structure to disappear as senior partners sell out.

If the partnership structure is the most efficient, we doubt that it faces extinction from a wave of sell-outs by senior partners to corporations. Even if some partnerships sell out, any inherent efficiency to the structure would likely prompt the emergence of new partnerships, which by hypothesis would have a competitive advantage over the companies sold to corporations. The experience of other professional service organisations provides support for this view.[5] The prospective gains from a sell-out may themselves provide strong incentives for the creation of new efficient firms.

Economic theory suggests that ownership structures might evolve to retain the service-quality incentives of existing partnerships while using limited amounts of outside equity to improve efficiency and enhance stability. A group of lawyers could retain the majority of shares for themselves, adjusting the distribution of shares and the compensation rules to replicate the strong quality incentives of current partnerships, while floating a minority of shares on the stock market. Such a structure might help overcome ‘handover’ problems as senior partners retire. In the year prior to retirement, an existing partner may lose the financial incentive to maximise the profitability of the partnership. In the last year, the partner could maximise wealth by overbilling clients, reasoning that they will become disaffected with the firm only after the partner’s retirement. The retiring partner may also have incentives to shirk responsibilities to help younger partners develop new clients, or to train younger staff. In theory a partnership could overcome handover problems by giving the retiring partner a continuing interest in the firm, in the form of a continuing percentage of the profits. However, such an interest might pose the difficulty of being

[5] For example, in 1970 Booz Allen Hamilton, a large management consulting firm, dissolved its partnership and went public, only to buy back the shares and become a private partnership again six years later. According to Business Week (December 1, 1975), “when Booz Allen went public, it appeared it might be a trend-setter among consulting firms. But before long earnings and the market began to erode, and service companies lost their allure among investors.” McKinsey, another market leader in management consultancy, has no outside equity.

illiquid. Floating some stock on the exchange would create liquidity facilitating the sale of such interests after retirement.[6]

Floating a minority stake could also improve efficiency by sending a market signal concerning the future prospects of the company, which prospective recruits might find valuable in choosing among alternative employers, and which a law firm could find helpful for evaluating its own performance.

The Clementi report already identified the possibility that outside equity could permit the evolution of multi-disciplinary partnerships. For example a law firm specialising in the project finance of international energy projects might benefit from having engineers working alongside lawyers. Giving the engineers stock in the law firm might be important for rewarding them appropriately, giving them the necessary stature within the firm, and aligning their incentives more closely with those of the legal practitioners. The Clementi report recognised a similar principle governing professional managers in law firms, such as finance directors. We agree that outside equity could permit an evolution of existing partnerships to become more efficient, by granting ownership interests to professional managers and to others who provide related technical services.

The case against MDPs involves the potential for damaging conflicts of interest. There are well-known problems concerning the objectivity of equity analysts employed by investment banking, or of the audits provided by accounting companies that also provide management consulting services. We do not take any position on the optimal rules to prevent conflicts of interest. However, permitting outside equity need not imply a relaxation of such rules. Rules concerning conflicts of interest are likely to be the most efficient mechanism for addressing problems, since they present a less restrictive alternative than the prohibition of outside equity.

3 Prospective Reforms to the Profession

The Clementi report responds in detail to many of the possible problems that might arise as a result of liberalisation of the market for legal services. It makes a broad presumption in favour of removing restrictions on ownership structure. There is no need to enumerate all the possible benefits of reform so long as any drawbacks are minor or can be addressed more effectively by other forms of regulation. Nevertheless, we consider the prospective improvements that alternative ownership structures might offer, to provide useful context in a debate where strong concerns continue to be voiced.

In the previous section we cited some efficiency benefits or greater stability that might accrue to a partnership that floated a minority equity stake. However, the principal changes to the profession are likely to involve large capital infusions that can finance the introduction of more

[6] Senior partners could be allowed to sell their stock after the market can gauge the effectiveness of their handover. For example, until 1996 Goldman Sachs forced retiring partners to cash-out their equity share over several years, and the management committee could extend this cash-out schedule if it wished. See Morrison, Alan and Wilhelm, J William Jr, "The Demise of Investment-Banking Partnerships: Theory and Evidence" *Centre for Economic Policy Research,* Discussion Paper No. 4904 (February 2005) at 3.

technology into the provision of legal services. New technology allows capital to replace labour, and makes it possible for different workers with different skill levels to work together on different parts of the same jobs. We distinguish between two cases: the extreme case of "commoditisation" where information technology comes to dominate a particular legal service, and a more moderate case where a person's legal expertise retains a controlling role but technology improves the assembly and processing of information.

Some legal services are ripe for commoditising. An extreme example is conveyancing. As one lawyer put it to us, the entire conveyancing system for the UK only needs one lawyer to operate it – this person would be responsible for approving the design and operation of a large IT system. This is an exaggeration, but everybody seems to agree that conveyancing, in the vast majority of instances, can be largely commoditised. Many cases of labour law, divorce, debt collection, and probate also seem ripe for a similar transformation, although perhaps not to such an extreme degree.

Even when a legal service is not a straight commodity, there may still be scope for significant change. For example, large parts of the work could be done by administrative (non-lawyer) staff and by machine, with a lawyer overseeing the process and also intervening to provide specialist input on non-standard cases or on particular aspects of cases.

Almost all white-collar work has been drastically changed by new technology in the past ten years. In other industries that permit a diversity of ownership structures, partnerships have become corporations when opportunities arose to improve the efficiency of services through the introduction of information technology. Recent research by Morrison and Willhelm analyses the shift from partnerships to corporations among financial services companies in the United States, concluding that "the going public decision was affected by technological innovations in both information technology and finance."[7] U.S. retail banks led a wave of public offerings in the early 1970s. Similarly, in accounting, many tax services are relatively straightforward and amenable to productivity improvements from the use of information technology. Levin and Tadelis observe that in the U.S. in 1997 "measured by revenue, 67 percent of tax preparation work was done by corporations while only 4 percent was done by partnerships (almost all of the remainder is done by sole proprietorships)."[8] Partnerships still dominate certain aspects of banking and accounting services, but focus on those areas that involve less information technology and more personal skill.[9] This is consistent with the prediction that partnerships can be more efficient where quality is especially difficult to evaluate, and that partnerships will survive over time if they offer efficiency advantages.

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[7] *Ibid,* at 2.

[8] *Loc. cit.* footnote 4 p.155.

[9] Wholesale banks – whose mergers and acquisitions businesses relied heavily on human capital – did not float until more than six years later, with some banks holding out until the mid-1980s. The only two banks in Morrison and Willhelm's sample not to float were wholesale banks (ibid, Note 2, p.19). They also found that about 61 percent of financial accounting work, which relies particularly on professional skill, was done by partnerships while only 32 percent was done by corporations.

Levin and Tadelis have also investigated the provision of legal services in the U.S. The U.S. provides an interesting case study for the UK, because firms of non-lawyers are allowed to provide certain specialized legal or paralegal services such as title handling. Levin and Tadelis find that corporate structures now predominate for such services.[10]

4 Funding Innovation Under the Current Rules

We examine why the current legal system cannot itself fund a transformation of certain legal services to rely much more heavily on information technology. Some large law firms in the United Kingdom have substantial access to capital, but they do not offer the personal legal services that are most susceptible to commoditisation, and they have neither the incentive nor the practical ability to change course. Smaller firms could in theory lead the introduction of more information technology, by signing complex contracts to co-operate with large companies that have access to capital. However, contracts are imperfect instruments for such ventures. Smaller firms could in theory raise their own capital through debt, but there are several limitations to raising debt. The problems under the current rules suggest that outside equity is critical for funding the transformation of personal legal services.

4.1 The Large UK Firms

Some large UK law firms have access to significant capital, but these firms are not likely to invest large amounts in information technology that could commoditise or otherwise transform the provision of personal legal services. The partners of the large firms are lawyers who spend their time principally on legal work rather than management. These firms specialise in extremely complex services demanded by large corporate clients. Information technology is more likely to transform small but repeated legal transactions that are more uniform, where the purchasers tend to be individual consumers. The large law firms do not participate in this market. In contrast to corporate entities like the RAC, the large legal firms do not have brand names that carry weight among individual consumers. The large legal firms do not have access to existing IT infrastructure such as call centres that could be tapped to serve this market more efficiently, and do not have IT skills comparable to those of the large corporations in the UK.

4.2 Contracts as a Vehicle for Co-operating with Large Companies

Our consultations revealed that the RAC already co-operates to some extent by offering consumers a list of recommended law partnerships. In theory the RAC could sponsor the introduction of information technology into personal legal services by signing contracts with these partnerships. The contracts would have to fall short of giving the RAC an ownership interest in these partnerships.

[10] *Ibid*. p.156.

Economic literature emphasises the limitations to bilateral contracts in aligning incentives between companies.[11] Contracts are by nature incomplete, subject to alternative interpretations, and are costly to enforce. Equity remains the most efficient way of aligning incentives in complex ventures that require close co-operation. The RAC's list of recommended partnerships is a signal that the RAC has a valuable reputation that can extend to the provision of personal legal services. The RAC also has other attributes such as IT infrastructures that could facilitate the efficient provision of personal legal services. If permitted to own equity in a law firm, the RAC could co-operate more closely and efficiently with law firms than is now feasible with contracts. Owning equity in a law firm would facilitate a successful venture that could tap the RAC's existing reputation and assets to offer legal services.

4.3 Limitations to Debt Funding

The choice between debt and equity is not significant in terms of cost of capital. Standard finance theory shows that the average cost of capital remains unchanged when the debt-equity mix is altered. However, there is a limit to how much debt can be raised. Partnerships face a clear disadvantage when it comes to raising funds, and potential investments in information technology are not likely suitable to debt financing.

Potential investments in information technology are likely to involve a degree of customisation for the provision of legal service. Customisation would make the assets difficult to transfer to other uses without a significant loss in value. Banks are therefore unlikely to accept the IT assets themselves as security for a loan.

The principal existing assets of a partnership are its staff, which in contrast to physical assets cannot be assigned to the bank or compelled to a particular use. Partnerships risk failure if a significant percentage of existing partners depart to seek employment elsewhere. Hence, a professional services firm is not well suited to debt finance. Similarly, other industries that require large amounts of specialised and non-transferable equipment, like the biotechnology sector, tend to rely much more on equity than debt.

Also, debt for a partnership or bar chambers loads risk onto the partners. To transform the provision of legal services with information technology is similar to a typical venture capital project. Venture Capitalists normally expect a certain failure rate on a portfolio of projects. This risk would deter most sensible partnerships, or indeed any sane investors assessing it as a sole project forming the bulk of their wealth. However, for a diversified investor assessing the project in a portfolio context, it would be attractive if substantial rewards from successful projects success were available to offset losses on the failures. Equity capital is not just a mechanism for making funds available, but also for sharing risk.

[11] For a seminal discussion on the costs of contracting compared to the costs of vertical integration, see Klein, Benjamin., Crawford, R.G. and Armen, A.A., 'Vertical Integration, Appropriable Rents, and the Competitive Contracting Process' *Journal of Law and Economics*, Vol.21, No. 2 (Oct., 1978), 297-326.

5 Innovation, Entry and Competition

Prohibiting outside equity could make it more difficult to establish large firms offering legal services. For example, a group of lawyers may wish to form a large firm offering legal services such as conveyancing. For the reasons discussed above, it would be difficult to finance such a venture by a partnership. Hence, the current limits on ownership structure could act as a barrier to entry in many areas of legal services.

The entry of new firms is a principal catalyst for innovation in many industries. To capture market share, new firms must offer something different. Existing firms must respond by matching or exceeding the innovations of the newcomer, or face extinction. Existing firms can be less likely to innovate because they have an interest in protecting the value of their existing franchises. Innovation is likely to require equity capital for the reasons described above. If ownership restrictions make market entry difficult, existing firms can become complacent, and product quality can suffer.[12] Removing restrictions on ownership could stimulate new entry and innovation in legal services.

International business transactions frequently rely on English law. English lawyers successfully export their services to support such transactions, in competition with lawyers from other countries. We spoke to lawyers who see no financial constraints limiting their desire to expand into internationally competitive markets, but at the same time see no opportunities for more ambitious expansion in the short term. However, the international legal services market could be very different in ten years' time, and the liberalisation of ownership structures might enable more effective competition and expansion into these markets further into the future. Regulatory structures, however, are slow to react to change.

6 The Bar

Existing ownership structures may be well-suited to advocacy unless there is radical change in the way that advocacy is used as part of the legal process. Many advocates have highly individualistic working practices. If this is efficient, then natural market forces may perpetuate the existing structures even as the government permits outside equity. Solicitors prepare much of the documentation for barristers, which would seem to reduce a barrister's needs for IT investment. However, we do not rule out the possibility that significant IT investment, or restructuring of work practices, could potentially take place in parts of the Bar.

The Bar Council presented strong objections to alternative ownership structures. However, the economic arguments for permitting alternative ownership structures are not specific to solicitors. Some of the issues concerning the bar relate to matters such as regulation, competition and liberalisation of working practices, which mainly lie outside the scope of this report but in general can be addressed by less restrictive alternatives than prohibiting outside equity.

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[12] For example, some commentators claim that Microsoft's de facto monopoly on PC operating system software has reduced product quality, resulting in numerous security flaws in Windows software. Perhaps several similarly sized competing firms in this sector may have produced more secure software.