



Competition, growth and consumer outcomes - challenges for policy

Westminster Legal Policy Forum

Legal innovation and the business of law:

technology, skills and new business models

25 January 2017

Caroline Wallace

Strategy Director, Legal Services Board

I'd like to start this session with a quotation from Michelangelo: "the greatest danger for most of us is not that our aim is too high and we miss it, but that it is too low and we reach it".

Well, I am aiming to speak for about 15 minutes today, and I think that you will all be grateful if I reach rather than surpass that aim. But, on a more serious note, from what we have already heard today and based on research and analysis by the Legal Services Board (LSB) and others which I will come on to, it would seem that there is scope for the legal sector to 'aim higher' when it comes to innovation.

Before I get into that, may I first of all thank the team at the Westminster Policy Forum for inviting me to speak today? I realise I have the unenviable pre-lunch slot, so I'd like to take the opportunity to step back a bit from technology and think about what the future might hold for competition and consumers of legal services.

The relationship between competition, innovation and growth

Growth and innovation are some of the so-called ‘dynamic benefits’ of competition, in other words the benefits to society and consumers over and above ‘static benefits’ such as lower prices or higher volumes. As firms vie with each other for customers and market share, they try new and different ways of becoming more efficient and giving customers what they want. The LSB doesn’t seek to promote competition for its own sake, we do so because the benefits it brings in terms of lower prices, higher quality, innovation and growth are good for consumers and the public as a whole. LSB research shows that there is significant unmet demand for legal services. More affordable prices and different ways of doing business, both of which are pushed forward by competition, are part of the answer to this very serious problem. Competition is good for consumers, it isn’t in tension with the consumer interest. But let’s not forget that competition is also good for the legal profession – it allows good firms with innovative ideas to adapt and thrive.

We are very conscious of importance of the legal sector to the wider economy. It is worth bearing in mind that the legal services market has grown substantially since 2007 despite challenging times for the wider economy. UK wide legal services turnover grew from a post crisis low of £27bn in 2009 to an all-time high of £32bn in 2015. As part of this growth, there has been significant growth in net exports of legal services. For the UK as a whole, net exports of legal services grew by £980m in real terms between 2007 and 2014¹. This is a good news story.

¹ Office for National Statistics data as set out in the LSB report *Evaluation: Changes in the legal services market 2006/07 - 2014/15* <https://research.legalservicesboard.org.uk/wp-content/media/2015-2016-FINAL-Market-Evaluation-Main-report11.pdf>

On the other hand, as many of you will know, the Competition and Markets Authority (CMA) has recently found that competition in the legal services sector is not working well for individual consumers and small businesses. In its report, the CMA identified adverse outcomes for consumers as a result, including that:

- lack of information about legal services contributes to unmet legal need
- there is a considerable spread of prices for the same legal service, suggesting that consumers could make considerable savings from shopping around; and
- consumers may be losing out from lack of innovation.

In relation to innovation, it is worth looking briefly at the evidence that there is less innovation in legal services than there could be. We analysed data on levels of innovation in legal services and in four other sectors of the economy: accountancy, architectural services, consultancy and software & IT services. We used data from three different surveys², so caution needs to be applied as the surveys were different and had different survey sizes.

The data suggests that:

- (i) levels of innovation in the legal services market are comparable to levels of innovation in accountancy (with the exception of service innovation – which is higher in accountancy in 2016), but
- (ii) levels of innovation are lower in legal services than in the other sectors analysed.

² NESTA 2009 *Measuring Sectoral Innovation Capability in Nine Areas of the UK Economy*
<https://www.nesta.org.uk/sites/default/files/measuring-sectoral-innovation.pdf>

ERC 2015 *Innovation in Legal Services* commissioned by the SRA and the LSB
<https://research.legalservicesboard.org.uk/wp-content/media/Innovation-Report.pdf>

ERC 2016 *Innovation and HR Practices in Five Professional Service Sectors* commissioned by the UK Commission for Employment and Skills <http://www.enterpriseresearch.ac.uk/wp-content/uploads/2016/06/ERC-ResReport-UKCES-RoperLoveBourke.pdf>

Coming back to the growth in legal services exports over recent years: you might argue that the firms that are exporting legal services are very different in nature from the small and medium-sized firms serving individual consumers and small businesses. But research commissioned jointly by LSB, TLS and MoJ³ suggests that firms of all sizes may be engaged in exporting legal services and, in any event, the success of different parts of the legal sector is linked. Not least, an effective domestic legal services sector with its well-established and demonstrable rule of law and high professional standards is likely to be a vital element of the attractiveness of the England and Wales jurisdiction internationally. And the CMA's finding that competition is not working well for individual and small businesses means that there is less innovation and less growth than there could be if, for example, providers did things differently and were able to address the unmet need in the market.

The CMA's recommendations

The CMA has made recommendations to remedy the lack of competition in the legal services market. These include:

- Recommendations to the legal services regulators to increase the transparency of price and quality information, to facilitate the development of comparison websites and to develop a consumer information hub based on the existing Legal Choices website.
- Recommendations to the Ministry of Justice, including two that the LSB particularly welcomes, namely that:
 - The MoJ should undertake a review of the independence of the legal services regulators and that
 - It should, in the longer term, undertake a review of the regulatory framework.

³ LSB/TLS/MoJ report by Professor Pascoe Pleasence, Dr Nigel Balmer, Professor Richard Moorhead: *A time of change: solicitors' firms in England and Wales* <https://research.legalservicesboard.org.uk/wp-content/media/time-of-change-report.pdf>

- Recommendations for the LSB relating to the implementation of the CMA's other recommendations. The CMA has recommended that the LSB monitors the progress of the frontline regulators, reports publicly on the sufficiency of and progress against their action plans and takes appropriate action where regulators fail to address information gaps. The LSB Board is talking through these recommendations with a view to responding formally soon.

It is the CMA's recommendations on transparency of price and quality information and on consumer information on which I particularly want to focus today. This is because, if these recommendations are successfully implemented, the voices of consumers of legal services are likely to be heard much more clearly in future. Law firms need to prepare themselves to respond more efficiently and effectively to consumer needs.

Reflections on the CMA's recommendations

The CMA is, amongst other things, seeking a change in the behaviour of providers of legal services to individuals and small businesses. In particular, the CMA wants such providers to be more transparent about the price and quality of their services.

You may have heard a lot about behavioural economics applied to consumer behaviour. For example, there is evidence across different markets that consumers tend to be biased in favour of the status quo and that choice overload can make our choices poorer rather than better. We as regulators will be taking into account these insights as we implement the CMA's recommendations. A personal interest of mine is what behavioural economics can tell us about firms' behaviour as well as consumers' behaviour. Firms are, like consumers, also subject to 'bounded rationality' – they do not have infinite time to devote to developing their strategy. How might this apply to legal services? When looking at solicitors, there are around 10,000 firms but the largest 100 have over 50% share of the market. So there is a long tail of

small firms – even more so than in other sectors of the economy. Small firms are particularly subject to bounded rationality – they have very limited resources for strategic thinking.

So what do firms do in such situations? Firms may use rules of thumb – “we have always priced by the hour so we’ll keep doing that while our profits are satisfactory (even if not the best they could be)”. Firms may imitate those firms perceived to be successful and save themselves the cost of figuring out the right strategy for themselves. That works fine if the ‘best-performing’ firms are indeed doing well, and not just saying that they are doing well. Otherwise what is known as ‘inefficient herding’ can arise. I wonder whether what appears to be great reluctance among some law firms to ‘break from the pack’ is evidence of these sorts of dynamic in the market. So it is right – and important - for regulators to look at firms’ behaviour alongside consumer behaviour – and to inject accurate information into the market (for example through research – of which more shortly) to help firms set their own strategies.

How regulators can help

Firms compete and innovate, not regulators. But what can regulators do to help?

First: Regulators can make new ways of doing business possible, while also (and this is important) maintaining the necessary protections for consumers and the wider public interest to ensure that confidence in the sector is maintained. A great example is the licensing of ABS, which removes restrictions on ownership of and investment in law firms, but which maintains protections for consumers and the wider public interest. And firms don’t have to convert to ABS for consumers to benefit from these new freedoms. Consumers also benefit when traditional law firms respond to the existence of ABS through changing the way they do business to maintain or build their market share – the essence of competition.

The **second** thing regulators can do to help is to gather and share evidence on competition and innovation, and shine a light on barriers and enablers. For example, the SRA and LSB jointly carried out the largest ever survey of innovation among legal service providers, covering 1500 organisations including barristers' chambers. The results were published in July 2015. There were several important findings:

- The adoption of ABS status has had a positive (and statistically significant) effect on innovation. All else being equal, ABS firms are 13-15 per cent more likely to introduce new legal services than traditional law firms.
- It is also interesting to note that other analysis we have conducted shows that ABS firms tend to be more productive – they have a higher turnover per fee earner - than traditional law firms⁴. ABS firms are also better at complaint handling than traditional law firms⁵, suggesting that consumer protection has been maintained – or possibly even improved – alongside the introduction of ABS.
- In our innovation research, regulatory and legislative changes emerge as both a barrier to and driver of innovation:
- There are also some interesting insights into what innovative practices seem to be most important in the sector. Things like making strong connections to external partners, working in cross-functional teams, emphasising and valuing team-working, having an innovation strategy, acknowledging and rewarding innovative practices and developing staff specifically to be innovative.

⁴ LSB analysis of SRA data suggests that in 2014/15, 44% of ABS had turnover per fee earner over the upper quartile, as did 44% of LDPs.

⁵ Complaints resolution ratios: ABS resolved 9.8 complaints for every one referred to LEO, compared to 5.1 for LDPs, and for all other entities (LSB market evaluation report para A.2.18)

The LSB is also currently undertaking research into investment in the legal sector. We're looking at sources of investment, how the investor community views the market and whether there are any barriers to investment. Keep an eye out for our findings.

The **third** thing regulators can do is to collaborate to foster innovation. This is particularly important given the erosion of the boundaries between traditional legal professions.

Collaboration amongst the legal services regulators is happening, and is starting to bear fruit. The aim is to lighten the regulatory burden, share knowledge and discuss possibilities for legislative reform.

And collaboration doesn't just have to be amongst the regulators, but also between regulators and practitioners. As you've heard earlier this morning, the SRA has developed "SRA Innovate" to bring together in one place the support that the SRA can offer to those firms who want to try to do things differently while keeping the regulator happy.

Policy challenges – a balancing act

To finish, I'd like to say a word or two about what I see as the over-arching policy challenges. There are three things in particular I'd like to mention.

Firstly: regulators need to balance competition and regulation. Regulation must not inhibit competition, but, as I mentioned earlier, it must provide and maintain the necessary protections for consumers and the wider public interest to ensure that confidence in the sector is maintained. Regulation needs to be risk based and outcomes focussed. It is **not** the same as doing nothing **nor** is it stepping back completely and letting the market 'do what it

does'. Complete 'regulation aversion' would be wrong because regulation in this sector allows the market to exist:

- Without it, consumers would not have confidence to purchase legal services;
- Regulation ensures that rogue practitioners do not compromise the quality and credibility of legal services more generally; and
- Regulation allows practitioners to act ethically without putting their reputations or livelihoods at risk.

The **second** policy challenge I want to mention is the balance that must be struck between the public interest and the consumer interest. Accusations are sometimes made that some of the legal services regulators – including the LSB - are 'obsessed with the market'. The reality is that, as discussed above, competition delivers benefits to both consumers and the public, and that professional standards, ethics, rule of law and the wider public interest are 'front and centre' in what we do. This is clearly demonstrated by the over-arching regulatory objective that the LSB suggested in its vision for reform of the regulatory framework, published in September last year. We proposed that the over-arching regulatory objective should be "to safeguard the public interest by protecting consumers and ensuring legal services deliver outcomes in the interests of society as a whole".

Thirdly and finally in terms of policy challenges, it can be difficult to unwind regulation in favour of competition where there is no evidence of what might happen – because it hasn't happened yet. So consumer piloting and testing of potential changes are vital, along with reviewing the impact of changes once they have had a chance to bed in. I see this as part of the continuous learning culture that regulators need to foster, which is part of the regulator's wider role that I mentioned earlier in gathering and sharing evidence to inform policy. As the American physicist William Pollard said: "Learning and innovation go hand in hand. The arrogance of success is to think that what you did yesterday will be sufficient for tomorrow."