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**Alternative Business Structures: A Brave New Legal Services World?**

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**Abstract**

*Ever since the concept of the Alternative Business Structure (ABS) was introduced by the Legal Services Act 2007, opinions within the legal community have been sharply divided. Some see them as revolutionising the legal market and the way in which legal services are delivered, introducing big brands such as the Co-Op, Direct Line and the AA to the market for the first time. Reactions to such predictions are predictably mixed; the Law Society has conducted an advertising campaign extolling the virtues of the traditional high street solicitors practice; Quality Solicitors, a network of independent solicitors, has recently conducted a viral advertising campaign contrasting “Faceless legal advice from supermarkets” with their own solicitors who “know their onions”. Recent research*

*by The College of Law suggests that only 1% of law students would choose to work for an ABS over a traditional law firm. For others change has to be positive, and the introduction of greater competition and choice to the market can only be a good thing, with consumers being the big winners.*

*It is certain that some big players will enter the market; indeed, the Co-Op has been in the legal services market since 2006 and already has an ABS licence; others will certainly follow. However, many ABS applications have come from existing law firms. So, does the introduction of the ABS really threaten traditional law firms or will in fact the greatest impact be to allow those traditional firms who have the foresight and ability to grasp the opportunities provided to strengthen their financial position and provide better and more competitive services to clients. What then will be the response of the traditional legal services providers to the introduction of the ABS? What are their views? What do they perceive to be the benefits and risks? Is it the attraction of multi-disciplinary partnerships or the ability to secure external investment that draws firms to the ABS model? Is the ABS likely to replace the partnership as the principal practice structure for law firms? And what will be the knock-on effect of these changes on those firms that choose not to convert to the ABS structure? Will the result be increased pressure for consolidation in the market, leading in fact to less choice for consumers rather than more?*

*This survey will attempt to answer these questions by analysing the limited evidence so far from the applications received by the Solicitors Regulation Authority, and the relatively small number of licenses issued to date. It will in particular consider the views of local and regional law firms, collected by questionnaire and interview, some that have either already applied to convert or are actively considering doing so, looking at their motivations, hopes and fears. How do they view the brave new legal services world?*

1. **Introduction: ABS – the Story so Far**

The UK legal services market is an increasingly important part of the UK economy, with a total gross value (GVA) of £26.8 billion in 2011[[1]](#footnote-1), accounting for 1.5% of the UKs total GVA in 2010. Net exports of legal services have also grown rapidly in recent years, from 6.1% of total domestic output in 1995 to 11.1% in 2010[[2]](#footnote-2). The UK legal services market accounted for nearly 7% in value of the global legal services market, and 20.3% of the total European market in 2011[[3]](#footnote-3). So, when change occurs in this market, it is significant. When the Legal Services Act was first enacted in 2007, it promised not just change, but a radical overhaul of both the regulation of the legal profession and the operation of the entire legal services market in the future. There are three main areas in which the Act introduced significant change:

1. Creation of the Legal Services Board to oversee the regulation of legal services by approved regulators such as the Solicitors Regulation Authority (SRA), the Bar Standards Board (BSB) and the Council for Licensed Conveyancers (CLC);
2. Introduction of the Office for Legal Complaints and the Legal Services Ombudsman to provide an independent complaints service for consumers; and
3. Licensing of different forms of legal practice, namely the legal disciplinary practice which allows solicitors to practice alongside other layers or non-lawyers, and Alternative Business Structures (ABS), a more radical alternative allowing for external investment in and ownership of legal practices.

However, in the first few years after the Act came onto the statute book, its impact seemed less than overwhelming, and far from the “Big Bang” that it had originally promised and which some in the legal professions feared. This was partly due to the delay in implementation of the last and potentially most significant change, the ABS. This Part 5 of the Act containing the provisions relating to ABSs did not come into force until 6th October 2011, and it was not until 3rd January 2012 that the principal licensing authority for ABSs, the SRA, began accepting applications. Even then, it seemed that the ABS structure would be slow to take off. By July 2012, only eight licences had been issued.[[4]](#footnote-4) However, bearing in mind the intrinsically cautious and conservative nature of the traditional legal profession, this was perhaps not surprising. Writing in The Guardian in March 2011, Neil Rose characterised lawyers as “second movers”, and commented that:

“This October will not be the “big bang” some characterise it as – the law just doesn’t move that quickly. But in five or ten years’ time, the face of legal services could look very, very different”.[[5]](#footnote-5)

Whilst it is clearly too early to know if Rose is correct in his assertion, indications in recent months would suggest that something significant is happening in the legal services market. The pace of change has increased dramatically over the last year, and by the end of January 2013 after 12 months of accepting licence applications, the SRA reported that 454 firms had commenced the application process, 117 had completed submission of all information, and 74 ABS licences had been granted, with a further 19 close to completion.[[6]](#footnote-6) As of 5th March 2013, the number of licences granted by the SRA had increased to 103[[7]](#footnote-7), with the number increasing all the time. Of these, some are significant new entrants to the legal services market, such as Parabis Law, Direct Line and BT, as well as organisations such as The Co-operative Legal Services who, whilst not traditional law firms, have in fact offered legal services for some years. Entirely new businesses have been established to take advantage of the new competitive opportunities, with Riverview in Wirral being one of the most notable examples. The impact of businesses such as these on the market remains to be seen. But it is certainly true that the challenge they present, and the new ways of working that they represent cannot, cannot be ignored by traditional law firms. As Susskind has commented,

“These kind of development are of profound significance and represent a major departure from conventional legal services...........No-one knows where this will lead us. It is too early for authoritative pronouncements about the precise outcomes. This is the nature of the market. All we can be sure of, I believe, is that major change is upon us”.[[8]](#footnote-8)

Early signs are that at least some within the traditional legal profession are facing up to the challenge that Susskind identifies. Major players such as Irwin Mitchell, Russell, Jones & Walker and Keoghs have already obtained ABS licences. Several members of the national solicitors grouping, Quality Solicitors have recently converted or are in the process of doing so[[9]](#footnote-9). However, a number of smaller firms have also chosen to convert; indeed two of the first three licences issued were granted to two much smaller firms, John Welch & Stammers in Oxfordshire, and Lawbridge in Kent, and two of the most recent converts are Hacking Ashton, a ten partner firm in Staffordshire, and two partner firm Astons in Northamptonshire[[10]](#footnote-10).

Recently, both The Legal Services Commission[[11]](#footnote-11) and The Law Society[[12]](#footnote-12) have published reports on the state of the current legal services market to identify attitudes, trends and perceptions. The purpose of this survey is both more limited and more focused: to investigate the impact of the introduction of ABS upon a range of typical provincial firms that form the vast majority (numerically) of the traditional legal profession. We wanted to find out the extent to which they too share the vision of profound change identified by those such as Rose and Susskind, and, if so, whether they view such change as a challenge to their livelihood, or an opportunity to expand their business. Before looking at the results of the survey, however, we will consider in more detail what are generally considered to be the most significant arguments in favour of converting to the ABS structure, as well as considering some factors that may hinder the take-up of this new form of business, at least amongst some traditional law firms.

1. **ABS: Liberation is Not for Everyone**

There are a number of reasons why law firms may consider converting to become an ABS, and significant environmental drivers which will make this the right choice for some firms. There are significant forces at work on and within the legal services market, quite separate from the Legal Services Act itself, which will drive many law firms to consider the ABS structure. To quote again from Susskind,

“market forces are sweeping through the legal services market in the UK and these will bring intense new competitive pressures for traditional law firms”[[13]](#footnote-13).

These market forces have been growing stronger and stronger over the last 5-10 years, and will only become more intense now that the Legal Services Act has opened the way for large organisations such as Direct Line and BT to enter the market. Khiara and Jones [[14]](#footnote-14) identify three drivers within the general commercial environment that will bear upon the legal services market. These are:

* Globalisation – increased ease and speed of communication facilitated by the development of the internet has created a market for global services, and although the legal services market has been slow to respond, legal process outsourcing has expanded rapidly in recent years. Pressure from clients to reduce costs has forced law firms into exploring options for unbundling services via offshoring or northshoring (moving services to cheaper parts of the UK).
* Consolidation – for a number of years, a process of consolidation has been taking place within the UK legal services market. This process has taken place at all levels but, as Khiara and Jones indicate, the greatest consolidation activity has taken place within the high volume low margin sectors of the market[[15]](#footnote-15).
* Commoditisation – this means the process by which a service becomes less and less differentiated from the buyers perspective, so that buyers care less about where and from whom they buy. This is what Susskind terms “the more for less challenge”[[16]](#footnote-16). Because price becomes the determining factor for the buyer, the traditional response from law firms would be to compete on price or to exit the market.

The Law Society[[17]](#footnote-17) identifies four drivers of change, namely

* Demographic and buyer shifts – factors such as greater knowledge of what lawyers do, ability and willingness to shop around, falling levels of trust in professionals and increased focus on value for money.
* Government agenda and sector regulation – the political and regulatory agenda affecting the business sector generally, and sector specific matters such as liberalisation of the legal services market, and reform in areas of law such as legal aid.
* Global and national economic environment – inevitably, the legal services market will be impacted by macro and micro economic and changing patterns of world growth, in particular the emergence of the BRIC countries (Brazil, Russia, India and China) as major world economic powers. More specific factors influencing the market are the use of English law in international commerce and dispute resolution, and the position of the City of London as one of the main global business and financial markets.
* Technological and process innovation – in particular the internet, the exponential growth of social media and mobile connectivity, and the consequent facilitation of new business strategies such as outsourcing and offshoring.

It can be seen that there is a clear overlap between the drivers highlighted by Khiara and Jones, and those identified by The Law Society, but also that those identified by the latter are themselves drivers of the consolidation and commoditisation drivers identified by the former. Analysis of their drivers leads Khiara and Jones to conclude that not only will new entrants enter the legal services market leading to increased competition from major companies well able to compete on price, but that traditional law firms, if they are to survive, will need to adapt, and find new ways of working. One way for them to adapt, albeit a challenging one for many firms, is to secure external funding via an ABS structure. The challenge is not only to adapt to a new and often alien business structure in which external, non-lawyer investors will have significant influence over the management of the firm, but also simply to attract external investment in the first place. There are a number of factors that potentially may deter external parties from investing in law firms. For one thing, it is inherently difficult to value what is essentially a people business. There may also be cultural and structural barriers, as the traditional management ethos of law firms, based on the Partnership Act 1892, is to aim for consensus and inclusivity. Partners have been expected to multi-task; as Howard and Roskill describe it,

“Not only must they be good at the law, but they must also excel at selling, finance, people management and so on”[[18]](#footnote-18)

This ethos may well be viewed adversely by those more used to a top down, corporate management approach, where businesses are supported by specialist marketers, finance professionals and personnel managers. A reluctance by the firm to accept a change in culture is likely to deter potential investors (interestingly, as we shall see later when looking at the results of the survey, one firm that has already converted to an ABS and received significant external investment perceives this change of management culture as being perhaps the biggest advantage they have derived from the decision to convert). For some firms, the prospect of this loss of control will inevitably be a major barrier to conversion. A recent survey by The Law Society suggested that amongst top 200 firms there was a lack of interest in ABS largely due to a reluctance to cede control to external investors[[19]](#footnote-19). But it is unlikely that external non-lawyers will wish to invest in law firms unless partners are prepared to relinquish control (and status); they simply will not accept the need to work within the traditional processes and cultures that exist within most law firms. It is also possible that the extensive regulatory structures existing in the legal services market will deter some potential investors familiar with a more liberal regulatory regime[[20]](#footnote-20).

So, in spite of the many advantages, not all firms will be able to or wish to embrace the ABS business model. Our survey, then, looked at attitudes of a range of traditional, local law firms to the prospect of converting to an ABS structure, to find out which if any of the drivers identified above, positive and negative, are currently influencing local law firms.

1. **Survey – Attitudes of Law Firms in the Staffordshire area**

This was a small survey, but one which we feel provides a representative snapshot of the views of what might be termed the silent majority of law firms in England. The legal services market in Staffordshire is fairly typical of most parts of England outside of the main cities, with a large number of small, high street firms who derive the majority of their income from traditional areas of work such as property, family law, PI, civil litigation and wills and probate. There has been some consolidation within the market in recent years, and at least some of the firms surveyed have expanded their businesses in recent years by following an acquisition strategy. However, due to its location between Manchester and Birmingham, the major national and international law firms are largely absent from the Staffordshire legal market.

In the survey, we obtained the views of seventeen law firms in Staffordshire. The majority of firms surveyed were small, with 47% having one to five partners, but at the other extreme were two firms each with over thirty partners, and included two firms that had already converted to become an ABS. We conducted the survey by online questionnaire, followed up in some cases by face to face or telephone interview. As well as asking the firms about specific business structures we asked them to rank in order of importance a list of matters that they considered when selecting an appropriate business structure. Perhaps unsurprisingly, financial considerations were considered to be of most importance, with “maximising income” ranked first and “capital protection” ranked a close second. However, four of the firms identified “flexibility to take advantage of business opportunities” as the most important factor, and this came out third overall based on mean average. Interestingly, when considering possible changes to the business structure, only one firm other than the two that had already converted had even considered converting to an ABS. Of much more interest to the firms surveyed was incorporation, with 47% having at least considered this change, this result presumably heavily influenced by the desire to protect capital which was identified as one of the top two factor influencing choice of business structure. A substantial proportion, 41%, had also actively contemplated merger.

Attitudes to ABS vary widely. Some were predictably hostile, with comments such as:

“It will make high street practices extinct”

“Reduce high street firms/choice”

“The death of the high street firm, domination by supermarkets and an erosion of the law as a profession”

Some firms were ambivalent, rather than hostile:

“The widening of choice available to clients, but this does not necessarily ensure they are getting the best quality of service”

As this suggests, for many increased competition was the key factor, which some at least viewed as positively:

“Diversify the market and increase competition”

“Competition but also potential for combined professional services offerings”

“Survival of the fittest who embrace the opportunities to deliver a better service for clients”

“Positive effect which will open vast opportunities for business and cross selling services”

Judging from these comments, there is no clear consensus amongst the firms surveyed as to whether the impact of ABS will be positive or negative. However, responses to another question indicate that most firms certainly see potential for positivity. When asked “Do you see ABS as an opportunity or a threat, only two firms saw ABS as nothing but a threat. The vast majority saw ABS as an opportunity (41%) or as both threat and opportunity (47%). In spite of this, though, the results of the survey certainly seem to support Neil Rose’s categorisation of lawyers as “second movers”[[21]](#footnote-21). When asked about their approach to ABS, comments such as “cautious”, “considered”, “open minded”, “healthy scepticism” and “wait and see” were common, suggesting that many firms will adopt the traditional lawyers approach of maintaining their current way of doing business unless and until that business starts to become adversely affected financially. In stark contrast, those firms that have already converted to ABS clearly saw themselves as “leaders” and “innovators”, and one senses that the positivity flowing from such responses will drive the firms’ business forward over the next few years. One thoughtful comment was that,

“ABS are seen as competition, but there is also an opportunity for smaller businesses to market a more bespoke/boutique approach”,

suggesting that not all firms identify ABS with a “pile ‘em high, “sell ‘em cheap” approach to business, and that as has already been the case, at least some small, niche practices will decide to convert to become ABSs.

An interview with a partner in one of the firms that had already converted to ABS provided some interesting insights into the reasoning behind the decision to convert, and the business advantages that they had already gained from the decision. The main reason for converting, and the greatest benefit gained from conversion, was identified as professionalization of the management of the business. Under the traditional partnership model, the need to achieve consensus amongst a group of partners, often with disparate interests and priorities, can often lead to an excessively conservative approach, avoiding the really big decisions, and simply carrying on doing the same things due to a lack of agreement as to whether and how to change things. Under the traditional partnership model, solicitors are promoted to partnership on the basis of their talent at legal work. Having become partners, they then have to multi-task (as identified above[[22]](#footnote-22)) and many of these tasks will be knowledge skills and expertise quite different from their legal skills, and with which many partners may struggle. So, the ability to professionalise management under the ABS structure, with a managing director/CEO taking most day to day management decisions, and an external board of non-lawyer business specialists approving major investment decisions, can be seen as a major advantage of the new structure. This allows the lawyers to specialise on what they do best, with business decisions taken by experts who can take a more professional and objective view than is often the case with traditional law firms. Interestingly, operating the business on a more professional basis was also seen to be attractive to clients, especially commercial clients, who appreciate having their legal work carried out by a more “commercially savvy” law firm. As Chapman, (2013) states;[[23]](#footnote-23)

‘The idea that, at the end of each year, law firms distribute their profits and do not invest in their business or pay down debt is a bizarre one to the rest of the business world.’

Conversely, other firms actually identified client conservatism as an argument against conversion, one partner arguing that clients are uncomfortable with new business structures with which they are unfamiliar. The same partner also felt that clients generally are more comfortable with the traditional partnership structure where they are dealing with the owners of the business rather than a structure which appears to them to be more “corporate”, citing the general public disaffection with the big banks and other large corporate organisations. Another partner also questioned clients’ readiness to embrace new ways of doing business, having established an on-line service enabling clients to obtain a simple divorce at significantly reduced costs, only to find that there was almost no demand for the service, clients preferring to pay more for a more personal service.

The other major benefit of ABS identified by those firms that had converted was access to external sources of finance. This was seen by both firms as crucial, allowing them to make major spending decisions quickly without worrying about the cost of financing the partnership debt, and thus allowing them to become a more agile, responsive business. Repayment of capital to equity partners, thus freeing them from personal financial risk, was also identified by one firm as being a major benefit arising from ABS conversion. A partner in another firm summarised the perceived advantages of ABS in this way:

“Offers opportunity of investment and input which would bring added value in terms of skills and overall direction”.

1. **Conclusions**

Back in 1996, long before the Legal Services Bill was published bringing the promise of a new legal services landscape, Susskind wrote the following:

“What will not be sustainable is any continuation from the position in today’s legal paradigm whereby the legal profession enjoys an exclusive position as the interface between individuals and businesses on the one hand and access to the rule of law on the other”[[24]](#footnote-24).

It can now be seen that this legal paradigm was indeed not sustainable. Societal and economic changes were inevitably pushing towards the creation of a new legal paradigm (to use Susskind’s terminology. The changes introduced by the Legal Services Act have simply facilitated and provided a vehicle for these changes in the creation of the ABS. Like it or not, the legal services world is changing. Co-operative Legal Services recently announced that in its first year of trading as an ABS, it increased its revenue by 12.87% to £33 million, and achieved a small tax free profit of £26,000 in spite of incurring significant one off investment costs[[25]](#footnote-25). They now provide a broad range of legal services, including family, conveyancing, personal injury, employment, will writing and probate. Just a few weeks previously, The Law Society had revealed that for the first time in living memory the number of solicitors in private practice had fallen[[26]](#footnote-26). However, the same survey reveals a high degree of uncertainty amongst law firms regarding the real impact of ABSs, with only 25% of firms surveyed concerned about the threat of competition from ABSs[[27]](#footnote-27). Of course, this survey was conducted during 2012 before ABS conversions started to become a reality, and perhaps the result would be different now, although our survey would suggest not. This uncertainty as to the impact of ABS, is to an extent hinted at in our survey, with comments such as:

“I do not believe in the short term it will have an impact”, and

“Providers of bespoke legal services will see little impact”.

The most common attitude that we detected, however, was one of “wait and see”, a very typical lawyers approach to any form of change. It is clear, though, that those firms that have already embraced change and have chosen to convert to ABS see themselves as being pioneers and leaders rather than followers, and they certainly feel that this pioneering attitude, of being ahead of the game, will provide them with a significant competitive advantage over other more conservative law firms when it comes to surviving and prospering in the brave new legal services world. As The Law Society has concluded,

“....it is entirely possible that a small number of successful ABS could radically alter the shape of supply of typical “high street” services. If a small number of entities dominates the supply of retail services, the overall number of solicitors firms could be reduced very significantly”[[28]](#footnote-28).

Our survey certainly suggests that most firms do accept that the way in which legal services are delivered has to change, although with a high degree of uncertainty as to the extent of the changes demanded by, or even acceptable to, their clients. A commonly held view, though, is that legal services can successfully be delivered in new and more innovative ways whilst maintaining the traditional law firm structure. Only time will tell whether this belief is well founded, and that those firms adopting the traditional lawyers “wait and see” approach to ABS will be able to successfully compete with new ABS entrants to the market and with those firms who have taken an early decision to convert.

1. The Law Society, *Legal Services Industry Part 1 – an Overview*, (2012) 18 [↑](#footnote-ref-1)
2. Ibid 22 [↑](#footnote-ref-2)
3. Ibid 23 [↑](#footnote-ref-3)
4. ‘first name’ Robins, ‘*ABS fab?*’, (2012) 162 NLJ 887 [↑](#footnote-ref-4)
5. Neil Rose, ‘Tesco law – not the big bang, but it will change the face of legal services’ *www.*guardian.co.uk, 25 March 2011 [↑](#footnote-ref-5)
6. Solicitors Regulation Authority, *News Release: SRA marks a year of ABS licensing,* 11/01/13 [↑](#footnote-ref-6)
7. Legal Futures, , <http://www.legalfutures.co.uk/latest-news/top-media-firm-regional-practice-seeking-external-cash-help-take-abs-total-100>5th March 2013 [↑](#footnote-ref-7)
8. Richard Susskind, *Tomorrows Lawyers* (1st OUP 2013) 7-8 [↑](#footnote-ref-8)
9. The Law Gazette, *QS firms poised for ABS status*, 19/02/2013 [↑](#footnote-ref-9)
10. Legal Futures (n7) [↑](#footnote-ref-10)
11. The Legal Services Commission, *Market Impacts of the Legal Services Act 2007 – Baseline Report (Final),* 2012 [↑](#footnote-ref-11)
12. The Law Society, *Legal Services Industry Part 1 – an Overview*, (2012) and *The Legal Services Industry Part 2 – Main Sectors*, (2012) [↑](#footnote-ref-12)
13. Susskind (n 8) 8 [↑](#footnote-ref-13)
14. Khiara & Jones, ‘The Legal Services Act 2007: the final countdown’ (2011) 7 JIBFL 410, 411-412 [↑](#footnote-ref-14)
15. Ibid 412 [↑](#footnote-ref-15)
16. Susskind*,* (n8) 4 [↑](#footnote-ref-16)
17. The Law Society, *Legal Services Industry Part 1 – an Overview*, (2012).35 [↑](#footnote-ref-17)
18. Howard & Roskill, ‘*A Whole New World’*, 162 NLJ 1292, 1293 [↑](#footnote-ref-18)
19. The Law Society, *The Legal Services Industry Part 2 – Main Sectors*, (2012).12 [↑](#footnote-ref-19)
20. Khiara & Jones, (n14) 411 [↑](#footnote-ref-20)
21. The Law Society, (n17) [↑](#footnote-ref-21)
22. The Law Society, (n12) [↑](#footnote-ref-22)
23. Chapman, *Buying legal services: the time has never been better,* (30 January 2013) at p1 [↑](#footnote-ref-23)
24. Susskind, *The Future of Law,* (1st Edition, Oxford, 1996) 291 [↑](#footnote-ref-24)
25. The Law Society Gazette, *Probate work helps Co-op ABS break even in year one*, Thursday 21 March 2013 [↑](#footnote-ref-25)
26. The Law Society, *The Legal Services Industry Part 2 – Main Sectors*, (2012) 44 [↑](#footnote-ref-26)
27. The Law Society, *The Legal Services Industry Part 1 – an Overview*, (2012) 56 [↑](#footnote-ref-27)
28. Law Society, *The Legal Services Industry Part 2 – Main Sectors*, (2012) 98 [↑](#footnote-ref-28)