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# Briefing Paper

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## THE STRUCTURE OF LEGAL SERVICES MARKETS IN SCOTLAND

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In a recent Green Paper on restrictive trade practices policy [HMSO, 1988] the government suggested that those who currently occupied a privileged position in terms of restrictive trade practices would be required to justify the continuation of these privileges. The professions were identified as being in such a privileged position. Attention was particularly focused on the legal profession.

This is the latest in a series of pronouncements by public bodies which have questioned whether the practice rules adopted by the solicitors profession (both north and south of the border) are necessarily in the public interest. The Monopolies and Mergers Commission in a series of reports in the 1970s (HMSO, 1970, 1976a, 1976b) argued that restrictions on the freedom of solicitors to advertise restricted the information available to the public about the services offered by solicitors and were likely to reduce the competitiveness and efficiency of the profession. Although some relaxations of the rules were adopted, the Royal Commissions on Legal Services in England and Wales and Scotland (HMSO, 1979, 1980) both concluded that further relaxations were necessary. However, it was only after protracted negotiations that the profession came up with modifications of their practice rules which met the requirements of these public bodies as interpreted by the Director General of Fair Trading. New rules were drawn up by the two Law Societies which permitted various forms of advertising. Those for England and Wales came into effect on 1 October 1984 whilst those for Scotland took effect from 1 March 1985. The Law Society of Scotland also withdrew its Table of Recommended Fees for Conveyancing and Executries from 1 January 1985. Yet more liberal rules on advertising were introduced by both professional bodies in early 1987. Currently consultations are taking place on whether solicitors should be permitted to practice in partnership with members

of other professions (such as accountants, surveyors, estate agents etc) and whether they should be permitted to operate in business forms other than partnerships.

All of these recent developments and some of those currently being proposed are based on the premise that the market for legal services should be subject to the same competitive forces as any other market. Many would disagree with this premise and argue that the purchase of legal services differs greatly from the purchase of a tin of beans ie the provision of legal services cannot be left to unfettered market forces. However, both sides in this argument are arguing from partial ignorance because there has been very little systematic study in the UK (or indeed elsewhere) of legal service markets. A series of studies are being carried out involving staff of the Economics Department and the Law School at Strathclyde University and we hope to report on these in the Quarterly Economic Commentary in the future. The present article outlines the results of work (which we believe is the first of its kind) which looks at the structure of legal service markets in Scotland.

The data on numbers of solicitors and law firms is derived from the Scottish Law Directory, 1985 and the Scottish Law Directory, 1965. It has been compiled from the lists of law firms by location and lists of practitioners by address published in these Directories. The accuracy of the data is, of course, conditioned by the accuracy of this source. However, we believe that this is the most reliable, publicly available, source of data on law firms in Scotland. It should be stressed that we are concerned in this study only with solicitors in private practice. We have excluded from the analysis all solicitors who are employed by public bodies, commercial and industrial organisations. Nor can we readily distinguish between those law firms which are primarily

servicing the needs of the business community and those primarily providing legal services to individuals. Thus, when we discuss individual markets below we inevitably lump together the commercial and personal sectors which are in fact distinct markets. With these caveats in mind we now turn to a discussion of the aggregate numbers of solicitors and solicitors' firms in Scotland.

Table 1 shows this data for 1985 and 1965.

Table 1 Solicitors in Private Practice in Scotland 1965, 1985

	1965	1985	% Change
No of solicitors in private practice	2,419	4,487	+85.5%
Number of firms of solicitors	905	896	-1.00%
Population per solicitor	2,128	1,136	-46.62%
Average no. of solicitors per firm	2.67	5.01	+87.6%

Source: Compiled from Scottish Law Directory, 1965, 1985

The number of solicitors in private practice has risen considerably over this twenty year period. In 1985 there was one solicitor for every 1,136 members of the population compared to one for every 2,128 members of the population in 1965. Since this service is human capital intensive this clearly represents a considerable increase in the service provision. However, it should be recognised that over the same period the demand for legal services has also risen considerably as evidenced by the rise in home ownership, divorce rates, and the increase in the provision of legal aid. In contrast to the rise in the number of solicitors the number of law firms has fallen slightly. This of course, means that the average size of law firm (measured by the number of qualified solicitors) has risen: by 87.6%. However, the average population served by each law firm was unchanged over this period, remaining at 5,688.

These aggregate figures are, to some extent, misleading when we consider the economic structure

of the market for legal services in Scotland. They suggest that close to one thousand law firms are competing to meet the legal requirements of the population. If this were so this market would be highly competitive, indeed. It would be what economists describe as an atomistic market. However, Scotland is not a single market when it comes to personal legal services or legal services for small businesses. In these sectors (as for most services) markets are relatively localised. This arises because of the frequent need for provider and client to meet face to face. A factor which will heavily influence size and location of service markets is travel-to-work patterns. Households can purchase their services at either or both ends of the travel-to-work journeys of their members. This poses a considerable problem in defining the geographical boundaries of service markets. In our studies we have defined our markets using the Department of Employment's Travel-To-Work Areas. These are defined in such a way that a relatively small proportion of the working proportion of a TTWA crosses its boundary when travelling to and from work. [For a full discussion of how TTWAs are defined see Employment Gazette, Occasional Supplement No. 3, Sept. 1984]. There are 60 TTWAs defined for Scotland, yielding 60 geographical markets for personal legal services. These vary greatly in geographical size and population. The Glasgow TTWA has the largest population (1.43 million at the 1981 census). The smallest is Islay and Mid Argyll (8,961). There are of course corresponding differences in the numbers of solicitors and solicitors' firms in such areas. In the Glasgow TTWA in 1985 there were 1,333 solicitors in private practice in 274 firms, whilst in Skye and Wester Ross there were three in practice in just one firm (according to the Scottish Law Directory, 1985).

The population per solicitor given in Table 1 masks very wide variations across TTWAs. In 1965 the figures ranged from one solicitor per 880 members of the population in Edinburgh to one solicitor for 32,607 in the Western Isles. (In fact the Directory lists no solicitors in Skye and Wester Ross for a population of 14,576.) There were 12 TTWAs in 1965 where the population per solicitor was greater than 5,000 whilst there were 25 where the figures was less than 2,000. By 1985 the population per solicitor had fallen in all but two TTWAs. Skye and Wester Ross was by then the only area with a population per solicitor of more than 5,000 (5,682). Ten areas had a figure of

less than 1,000 to one whilst forty-one had less than 2,000 per solicitor. Thus over the twenty year period the distribution of solicitors throughout the country with respect to population had become more even. There are a number of summary statistics which could be constructed to illustrate this pattern. One relatively straightforward measure is the Coefficient of Variation (CV) of population per solicitor. This is the ratio of the standard deviation of population per solicitor in each TTWA to the mean population per solicitor. In 1965 the CV of population per solicitor was 1.253. By 1985 it had fallen to 0.548, a reduction of over 56%.

Whilst this data on population per solicitor indicates that access to solicitor's services has greatly improved over the twenty year period throughout most of Scotland it does not shed much light on the question of competitiveness. Economists when discussing such questions usually begin by considering the degree of concentration of a market. This is a way of measuring the relative market power of the firms operating in the market. A number of indices have been proposed by which concentration can be measured. The index now in most common usage by economists is the Herfindahl Index (HI) constructed over output where:

$$HI = \frac{\sum_{i=1}^n S_i^2}{n}$$

when  $S_i$  is the share of the  $i$ th firm in the output of the market and  $n$  is the number of firms operating in the market. HI ranges from 1 when there is only one firm to zero when there are a large number of firms. An attraction of HI over other measures of concentration is that it takes account of the relative size of all firms. By squaring  $s$  before summing, greater weight is given in the index to firms with a large share e.g. in markets with say four firms HI will be lower the more equal is each firm's share of output.

It is not possible for us to calculate the HI over output for Scottish law firms since there are no data available on the output of this industry far less for each firm. (Indeed, there are considerable problems in defining a measure of legal service output at all.) However, because the critical input in the generation of legal services is the knowledge and skill of the solicitor providing the service a proxy measure from output is the number of qualified solicitors.

We have therefore calculated each firm's share of the number of solicitors in private practice in its TTWA and constructed HI for each of the 60 TTWAs in 1965 and 1985. These data are summarised in Table 2.

Table 2 Herfindahl Indices for Scottish TTWAs

Range	Number of TTWAs	
	1965	1985
HI>0.5	5	5
0.25<HI<0.5	21	18
0.1 <HI<0.25	18	24
HI<0.1	15	13

Source: Calculated from data in Scottish Law Directory 1965, 1985.

The significance of a particular Herfindahl Index can be seen by using its "numbers equivalent": the number of equally-sized firms which would generate that value of HI. A market where there were two equally-sized firms would generate HI = 0.5; one with four would have HI = 0.25; one with 10 would have HI = 0.1. Thus in both years there were five markets whose numbers equivalent was below two. In 1965 there were 26 markets whose number equivalent was less than four. This fell marginally to 23 by 1985. Most observers would classify these markets as being highly concentrated forming what economists would call a tight oligopoly. In 1965 and 1985 there were only 15 and 13 markets respectively where the numbers equivalent was ten or more. Indeed, in both years there were only six markets (i.e. 10% of the total) where the numbers equivalent was twenty or greater. Whilst numbers of producers and their relative size are not the only factors which determine the competitive nature of a market, these data suggest that relatively few legal service markets in Scotland would be considered truly competitive.

The aggregate data suggest that the average size of firms has risen considerably over the period 1965-1985. However, since all firms are unlikely to have grown at the same rate it is possible that levels of concentration may have changed in industrial markets. In fact in 31 TTWAs the Herfindahl Index has fallen whilst in 27 it has risen.

However, most of these changes are relatively small and have not radically changed the degree of concentration. Some markets which were already highly concentrated have become more so e.g. the HI for Wick has risen from 0.375 to 0.625 and that for the Campbelltown TTWA from 0.333 to 0.54. There were relatively few with changes as significant as those for St Andrews (0.101 to 0.1694), Dumfries (0.0749 to 0.1371) and Greenock (0.0651 to 0.1207) whose numbers equivalents went from 10 to 6, 13 to 7 and 15 to 8 respectively. At the other extreme the HI for the Western Isles fell from 1 to 0.281 but its numbers equivalent in 1985 was still below 4. Bathgate, however, went from 0.2778 to 0.16736 which is a change from a numbers equivalent of 3.6 to 6. Although the number of firms rose from 4 to 12 in Bathgate and the number of solicitors from 6 to 44 the largest firm had one third of all solicitors in the market in both years. The overall picture is that in spite of the dramatic rise in the number of solicitors in private practice between 1965 and 1985 the degree of concentration in local markets has not changed significantly.

In this article we have looked at the distribution of solicitors in private practice throughout Scotland in 1965 and 1985. Our conclusion is that whilst the number of solicitors has risen dramatically over the period and the distribution of solicitors relative to population has become in some way more even, the structure of legal service markets has changed significantly in relatively few markets. The vast majority of local markets remain relatively highly concentrated. The implications of this for the consumers of legal services depends on the conduct of the firms in these concentrated markets. Were law firms to exert their market power consumers would undoubtedly suffer. The recent changes in practice rules have at least made it possible in principle, for consumers to obtain more information about the relative costs of using different solicitors. However the relatively small number of firms operating in most local markets makes competition unlikely in the absence of new firms entering these markets.

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