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COMPETITION COMMITTEE**

**Working Party No. 2 on Competition and Regulation**

**Competition and Regulation in Professional Services – Note by Denmark**

10 June 2024

This document reproduces a written contribution from xx submitted for Item 8 of the 77th meeting of Working Party 2 on 10 June 2024.

More documents related to this discussion can be found at  
[www.oecd.org/competition/competition-and-regulation-in-professional-services.htm](http://www.oecd.org/competition/competition-and-regulation-in-professional-services.htm)

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## Denmark

1. The Danish Competition and Consumer Authority has a general focus on liberal professions, due to the relatively low exposure to international competition among other things.
2. In 2021, the Danish Competition Council published a comprehensive analysis of competition within the legal profession. The findings revealed significant challenges. Based on the analysis, 16 policy recommendations were presented to strengthen the competition within the legal profession.
3. The policy recommendations aim to reduce barriers to entry and expansion that law firms and other providers of legal services may encounter, as well as the challenges that clients face when trying to navigate and select a provider in the market.
4. The recommendations include measures directed towards the regulation of the legal profession, the clients seeking legal services, competition for legal assistance for public clients, and measures aimed at strengthening competition for legal services in bankruptcies and estates.
5. Four of these recommendations have been fully or partially implemented, primarily with The Danish Bar and Law Society's latest amendment to the code of ethics for lawyers.<sup>1</sup>
6. In 2023, the Danish Competition Council published updated competition indicators. This updated analysis is presented below.
7. There are no signs of improved competition within the legal profession. Earnings have continued to rise from an already high level, and there are no notable signs of improvement in the market dynamics.

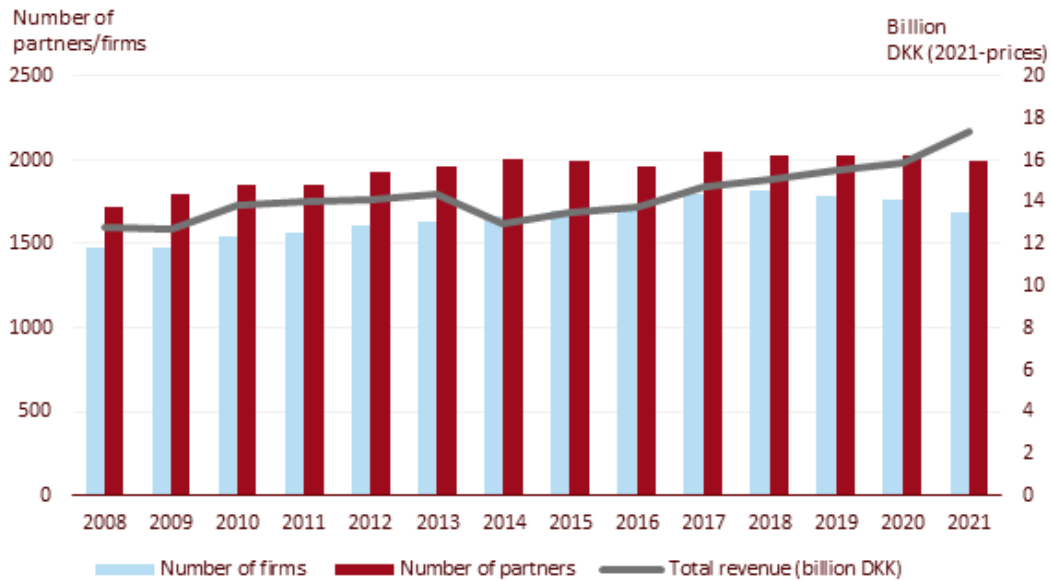
### 1. Introduction to the Legal profession in Denmark

8. The Danish legal profession comprises of approx. 1,700 law firms in 2021, cf. Figure 1, encompassing a range from a few very large law firms with several hundred employees to smaller law firms, including sole proprietorships. There are nearly 2,000 partners.
9. In 2021, the legal profession generated revenue of 17.3 billion DKK corresponding to an increase of almost 15 pct. in real terms since 2018, cf. Figure 1.

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<sup>1</sup> The changes to the code of ethics for lawyers were first adopted with effect from September 1, 2022, and any such changes have therefore not affected the described earnings in this article, which cover the period up to 2021.

Figure 1. The trend in revenue and the number of law firms



Note: Revenue is deflated to 2021 prices using the consumer price index.

Source: The Danish Competition and Consumer Authority based on Statistics Denmark's registers.

## 2. Earnings in the legal profession

10. Profits and earnings are fundamental aspects of running successful businesses operating within a market economy. A temporary rise in earnings may for example reflect companies developing popular products or finding new ways to streamline operations. However, a well-functioning market with effective competition is also characterized by gradually competing down supernormal returns.

11. In a market with effective competition, high returns will consequently attract new entrants seeking a share of the profits, thus putting pressure on prices and returns. If companies in a market can sustain supernormal returns for an extended period, this may indicate limited competition.

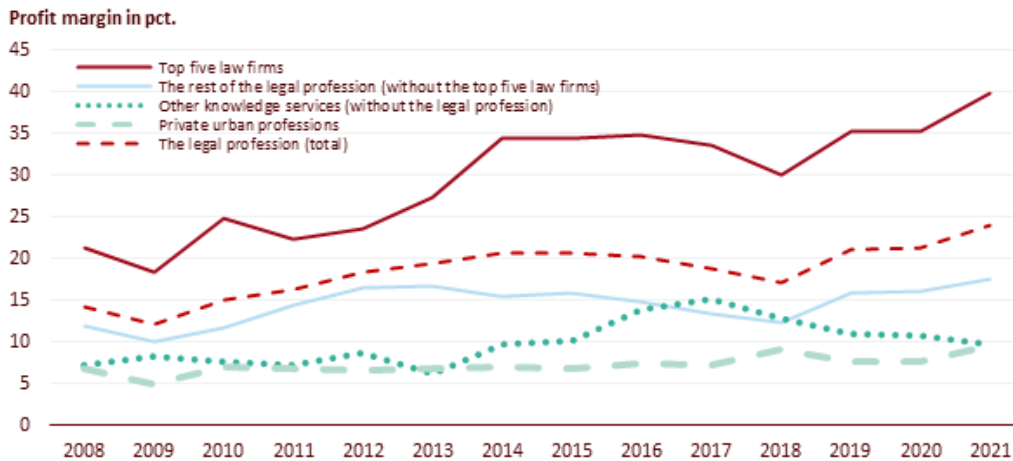
12. A company's profit margin denotes the percentage of revenue remaining for the owners after the company has covered its ordinary expenses. A significant expense in law firms is the salaries paid to the firm's employees. The legal profession differs from many other professions since its owners, the partners, also work in the law firm. Consequently, the total income earned by partners consists of a salary for their work in the firm and ownership return in the form of a share of the law firm's profit.

13. The profit margin within the legal profession was calculated to be 24 pct. in 2021, after accounting for partners' salaries for their work performed cf. Figure 2. Since 2008, the profit margin has increased by almost 10 percentage points, with a particularly notable rise since 2018. The profit margin in the legal profession is noticeably higher - and has increased more since 2018 - compared to other knowledge services and private urban professions.

14. In 2021, the profit margin in the five biggest law firms was nearly 40 percent. The profit margin has thereby increased by 10 percentage points since 2018 and nearly doubled

since 2008, cf. Figure 2. For the rest of the legal profession, the profit margin has fluctuated between 10 and 18 percent throughout the period but with an upward trend since 2018.

Figure 2. Profit margin



Note: The profit margin generally shows the difference between revenue and costs as a proportion of revenue. For sole proprietorships, the profit margin is only calculated in law firms where the partner is under 66 years of age. The profit margin for private city businesses has not been corrected for salary for work performed in the companies where the owners work in the company.

Source: The Danish Competition and Consumer Authority based on Statistics Denmark's registers.

15. Another method for assessing the level of earnings is to measure whether the return on the invested capital exceeds the return on capital that an external investor can reasonably expect in a well-functioning market.

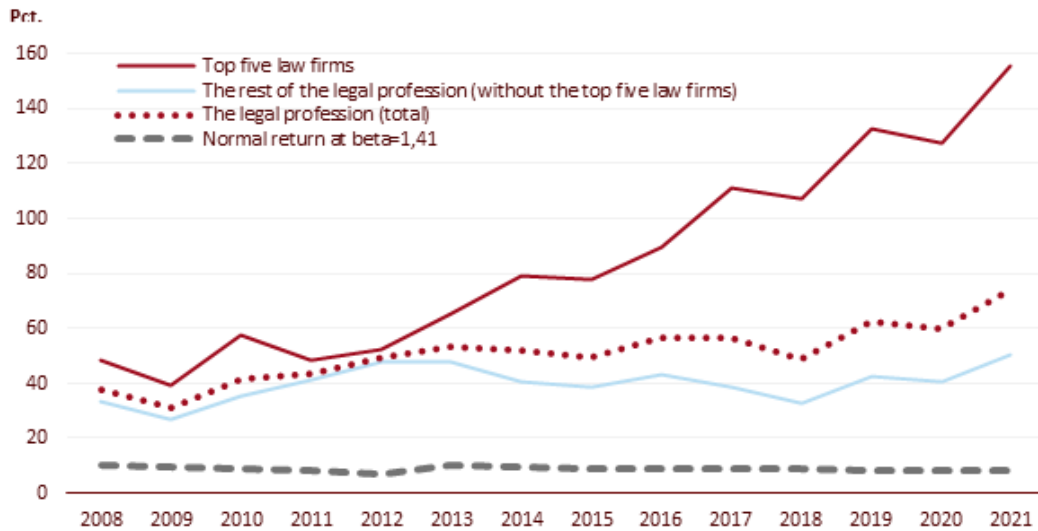
16. In the following, the return on equity in law firms is calculated as the total of the partners' return on ownership as a share of the firm's equity.

17. The estimated return on equity in the legal profession is 74 pct. in 2021, cf. Figure 3. The return on equity has increased from 38 percent in 2008 and has throughout the period remained significantly higher than a (highly set) estimate of a normal return. This supports that competition does not function well and that it is, moreover, not unlikely that external investors would see an advantage of injecting capital into the profession if given an opportunity for this.<sup>2</sup>

18. The return on equity in the top five law firms exceeds the industry average and have increased by 107 percentage points from 2008 to 2021. In 2021, the return on equity for these firms is 156 pct.

<sup>2</sup> The ownership and management of a law firm are regulated in the Administration of Justice Act. Thus, 90 percent of a law firm must be owned by individuals holding a Danish lawyer's license who are also employed by the law firm. 10 percent of a law firm may be owned by employees of the firm who are not lawyers. Additionally, law firms may generally only be managed by the owners of the firm.

Figure 3. Return on equity in the legal profession and normal return



Note: The return on equity is calculated as the accounting profit minus the calculated salary for the partners' work in relation to the accounting equity.

Source: The Danish Competition and Consumer Authority based on Statistics Denmark's registers and Yahoo Finance.

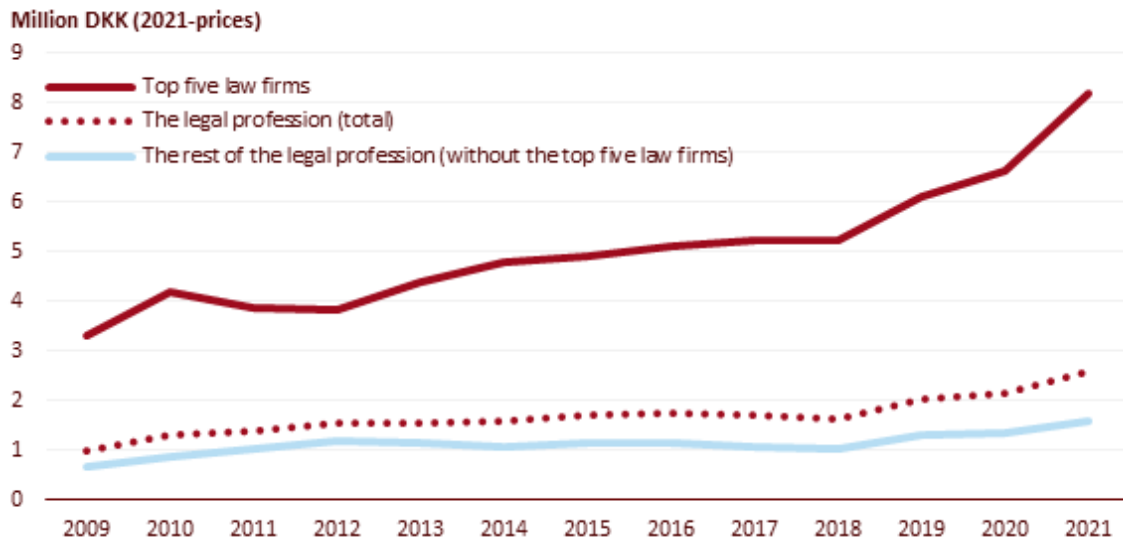
19. The owners of the law firms, the partners, gain any supernormal returns through return for their ownership. In 2021, the average return on ownership per partner in the top five law firms was approximately 8 million DKK, cf. Figure 4. This is an increase of almost 150 pct. from 2009 to 2021, amounting to 5 million DKK in real terms. The rest of the legal profession has an average return on ownership per partner of 1.6 million DKK in 2021, reflecting an increase over 80 pct. during the period. The total return on ownership in the industry (excluding estimated salaries) averaged around 2.6 million DKK per partner in 2021.

20. Return on ownership per partner is computed as the partners' total income minus the estimated salary for their work.<sup>3</sup>

21. High wages and return on ownership imply that partners in the legal profession enjoy relatively high incomes. Nevertheless, considerable variations exist. In 2021, 64 pct. of the partners income surpassed 1 million DKK, encompassing both labor and return on ownership. Furthermore, 16 pct. of all partners had an annual income exceeding 5 million DKK.

<sup>3</sup> In this calculation, only partners who are younger than 66 years old and who have been partner for at least one year are in the data. This group consists of 1,558 partners. The limitation is chosen to exclude law firms with very little or no activity, for example because the partner has retired.

Figure 4. Return on ownership per partner



Note: The calculation includes all partners under the age of 66 who have been a partner for at least one year. The remuneration of ownership is deflated with the consumer price index and converted to 2021 prices.

Source: The Danish Competition and Consumer Authority based on Statistics Denmark's registers.

22. The relatively high profits within the legal profession must be seen in light of a large demand for the profession's services and that lawyers often work long hours and possesses a set of skills, human capital, that allow them to create substantial value. For instance, owners in the legal profession have a higher grade average from upper secondary school (high school grades) than owners with comparable higher education diplomas (university degrees) from other knowledge services professions. In terms of grade point average, however, there are no signs that the partners' 'competence advantage' has increased over the past few decades. This indicates that the development in skills etc. can hardly explain the increasing profits in the legal profession.

23. In the economic literature, managers or employees with competencies that provide a particularly high value for their company are referred to as superstars. Bennedsen et al. (2020)<sup>4</sup> delves into the phenomenon of the "superstar effect" by examining the consequences of the unforeseen absence of a company's CEO. They find a negative effect of CEO absence (in the form of hospitalizations) on earnings.

24. The 2021 analysis attempted to replicate the Bennedsen et al. (2020) study with focus on the legal profession, aiming to shed light on the individual contributions of partners to the firm's revenue. However, the analysis did not uncover any evidence suggesting that unforeseen partner-absences have an impact on revenue generation within law firms. As a result, the identification of a "superstar effect" was not successful.

### 3. Concentration and Market Dynamics

25. In 2021, the top 10 law firms collectively accounted for approximately 45 pct. of the total revenue and has thus grown significantly since 2003, where it was around 28 pct

<sup>4</sup> Bennedsen, M., Pérez-González, F., & Wolfenzon, D. (2020). Do CEOs matter? Evidence from hospitalization events. *The Journal of Finance*, 75(4), 1877-1911.

cent. The increasing concentration reflects an increase of 8 percentage points in market share for the five biggest companies as well as an increase of approximately 11 percentage points for the 6-10 biggest. The biggest companies thus appear to be gaining market shares, and concentration is thus increasing.

26. In the 2021 analysis, it was shown that there are significant variations in concentration levels across the different specialties.<sup>5</sup> For example, average market shares are notably high within fields such as patent and copyright law, public law, financial advisory, as well as procurement and competition law. These specialties are typically demanded by business and public customers. Conversely, specialties with the lowest average market shares predominantly involve advising individual, private clients.

27. The mobility of market shares provides an overall impression of the dynamics within the market. Mobility is measured here by a mobility index, which assumes a value of 0 in a completely stagnant market where all firms maintain their market share from one year to the next, while an index of 100 signifies that all market shares "change hands". In the latter scenario, none of the firms holding market shares in one year will remain in the market the following year. The index thus indicates the proportion of turnover in the legal profession that shifts between firms.

28. Market share mobility within the legal profession has ranged between 6 and 11 percent throughout the period, with a decreasing trend over the past years. The calculations thus show that 6-11 percent of the turnover "changes hands" annually. This level is relatively low compared to knowledge services overall, but at approximately the same level as in the auditing and accounting profession.

#### 4. Recommendations aimed at more competition-friendly regulation

29. In the Competition Council's 2021 analysis, 16 policy recommendations were presented to strengthen the competition within the legal profession.<sup>6</sup>

30. The recommendations aim to reduce barriers to entry and expansion that law firms and other providers of legal services may encounter, as well as the challenges that clients face when trying to navigate and select a provider in the market.

31. The recommendations include measures directed towards the regulation of the legal profession, the clients seeking legal services, competition for legal assistance for public clients, and measures aimed at strengthening competition for bankruptcies and estates, as outlined in box 1.

32. The recommendations aim to ensure that both mid-sized law firms and firms from other professions can exert greater competitive pressure on large law firms. This will be achieved, for example, by facilitating law firms' access to capital, a barrier to growth identified by many mid-sized firms, and by permitting multidisciplinary partnerships,

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<sup>5</sup> This analysis does not include a formal definition of the market for legal advice in competition law terms. It has also not been assessed whether the individual specialties constitute separate markets in a competition law sense. Therefore, the calculation of concentration indices should be seen as an indicator of competition between law firms within specialties, without considering any competitive pressures from other sectors, for example.

<sup>6</sup> For an elaboration of the recommendations, please refer to the following link: <https://www.en.kfst.dk/analyser/kfst/publikationer/engelsk/2021/20210114-competition-in-the-legal-profession/>

which will contribute to increased competitive pressure from other industries such as the auditing sector.

33. Four of these recommendations have been fully or partially implemented primarily with The Danish Bar and Law Society's latest amendment to the code of ethics for lawyers (effective from September 2022).

34. The other recommendations have not yet been followed up on. This includes rules concerning who may own a law firm, the purposes of law firms, and the possibility for employed lawyers to provide external legal advice using the title of lawyer from companies other than law firms.

### Box 1. Recommendations aimed at more competition-friendly regulation

- 1.1 Easing the rules governing the ownership and management of law companies
- 1.2 Expanding law companies' possible 'objects', including permitting multidisciplinary partnerships in Denmark
- 1.3 Allowing employed lawyers to sell external legal advice using their title of lawyer from other companies than law firms, subject to compliance with the code of ethics for lawyers
- 1.4 Setting up a working group on the admission of other graduates than holders of a Master of Laws (cand.jur.) degree to the continuing legal education programme (implemented)
- 1.5 Easing the rules on conflicts of interest regarding identification with the interests of colleagues, for the use of informed consent as well as in connection with change of firms and mergers (partial implemented)
- 1.6 Abolishing the prohibition of so-called 'client fishing', however, not in criminal proceedings or cases involving particularly exposed or vulnerable persons (partial implemented)
- 1.7 Abolishing the prohibition of fee sharing with non-lawyers
- 1.8 Abolishing the prohibition of performance-linked price agreements, however, not in criminal proceedings (implemented)
- 2.1 All clients will receive a quotation in a fixed 'standard template' before an agreement is entered into
- 2.2 The law firms must disclose their prices for services at a standard price and hourly rates on their own website
- 3.1 Increased competition for the Danish State's procurement of legal assistance
- 3.2 Increased competition for municipalities' and regions' procurement of legal assistance
- 4.1 Establishment of a sector-neutral authorisation scheme for liquidators
- 4.2 Permanent liquidator panels must be appointed regularly on the basis of competition between the applicants, and the appointment of liquidators for insolvent estates without assets must be done in accordance with transparent allocation criteria

4.3 Working group on strengthened competition and greater predictability, transparency and efficiency in the administration of large insolvent estates with assets

4.4 The competition for administrator estates must be strengthened