COMMENTS OF BDO LLP ON COMPETITION COMMISSION WORKING PAPER ON THE LIFE CYCLE OF FTSE 350 COMPANIES

1 THE LIFE CYCLE OF FTSE 350 COMPANIES

1.1 Targeting of Mid-tier firms' clients by Big Four firms

1.1.1 Paragraph 13 infers from Tables 1, 2, and 3 that, "*there has not been substantial movement between index designations during the last ten years*". However, Table 1 shows that more than two thirds of companies have switched index designation in the past ten years. This would suggest that there has been substantial movement.

1.1.2 Paragraph 23 states that "*it is not necessarily the case that Big Four firms target Mid Tier firms clients in advance of FTSE 350 listings (any more so than Big 4 firms target other Big 4 firm clients)"*. This is based on Table 6. However, Table 7 does not support this claim. When a wider time frame is considered (switches occurring in the two years before, the year after or the year of a change of index designation, rather than those occurring in the year before or the year of a change in index designation), there is a much higher percentage of switches from Mid Tier to Big Four firms, as well as a higher number of such switches when companies are entering the FTSE 350 than when companies are leaving it. This is more consistent with BDO's experience of its clients being targeted by Big Four firms as they grow and have aspirations to join the FTSE 350.

1.1.3 Whether and when a listed company joins the FTSE 350 is not within its control, because this depends on its market capitalisation relative to that of other companies. Thus while a listed company may be on course to join the FTSE 350, it will not be able to predict precisely when it will do so, as this will depend on its share price, the share prices of the present constituents of the FTSE 350 and the share prices of other companies which may also be on course to join the FTSE 350. A wider (two year) time frame is therefore a more appropriate framework within which to review changes in advisers and the CC should not draw conclusions based on a narrow (one year) time frame: in other words, Table 7 is more representative of the position than Table 6 in this context.

1.1.4 BDO also notes that while the time window used by the CC for considering the link between switching auditor and FTSE 350 entry is up to two years before and up to one year after FTSE entry, when considering the link between merger activity and switching auditor the window used is up to three years before the switch and up to one year after (Table 8). BDO can see no reason why the appropriate window for considering a link between FTSE 350 entry and switching should be shorter than for the link with merger activity.

1.1.5 Since not all companies which aspire to join the FTSE 350 will actually do so, the CC's focus on companies which did join the FTSE 350 means that switching by companies which stayed in the "other listed" category is not considered in this context. However, the impact of targeting of growing companies by the Big Four will still be felt in relation to such other listed companies, because they may switch to a Big Four firm as part of their aspiration to join the FTSE 350, even if they never achieve that status (perhaps despite continuing to grow). BDO notes that paragraph 4 states that the: "*highest proportion of switches from a Mid Tier firm to a Big Four firm is found among other listed designation companies."*

1.1.6 A related point is that by excluding companies that were not in the FTSE 350 at any point in the past 10 years, the CC cannot properly consider or answer the question of whether Big Four Firms target the clients of mid-tier firms before entry into the FTSE 350. In order to answer this question, it would have been appropriate, for example, to compare:

(a) the targeting by Big Four firms of companies that subsequently entered the FTSE 350 (or which came close to doing so by virtue of their market capitalisation); against

(b) the targeting by Big Four firms of companies that had no realistic prospect of entering the FTSE 350.

The CC has not done this.

1.2 Merger activity and switching audit firm

1.2.1 Paragraph 25 states that "*we cannot tell how substantial the value of deal activity is relative to the size of the company and/or the type of companies that were acquired".* This may be correct in relation to Dealogic data, but it is not an immutable fact. Further research should reveal which companies did which deals of which size in what period: such information in relation to listed companies should be publicly available.

1.2.2 Paragraphs 25 to 29 inclusive concern switches close to deal activity, but the CC does not appear to have cross-linked switches close to deal activity and switches between type of audit firm (e.g. Big Four to Big Four, Big Four to mid-tier, mid-tier to Big Four). For example, if a company audited by a mid-tier firm merges with a company audited by a Big Four firm, is the Big Four firm likely to audit the merged firm? Such analysis could be informative.