

PwC Response

Economies of Scale in Operating Costs Working Paper

- 1 This paper sets out our comments on the Economies of scale in operating costs working paper.
- 2 We find it difficult to comment on the detail of the CC's work in respect of this paper due to the level of redactions. To the extent that the CC relies on this working paper in its provisional findings to any material extent, we reserve the right to comment and would need to agree with the CC a method for allowing access to the unredacted version of the paper.
- 3 From what can be seen in the published version, it appears the CC has found:
 - (a) There is no readily available evidence of economies of scale in relation to IT expenditure.¹ This suggests that IT expenditure is not a barrier to entry in the reference market.
 - (b) It is not possible to draw a firm conclusion in relation to economies of scale in respect of accommodation costs.² This suggests that accommodation costs are not a barrier to entry in the reference market.
 - (c) There is no readily observable economy of scale in marketing costs and that the level of absolute and relative expenditure is a strategic decision, with a significant range in the level of marketing spend. There is also no observable link between the size of firm and the level of partner activity devoted to marketing.³ This suggests that marketing costs and the need for partners to devote time to marketing are not barriers to entry.
- 4 In relation to marketing costs, we have submitted that there are likely to be significant differences in the ways the various firms record time and budget spent on marketing, such that comparisons are likely to be difficult and unreliable. The CC acknowledges this.⁴
- 5 The initial indications discussed above are that there are not barriers to entry arising out of economies of scale in the areas of operating costs considered by the CC. This is consistent with our view as expressed in our response to the Barriers to Entry Framework working paper.⁵
- 6 We would therefore expect the provisional findings to acknowledge that such costs are likely to be scaleable to the investment made in expansion by any smaller audit firms.

¹ Paragraph 4.

² Paragraphs 23 and 24.

³ Paragraphs 6 and 7.

⁴ This is noted by the CC in footnote 12.

⁵ See paragraph 17 of our response to the Barriers to Entry Framework working paper where we recognise that *"While a 'big bang' one-off expansion to enable the mid-tier firms to serve the largest FTSE 350 companies is unlikely to be feasible, a stepped, phased approach focussing on particular market and geographical segments and companies is perfectly realistic should a business opportunity arise. This would enable the new entrants to scale down their immediate investment requirement, with a view to increasing their experience and improving their reputation for quality and efficiency within the FTSE 350 audit market and using this as a platform for further investment and expansion. Much of the cost associated with providing large company audit services is associated with the audit team itself, and thus varies with the number and size of audits won. Centrally incurred costs, such as methodologies, systems and technical expertise, can also be scaled to a degree depending on the number and size of audits, building on what the mid-tier firms have already."*



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- 7 To the extent the provisional findings contain any suggestion to the contrary, and in particular given the difficulty with reliability of data in this area, we (and our advisers) would want to revisit this analysis with the opportunity to consider an unredacted version of this paper.

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