

**COMMENTS OF BDO LLP (“BDO”) ON THE
COMPETITION COMMISSION’S FIRMS STATED COMPETITIVE STRATEGIES
WORKING PAPER¹**

1 FIRMS’ STATED COMPETITIVE STRATEGIES

1.1 Introduction and summary

1.1.1 The statement in paragraph 3 that *“the parties believe that there is active competition within the market and that they each actively compete”* is too simplistic and too close to the position advocated by the Big Four. It implies that the relevant market is functioning normally and properly, which it is not. There is competition between the parties, but it is restricted by (among other things) the presence of significant barriers to entry and expansion, customer conduct and intermediary conduct.

1.1.2 BDO does not regard *“the smaller end of the FTSE 250”* as an *“immediate target for the mid tiers”* as stated in paragraph 5. BDO could audit all but the largest 35 companies in the FTSE 350 as of today. This is understating BDO’s aspirations.

1.2 Lowballing

1.2.1 Paragraph 12 attempts to justify “lowballing” by Big Four firms on the basis of seasonality. BDO considers this to be misconceived. Big Four firms do not “lowball” to even up seasonal lows in demand; they do so to win growing clients from mid-tier firms, particularly where those clients have the potential to become FTSE 350 companies and may buy non-audit as well as audit services. BDO believes that this pricing tactic is a key factor which operates as a barrier to entry or expansion by mid-tier firms.

1.2.2 Paragraph 12 incorrectly states that *“there has been no written submission that firms are strategically lowballing to prevent smaller firms entering the market.”* BDO has made submissions to the CC in relation to lowballing by Big Four firms:

(a) BDO stated in paragraph 1.6 of its response to the CC’s Issues Statement that:

“the four largest audit firms (the “Big Four”) reinforce their dominance in the Reference Market by, among other things... using deep discounts to try to win audit clients from BDO and other audit firms outside the Big Four, or to try to retain audit clients on the rare occasions when those clients invite audit firms outside the Big Four to tender against a Big Four incumbent”.

(b) BDO also stated in paragraph 5.1.14 of its response to the CC’s Issues Statement that:

“market power can be (and is) used by the Big Four to enable them to use deep discounts to try to win audit clients from BDO and other audit firms outside the Big Four, or to try to retain audit clients on the rare occasions when those clients invite a firm

¹ Reference to paragraph numbers are to paragraphs of the relevant working paper (“WP”) unless stated otherwise.

outside the Big Four to tender against a Big Four incumbent. BDO believes that the Big Four are willing to cross-subsidise certain clients' audit work for a period in order to try to win those clients from BDO and/or other firms outside the Big Four, or to try to retain audit clients when they are considering moving to BDO or another firm outside the Big Four. For example:

(a) in a recent tender for the [X] audit, in the face of deep discounting by Big Four firms ([X]), BDO was only able to retain the client (a FTSE 350 company) by [X]; and

(b) in a recent tender for [X], BDO were replaced as auditor by [X], who BDO understands quoted [X], well below normal rates for this work.

Such conduct reinforces and increases barriers to entry and expansion; it is anti-competitive and exclusionary."

- (c) In addition, paragraph 4.2 of BDO's response to the CC's Working Paper on Entry Restrictions provided specific examples of Big Four firms targeting clients of mid-tier firms who have potential to move into FTSE 350 with aggressively priced tenders:

"[X], which has been listed on the London Stock Exchange since [X], has been heavily targeted by [X] for several years. BDO understands that [X] has given unsolicited audit fee quotes at a discount to the existing fee and has made comments aimed at undermining BDO's depth (tracking partner rotation)." and

"[X] received an unsolicited audit proposal from [X] in [X] at a fee of [X], when BDO's audit fee was then [X] ... BDO audited [X] until [X] were [X] auditors".

1.2.3 BDO encourages the CC to investigate these examples forensically by seeking factual information from the other parties involved.

1.2.4 The issue is not that the Big Four strategically lowball to prevent "smaller firms" entering the market, as BDO and GT in particular are already present in the market; it is that the Big Four strategically lowball to weaken mid-tier firms' presence in the market and/or to prevent them from expanding in the market.

1.2.5 Footnote 4 says that "listed companies tend to have 31 December year ends" . Retailers generally have 31 January year ends. More importantly, however, "lowballing" is not about maintaining utilization rates in less busy periods.

1.3 **Attracting and retaining clients**

1.3.1 Paragraph 19 lumps all firms other than the Big Four together, rather than distinguishing between mid-tier firms, some of whom (including BDO) also audit companies generally, including FTSE 350 companies, albeit to a considerably lesser extent than the Big Four.

1.3.2 If the CC implements a package of remedies to open up the audit market by (among other things) reducing barriers to entry and expansion, mid-tier firms will be much better placed to target most of the FTSE 350.

1.4 **Alertness to opportunities and 'bid readiness'**

Paragraph 28 states that non-Big Four firms "*appear not to have dedicated central bid support teams.*" However, BDO does have a central bid support team, supported by specialists in regional centres. BDO also has sector teams made up of professionals who strive to keep close to the markets in which they operate. Sector teams, stream and office teams all have lists of managed targets which are actively worked upon to produce opportunities for engagement so that BDO is in a position to be considered for an audit bid when the moment arises.

1.5 **People**

The suggestion in paragraph 38 that partners in Big Four firms are targeted on the basis that they are unlikely to progress further in their own firm is erroneous. BDO considers where it needs external partner resource, based on its market needs, and then looks for the right candidates, those being ones with the relevant experience, skill and market knowledge. These may or may not come from the Big Four. There are many reasons for Big Four partners joining BDO, other than reigniting a stalled career, including, BDO would suggest, much greater empowerment and freedom to pursue objectives in a more collegiate environment, affording greater job satisfaction.

1.6 **General comment**

The Working Paper generally divides audit firms into two distinct camps – the Big Four and all other firms. The true position is more nuanced, as investors appear to recognise; in particular, that audit firms outside the Big Four are not homogenous and that larger mid-tier firms, in particular, offer a good alternative to the Big Four.

1.7 **Appendix**

1.7.1 Paragraphs 71, 181 and 250 show the size of the alumni networks of the Big Four: 22,000 former staff in Deloitte's alumni network; 25,000 former employees in KPMG's alumni network and 30,000 former staff in PwC's alumni network.

1.7.2 If the last line of Paragraph 191 refers to BDO, BDO reiterates its comments at 1.5 above.

1.7.3 BDO disagrees with PwC's claim at paragraph 253 that it "*lacks the capabilities and attributes necessary to audit most large companies*" and that it has made "*no serious investment...to develop these attributes*". BDO can currently audit all but the 35 or so largest FTSE 350 companies. BDO and the BDO network have made significant investments in recent years, including investments in:

- (a) Creating the global BDO brand;
- (b) Modernising and expanding the BDO network, including a number of mergers and acquisitions;
- (c) Developing and implementing a consistent business strategy across the BDO network;
- (d) Developing a consistent audit methodology, including appropriate software, and rolling it out globally across the BDO network;
- (e) Sector expertise;

- (f) Extending the 'exceptional client service' proposition from the UK to the worldwide network (this will be the subject of a global advertising and marketing campaign planned for 2013); and
- (g) International secondments.