Regulation of Television Advertising

Report with Evidence

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See Appendix 1.
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Q refers to a question in oral evidence;
RTA 1 refers to written evidence as listed in Appendix 2.
The UK television advertising industry has changed over recent years as a result of the growth in the number of commercial channels, competition for marketing budgets from internet advertising and the economic downturn. This has led to calls for changes in the regulation of television advertising.

Although there has been some deregulation within the television advertising industry there remain constraints on the quantity, scheduling and content of television advertisements and additional constraints on the price of commercial airtime on ITV1.

This report takes a fresh look at the impact of the regulations on viewers and consumers as well as advertisers and broadcasters. It focuses on the regulations which do not involve advertising content.

ITV plc is committed to a set of undertakings relating to the sale of advertising airtime on ITV1. These undertakings, known as Contract Rights Renewal (CRR), address competition concerns identified when Carlton and Granada merged to form ITV plc in 2003 and provide a fallback right for media agencies and advertisers to continue with the contract terms negotiated at the time of the merger if they choose to do so.

We have concluded that the CRR undertakings are no longer the most appropriate mechanism for regulating how advertising airtime is sold on ITV1. In return for CRR’s removal—as Adam Crozier, ITV plc’s CEO, suggested to us—we recommend that ITV plc increases its investment in quality, wide-ranging, original UK programming on ITV1. In addition we wish to see renewed investment by ITV plc in training. These commitments should take the form of binding undertakings which will enable ITV1 further to fulfil its public service obligations.

The changes to CRR may require primary legislation. However it would be preferable to deal with these as soon as possible under the aegis of the Secretary of State for Culture, Olympics, Media and Sport. We recommend that the proposed changes together with any proposals for changes to the way that television advertising airtime is traded are implemented at the very latest as part of the next Communications Act.

We agree with the Competition Commission and Ofcom that the trading system used for selling television advertising is complex and arcane. The lack of transparency within the trading system favours neither fair competition nor the viewer. We recommend that there be a short, focused review of the trading system for television advertising airtime in order to find a more transparent system which includes a robust appeals process to address any outstanding industry concerns.
We also believe that digital switchover, due to be completed in 2012, will be the right time to abandon the long-standing differences between the commercial public service channels—that is ITV1, Channel 4 and Channel 5—and other commercial channels, in the quantity of advertising airtime they are permitted to sell (the “COSTA” regulations). This “harmonisation” will level the playing field for television advertising airtime. It will also, we believe, release more money for commercial public service broadcasters to invest in quality UK-originated television programming. Research suggests that viewers would not support an increase in the amount of advertising on television, especially on ITV1, Channel 4 and Channel 5. On balance we have concluded, subject to Ofcom’s ongoing research, that it would be in the public interest to apply a maximum daily average of seven minutes of advertising per hour across all commercial channels with an appropriate maximum peak time limit.
Regulation of Television Advertising

CHAPTER 1: INTRODUCTION

1. Television plays an integral role in people’s lives and accounts for a high proportion of leisure time. It is an important source of information and entertainment and, despite the increasing number of media devices competing for consumers’ time and attention, certain television programmes continue to attract audiences of many millions.

2. In recent years television advertising revenues have been in decline. The economic downturn has had a profound effect on the advertising sector and this has undoubtedly played a major part in the fall in television advertising revenues. In addition, the price of television advertising has fallen as a result of increased supply in the market due to the rapid growth in the number of television channels broadcasting in the United Kingdom (UK). The growth of internet advertising has also had an indirect effect on television advertising, as some advertisers have moved resources away from display advertising (of which television advertising is a major part) towards key-word based search and classified advertisements online.

3. Television advertising airtime is not sold in a conventional way. A very complicated system has evolved over time based on the sale of television airtime with guaranteed numbers of viewers from specified demographic groups. This system lacks transparency but the industry has rejected calls for a detailed investigation into how an alternative trading system might be designed.

4. This market is subject to regulation by two specific rules. The first is the Contract Rights Renewal mechanism (CRR) which bears specifically on the marketing of advertising by ITV plc for ITV1. The second are the rules governing the quantity of advertising that can be shown on both the main commercially-funded public service broadcasting (PSB) channels (ITV1, Channel 4 and Channel 5) and on all other commercial channels. This is known as the Code on the Scheduling of Television Advertising, COSTA.

5. CRR was introduced as a result of competition concerns at the time of the merger between Carlton and Granada to form ITV plc in 2003. It was designed to prevent the newly merged ITV plc from abusing its dominant position in the television advertising market. ITV plc claims that ITV1’s position in the advertising market is no longer dominant and that CRR is therefore no longer necessary. It is calling for the removal of CRR, saying that it is restricting its advertising revenues and that this has hampered its ability to invest in original and diverse UK programmes.

6. The Competition Commission finalised its detailed inquiry into CRR last year. It found that although ITV1’s market position was not as strong as in 2003, it had retained an enhanced market position, primarily due to its unique ability to quickly deliver large audiences. As a result, the Commission concluded that the CRR undertakings should remain in place and indeed that they should be extended to other parts of ITV plc’s output (ITV1 +1 and ITV1 HD).

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1 Review of ITV’s Contracts Rights Renewal Undertakings, Final Report, Competition Commission 12 May 2010, para. 7.1
7. The conclusions of the Competition Commission inquiry have not, however, laid the debate about CRR to rest. In particular the Commission was required to conduct its review using a narrow definition of what constitutes the public interest, focusing exclusively on the interests of advertisers, media agencies and other broadcasters. The impact of CRR on the specific interests of viewers and consumers was not within the Competition Commission’s remit. For this reason, we concluded that a further inquiry into the broader issues of CRR would be appropriate.

8. In addition we also looked at the rules governing the amount of advertising which can be shown on television on each channel and at different times of the day. The rules are outlined in the Code on the Scheduling of Television Advertising (COSTA) and allow for the majority of commercial broadcasting channels to carry more advertising per hour than the three main commercial public service broadcasting channels. COSTA was originally formulated when multichannel television was in its infancy. However, given that digital television is now well established in the UK, with 92.6% of UK households now owning a digital TV service,\(^2\) and with analogue broadcasts to cease from next year, there have been several calls for the rules to be harmonised so that all broadcasters are allowed to carry the same number of television advertising minutes on average per hour per day.

9. Until September 2010, television advertising was also regulated by two airtime sales rules.\(^3\) One prevented commercial PSBs from withholding airtime on their channels in order to decrease supply and increase the cost of advertising (the withholding rule). The other prevented all broadcasters from only selling their airtime in a bundle with several channels in their portfolio (the conditional selling rule). Ofcom rescinded these rules in September 2010. There are a number of other rules governing the content of television advertisements.\(^4\) As these rules have recently been revised (most recently to incorporate Government changes to allow product placement in television programmes in the UK)\(^5\) they have not been the focus of this inquiry.\(^6\)

10. The membership of the Committee is set out in Appendix 1, a list of witnesses is in Appendix 2, and our Call for Evidence is in Appendix 3. Appendix 4 provides an outline of how television advertising is traded. Appendix 5 provides further details on the reasons for the decline in television advertising revenues in recent years. Appendix 6 sets out the relevant changes in television advertising on a timeline and Appendix 7 provides a glossary.

11. Our Specialist Advisers for this inquiry were Professor Patrick Barwise, Emeritus Professor of Management and Marketing at London Business School, and Professor Steven Barnett, Professor of Communications at the University of Westminster. We would like to express our thanks to them for assisting us in our work. We have benefited greatly from their expertise.

\(^2\) Digital TV Progress Report, Ofcom, Q3 2010
\(^3\) Review of the Airtime Sales Rules, Ofcom, 29 March 2010
\(^4\) For example, tobacco and guns cannot be advertised on television
\(^6\) From 28 February 2011, for the first time, references to products in programmes in UK television films and series can be paid for. In anticipation of this, Ofcom announced a set of rules governing product placement in December 2010. A timeline showing significant changes in the UK television industry is set out at appendix 6.
CHAPTER 2: REGULATION OF TELEVISION ADVERTISING

Background

12. On average, people in the UK spend 3.7 hours a day watching television on a television set. Despite technological advances, such as a digital video recorder (DVR) or catch-up services such as BBC iPlayer and 4OD, surprisingly little has changed over the last 40 years in the way people watch television. The main difference is that viewing is now spread over many more channels, although the five main public service broadcasting (PSB) channels (BBC1, BBC2, ITV1, C4 and Five) continue to account for more than half of all television viewing in the UK (57.8%). According to Ofcom, 94.1% of all television viewing is of live television content on a TV set.

13. Programmes on the traditional PSB channels still attract significant mass audiences. For example, ITV1’s X-Factor last year reached a peak audience of 16.5 million and the final results show was the most popular programme of 2010. ITV1’s Downton Abbey drew in an audience of 10.2 million. These high-rating programmes, as well as long-standing soap operas and live sporting events, are an integral part of the nation’s leisure time and commentary on those programmes is a staple diet for Britain’s newspapers, magazines, online blogs and social networking sites. In 2009, the five PSB channels continued to have the largest audience share in multichannel homes with BBC One drawing a 20% share and ITV1 16.9%. Of the top 13 most-viewed channels in 2009, all except one, Sky Sports 1, was either a PSB channel, or one of the PSB portfolio channels (such as ITV2, E4 or CBeebies).

The UK industry

14. With an annual turnover of £11.1 billion per annum, the UK television industry is relatively modest compared to telecommunications (£40.6 billion) or the motor industry (£52 billion). Nevertheless it is an important source of employment and export revenue for the UK. Almost 80,000 people work in the UK television industry, which includes broadcasters; independent production companies, and freelancers.

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7 Ofcom Communications Market Report (CMR) 2010, pp. 101, 160
8 Thirteen percent of non-linear television programme viewing time in 2009 was to on-demand content on a PC or TV set. For example, viewing programmes after they were initially broadcast on television using services like BBC iPlayer and 4OD. Ofcom CMR 2010, p. 107
10 Ofcom CMR 2010, p. 164
11 Most of the other 5.9% of viewing is to content recorded on a DVR. Ofcom CMR 2010, p. 101
12 BARB audience figure for X Factor results programme on Sunday 12 December 2010
13 BARB audience figure for the final episode of Downton Abbey, aired on Sunday, 7 November 2010
14 Ofcom CMR 2010, pp. 174–175
15 Ibid, p. 18
16 Ibid, p. 18
18 The British film and television industries—decline or opportunity? First Report, HL Paper 37, Select Committee on Communications, p. 46
15. Television programming also contributes significantly to UK exports. In 2009 the estimated total revenue from the international sale of UK television programmes and associated activities was £1.337 million, up 9% from 2008, despite the economic recession.\textsuperscript{19}

**How television is funded**

16. There are four main ways in which television is funded: by subscription (for example with BSkyB or Virgin Media); from advertising and sponsorship (for example ITV1, Channel 4 and most digital channels); by public funding (the BBC licence fee); and from other sources (for example exporting programmes, teleshopping, and interactive services). In 2004, advertising and subscription revenues generated equal amounts of money for the television industry. However by 2009, subscription was by far the biggest source of revenue, accounting for almost £4.6 billion per annum and still growing and advertising £3.1 billion across all channels. The BBC, wholly funded by the licence fee, provided a further £2.7 billion in TV revenue in 2009 (Figure 1).\textsuperscript{20}

![FIGURE 1](image)

**FIGURE 1**

**Total TV industry revenue by source in 2009**

<table>
<thead>
<tr>
<th>Year</th>
<th>Subscription revenue</th>
<th>Net advertising revenue</th>
<th>BBC income allocated to TV</th>
<th>Other revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>£10,030</td>
<td>24.4%</td>
<td>7.4%</td>
<td>10%</td>
</tr>
<tr>
<td>2005</td>
<td>£10,502</td>
<td>23.5%</td>
<td>6.9%</td>
<td>10%</td>
</tr>
<tr>
<td>2006</td>
<td>£10,619</td>
<td>23.8%</td>
<td>7.9%</td>
<td>10%</td>
</tr>
<tr>
<td>2007</td>
<td>£11,041</td>
<td>23.8%</td>
<td>7.1%</td>
<td>10%</td>
</tr>
<tr>
<td>2008</td>
<td>£11,157</td>
<td>23.5%</td>
<td>7.1%</td>
<td>10%</td>
</tr>
<tr>
<td>2009</td>
<td>£11,109</td>
<td>24.0%</td>
<td>6.4%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Ofcom CMR 2010, p 124

17. Expectations are that subscription will account for an even greater proportion of television revenues in the future. Toby Syfret from Enders Analysis told us his prediction was for television advertising revenue to be “more or less in line with

\textsuperscript{19} Annual TV exports survey, PACT, October 2010
\textsuperscript{20} Ofcom CMR 2010, p. 122
real growth, possibly a little bit below” over the next five years.\textsuperscript{21} Figures submitted to us by Enders Analysis predict that by 2015, almost half (48.5\%) of total TV revenues will be from customer subscriptions, compared with advertising at 27\% and licence fee funding at 17.8\% (Figure 2).

**FIGURE 2**

Total funding by revenue stream in 2015

\begin{figure}
\centering
\includegraphics[width=\textwidth]{figure2.png}
\caption{Total funding by revenue stream in 2015}
\end{figure}

\textit{Source: Enders Analysis, based on industry data}

18. Subscription revenues increased steadily between 2004 and 2009, whereas television Net Advertising Revenue (NAR) has been in decline since 2005. The main reason for this decline has been the effect of the economic recession, which has had a severe impact on the whole of the advertising industry, including television. In addition, the cost of television advertising airtime (per 1,000 viewers) has fallen as a result of increased supply in the market as more and more channels come on air. Finally, television advertising has faced indirect competition from the rapid growth of internet advertising, which overtook television in size for the first time at the end of 2009, although television narrowly regained the advantage again in 2010.\textsuperscript{22} Figure 3 shows the percentage share of revenues across all types of advertising out of a total advertising market revenue of £8.091 million.\textsuperscript{23} The reasons for the decline in television advertising revenues are explained in more detail in Appendix 5.

\textsuperscript{21} Q 4

\textsuperscript{22} According to Internet Advertising Bureau (IAB) data, in the first six months of 2010, television was marginally ahead of online advertising once again, with a 26\% market share, compared with internet advertising at 24\%.

\textsuperscript{23} Internet Advertising Bureau (IAB) Online Adspend Factsheet, H1 2010
Why television advertising is important

19. Television remains an important platform for marketing products and services. Ofcom highlighted television advertising’s crucial role for mass market advertisers as a means of delivering their message quickly to a large audience across all demographic groups. Tess Alps, the Chief Executive Officer of Thinkbox, the television advertising industry’s marketing body, stressed this point, telling us that television advertising was fundamentally very effective and that it provided a “tremendous return” on investment for advertisers. Nevertheless not everyone agrees about the importance of mass coverage advertising; Adam Crozier, Chief Executive ITV plc, told us that broadcasting programmes to a mass audience, so called ‘fast-build cover’, “accounts for about 1.65% of our revenue, so it is a tiny part of it.”

20. For the commercial public service broadcasters, which are entirely funded by advertising, the decline in television advertising (see Appendix 5) has had a significant impact on their revenues in comparison to those channels which also receive subscription revenues. In turn, there has been a corresponding reduction in the investment made by commercial broadcasters in television programmes and training within the television industry. Maintaining television advertising revenues is one method of ensuring that broadcasters have sufficient funding available to sustain their investment in the UK creative industries.

Source: PricewaterhouseCoopers, Internet Advertising Bureau, The Advertising Association, WARC
How television advertising is regulated

21. In addition to the competition regulations of CRR (outlined at Chapter 3) and COSTA (discussed at Chapter 4), broadcasters must also ensure that the advertising content which they carry on their channels complies with several other regulations, including the UK Code of Broadcast Advertising (BCAP Code) which outlines what types of products can and cannot be advertised on television.27

Considering the public interest

22. Television’s influential social, cultural, political and economic role means that regulatory decisions around competition issues—which examine the impact on other broadcasters and advertisers within the industry—should not be taken in isolation from the wider public interest.

23. The television industry is a two-sided market and both should be considered. On one side, the market includes advertisers, media agencies, and competition from other broadcasting sales houses within the television industry. On the other, the viewer side of the market includes the range, quality and popularity of television content and the consequential effects of the price paid for television advertising airtime on the cost of goods and services which consumers purchase.

24. Parliament, in passing the Television Act of 1954, confirmed the then Government’s wish that “in the expanding field of television, provision should be made to permit some element of competition.”28 This led to the advent of ITV which was designed as a set of regional commercial television licenses. Although the preceding parliamentary debate focussed on the BBC and ending its monopoly in British television, arguments were also advanced about the importance of sustaining a range of high quality programmes on a competing commercial channel, and of ensuring that a greater voice was given to the different nations and regions of the UK.29 In the House of Lords debate the point was made that this would be in return for the public and citizen benefits which would then accrue in terms of the range, quality and greater regional representation of ITV programming.30 In the Television Act 1954, it was provided that ITV licensees should be allowed a monopoly of TV advertising in each licence area.

25. In 2009 there were over 100 more television channels available in the UK than five years before.31 This has significantly increased the amount of advertising airtime available and has had an effect on the cost per thousand viewers of television advertising. Bob Wootton, Director of Media and Advertising at

27 For example, the advertising of alcohol and tobacco products on television is prohibited. Also, foods containing a high percentage of fat, sugar and salt (HFSS) cannot be advertised during programmes which are primarily aimed at children. We received several submissions in response to our Call for Evidence highlighting the importance of maintaining the restriction on advertising HFSS foods to children, and even calling for this to be extended to a prohibition on advertising these products. Whilst we note that this is an important issue this inquiry focuses on the regulation of television airtime rather than the television of advertising content. We therefore have not addressed the issues raised in this report

28 Cmd 8550 (London: HMSO, 1952)

29 HL Deb 26 November 1953, Col 671 and 680

30 Ibid, Col 699

31 Ofcom CMR 2010, p. 97
ISBA\textsuperscript{32} told us that in 2009, television advertising was as cheap in real terms as it had been in 1985.\textsuperscript{33} ITV plc\textsuperscript{34} and Thinkbox\textsuperscript{35}, the marketing body for commercial television in UK also note that the cost per thousand viewers for television advertising is as cheap as it has been since the 1980s. Advertisers are therefore now able to buy more advertising airtime, and often pay less for it in real terms than when CRR was introduced in 2003.

26. The Office of Fair Trading (OFT), the Competition Commission and the Office of Communications (Ofcom) all have a remit to consider television advertising regulations. The OFT and the Competition Commission are competition authorities and their remit focuses specifically on how to address competition concerns, as defined in the Enterprise Act 2002. They do not have a remit to consider the interests of viewers or consumers. On the other hand Ofcom has powers under the Communications Act 2003 to establish a regulatory regime for television advertising which includes powers to address both competition and citizenship concerns.\textsuperscript{36}

27. In this report we have considered the public interest to encompass the industry, viewers of television programmes and consumers of the products and services advertised on television. This builds on the principles of public service broadcasting outlined by Ofcom in its first Public Service Broadcasting Review of 2003–2005.\textsuperscript{37} In conducting our inquiry we have considered the following as relevant to the ‘public interest’:

- competition and transparency within the industry;
- the provision of UK-originated content;
- a range of national and regional quality programmes;
- investment in training and in the wider creative industries;
- the cost of goods and services advertised; and
- the number of advertisements on television.

\textbf{Competition and transparency within the industry}

28. The Competition Commission and the Office of Fair Trading have a duty to protect the public against businesses abusing their market position.

29. The OFT has a general remit to keep any undertakings addressing competition concerns under review and to consider whether they remain appropriate. If the OFT does not think that this is the case it can recommend that the relevant parties are released from them, or that the undertakings are varied or superseded.\textsuperscript{38}

\textsuperscript{32} ISBA is a non-profit organisation which represents the interests of advertisers

\textsuperscript{33} Q 368

\textsuperscript{34} Slide 28, ITV's 'Response TV' research presentation: http://www.itvmedia.co.uk/insights-and-effectiveness/insights/response-tv

\textsuperscript{35} 'TV's affordability', note on Thinkbox website, visited on 28 January 2011: http://www.thinkbox.tv/server/show/nav.1342

\textsuperscript{36} Communications Act 2003, section 319–322

\textsuperscript{37} That programmes should be UK originated; innovative; cover a diverse range of programme genres; and be widely available

\textsuperscript{38} OFT Advice to the Competition Commission on the Review of the Contract Rights Renewal Undertakings, May 2009, pp. 15–16
30. Ofcom has ongoing functions to monitor compliance with the CRR undertakings. 39 Also, under the Enterprise Act 2002, Ofcom has the discretion to make a Market Investigation Reference to the Competition Commission where it has reasonable grounds for suspecting that “any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts, or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.” 40

31. Transparency within the industry is important in order to ensure fairness, appropriate scrutiny and accountability. We discuss this further in Chapter 5.

The provision of UK-originated content

32. Investment in original UK content is highly valued by British viewers, contributes to employment and revenue in the UK television production industry and generates export income. ITV argued that there is a virtuous circle in which more investment in UK content generates higher audiences which in turn generates more advertising income to invest in content. 41

33. In its report on the British film and television industries published last year, our predecessor Committee found that “British audiences place particular value on UK-originated programmes.” 42 It quoted Ofcom research which found that over four-fifths of people believe it important that TV channels reflect life in the UK. This finding is supported by the continuing success of the five main PSB channels which continue to dominate viewing even in multi-channel homes, in comparison to non-PSBs.

34. In 2009, broadcasters in the UK spent a total of £5.1 billion on network TV programmes. 43 This represented a 0.3% decline over 2008, but continued to represent a rise on 2007 levels of £4.9 billion. 44 The five main PSB channels spent a combined total of £2,343 million on first-run UK-originated content in 2009; down from £2,495 million the previous year, and down from a total of £2,804 in 2005. 45 Figure 4 below shows that each of the main PSB channels decreased their investment in original content during this period. As the decrease in spend was less than the average decrease in revenues, the percentage of total revenues spent on first-run originated content has actually increased. In 2009, the commercial PSB channels spent 56% of their revenues on producing original content. 46

39 OFT and Ofcom launch review of Contract Rights Renewal undertakings, OFT news release, 30 January 2008
40 Section 131(1), Part 4 of the Enterprise Act 2002
41 Q 120
43 Programmes which have been purchased or commissioned by an individual television network including acquisitions, commissions and repeats as well as original content production, excluding content made specifically for the Nations and Regions. Ofcom CMR 2010, p. 128
44 Ofcom CMR 2010, p. 129
45 Ofcom Public Service Broadcasting (PSB) Annual Report 2010, p. 5
46 Ofcom PSB Annual Report 2010, p. 7
35. Non-PSB channels also invest a significant sum each year in UK content although accurate figures comparable to those for the PSB channels are difficult to obtain.\(^{47}\) David Wheeldon, Director of Policy and Public Affairs at BSkyB told us that it invests over £1 billion in UK original content annually.\(^{48}\) That figure includes sports rights which are a significant, but unknown, proportion. In their evidence for our predecessor committee’s inquiry into the British Film and TV industries the Satellite and Cable Broadcasters Group (SCBG) told us that its members contributed £193 million to UK-originated content in 2007, excluding sport.\(^{49}\) In a letter to this committee SCBG told us that preliminary findings from its research conducted by Deloitte showed that its members spent “in the order of £430 million on original UK commissions in 2009”, of which around £200 million was “derived from fully funded originations”, around 10% was in co-funded originations and the remainder was “production expenditure”.\(^{50}\) In an interview in the Guardian newspaper in November 2010, Sophie Turner Laing, Head of Entertainment and News at BSkyB, said that “Sky has increased its original drama investment by 400% between 2009/10 and 2011/12”\(^{51}\) but gave no details of what this meant in terms of budget or number of hours. David Wheeldon told us that BSkyB invested “tens of millions” of

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\(^{47}\) QQ 205–209, 210, 213, 218–221

\(^{48}\) Q 225

\(^{49}\) The British Film and Television Industries, op cit, paragraph173

\(^{50}\) RTA 22

\(^{51}\) Sky’s Sophie Turner Laing defends its investment in programming, The Guardian, 1 November 2010
pounds in original UK drama, which is a very welcome addition to the traditional sources of investment in UK creative content by the main PSB channels. It is important to recognise, however, that this is a small proportion of BSkyB’s overall revenue.

36. At present it is not possible to make a direct comparison between the levels of investment in original UK programming made by SCBG members and PSB channels. However, we understand that a full report by Deloitte, commissioned by SCBG, is due to be published in March and that it will go into more detail about the context and relevance of the interim figures presented to us by SCBG.52

37. In 2009, the overall network programme spend of public service broadcasters on drama and soaps was £732 million.53 In the same year, Channel 4 spent £341 million on all UK originated content on its core channel (Channel 4)54, which represented 59% of its total revenues of £575.1 million.55 ITV1 spent £540 million on all original UK commissions in 200956 which represented 50% of ITV1’s total revenues from advertising, sponsorship and interactive in 2009 which were £1,082 million.57

38. We welcome the increasing investment made by non-PSB channels in UK-originated content. However, we consider that the main advertising-funded PSB channels appear to offer the only likely means of generating significant growth in original non-sport UK content over the next few years given the comparatively small—albeit growing—levels of investment in UK original content by subscription based channels and the recent cuts in the licence fee which will constrain the BBC’s ability to maintain its investment levels.

39. We believe that there is a strong public interest in supporting and promoting investment in UK originated content on television. It is therefore essential that the commercial PSBs’ revenue potential is maintained and that revenue is reinvested in quality original UK television programmes.

A range of national and regional quality programmes

40. Advertisers like predictability in programming. From an advertiser’s perspective it is important to know in advance the audience ratings that a show will deliver. This is an incentive for advertising-funded broadcasters to produce long-running series and light entertainment programmes such as Coronation Street and the X-Factor, which are guaranteed to deliver large audiences. ITV plc’s Chairman Archie Norman said that some television advertising regulation encouraged commercial television channels, ITV1 in particular, to pursue a “ratings rat race”, chasing the lowest common denominator of programmes in order to achieve mass audiences.58
41. A range of programmes is also important to advertisers as this enables commercials to be targeted at audience-specific demographics, for example adults over 50. ITV plc’s Chief Executive, Adam Crozier, told us that ITV has “not had enough diversity in [its] schedule over the past few years” and that specific changes to the television advertising regime would allow ITV1 to address this deficiency.

42. On the other hand, Anne Bulford, Chief Operating Officer Channel 4, was sceptical that specific changes to the regulation of television advertising would result in a more diverse schedule on ITV1. She told us that the trends in the schedule, for example increasing the number of episodes of the most successful soaps, pre-dated changes to the advertising regime and in her opinion: “the trend towards schedules with more peaks in them had always been there”. She suggested that this was because ITV’s business model had always been based around programmes which deliver mass audiences. Geoffrey Russell, Secretary and Director for Media Affairs at the Institute of Practitioners in Advertising (IPA) agreed that changes in ITV1’s programme schedule pre-dated the introduction of CRR in 2003. He described the 40 years between the creation of commercial television in 1955 and the emergence of the multichannel in the mid-1990s as “the golden age of public service broadcasting in the commercial sector” when ITV was able to produce public service programmes and it did not matter whether they attracted large audiences. This was because ITV had no commercial competition. However, with the arrival of other commercial channels, both PSB and non-PSB, ITV moved towards “more populist programming” and began calling for some of their PSB obligations to be reduced or removed. Mr Russell therefore believed that the diminution of diversity in ITV’s schedule was the result of increased competition from other commercial broadcasters which caused ITV to compete more strongly for audiences, and that this trend started far earlier than 2003.

43. Channel 5 was also sceptical about ITV’s claims. Martin Stott, Head of Regulatory Affairs at Channel 5, said that if there were changes in the way television advertising was regulated “there is no guarantee that ITV would spend any more money on original content”. He thought that that there had probably been “a narrowing of all broadcasters’ range of programming” in recent years as “we are in a more competitive age”, with more channels available. He said that because there were more channels to choose from, the market had become more competitive for broadcasters and “the sorts of programmes that one might have been able to put on when there were only five channels” which attracted smaller, niche audiences (for example children’s and arts programming) “cannot survive commercially.” Mr Stott also told us that this had “been the real change” and that it had had an impact on Channel 5’s programming decisions, as well as those of ITV.

59 Q 122
60 Q 123
61 Q 311
62 Q 486
63 Q 306
64 Q 310
65 Ibid
44. For commercial broadcasters, it is riskier to commission innovative programmes because ratings and audience demographics will be uncertain and no guarantees can be made to advertisers. Nevertheless, it is in the viewer’s interest that programme schedules are varied, and that innovation is encouraged. Indeed Channel 4, as a public body, has a statutory obligation to provide a diverse range of programming which “demonstrates innovation, experiment and creativity in the form and content of programmes.”

45. National and regional programmes are also important in protecting the diverse range of social and cultural interests across the UK. These programmes, which reflect local interests and issues, also encourage local advertising and promote local businesses. ITV is the only major commercial channel to provide regional news programming and it has significantly reduced this output in recent years.

46. We also believe that ITV1 programmes should be of high quality although we recognise that the provision of “quality programming” raises the difficult and essentially subjective question of quality. Mary McGovern, Media Manager at Procter & Gamble, told us that “a quality programme is quality to whoever wants to watch it. It might not be what you or I would consider to be quality.” She gave the example from her own experience “It depends what your definition of quality is. We will try to match up the target audience with our products and we then find out where that target audience is viewing. Procter & Gamble makes a lot of household products and we are looking for a fairly broad audience, perhaps members of families or what we would call housewives”. Whilst we acknowledge the complexities of the issue of “quality programming” we are also aware that quality can be reflected in well made programmes of any genre.

47. We were encouraged by ITV plc’s desire to re-invest revenue in more diverse programmes which were not necessarily aimed at securing the highest rating. However, we are conscious of the pressures of commercial realities and if the television advertising regime is to be changed, we would wish to see binding undertakings in place. These undertakings would ensure that ITV plc invests an appropriate proportion of any additional ITV1 advertising revenue in moving beyond its basic contractual obligation to public service broadcasting by developing a range of high quality UK-produced programmes. This should be rigorously enforced by Ofcom.

Investment in training and in the wider creative industries

48. We believe that it is in the public interest for some of the revenues which broadcasters gain from advertising to be invested in training and development opportunities for people working in the television industry. Over 80,000 people work in the television industry in broadcast television (terrestrial, cable and satellite) and the independent production sector. We believe it is essential that they receive sufficient opportunities for training and development in order to ensure that they are able to continue producing original UK content in the future. As outlined by Ms Dinah Caine, the Chief Executive of Skillset, the

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66 Communications Act 2003, Section 265
67 QQ 385–386
68 The British Film and Television Industries, op cit, paragraph 161
principal body for delivering training for people working in the television industry, “investing in training skills, education, new talent and existing talent is critical to growing production going forward”. Worryingly, she told us that Skillset’s total budget had reduced by forty percent in 2009 and it had lost all of its funding from ITV for this financial year.

49. Adam Crozier, Chief Executive of ITV plc told us that ITV plc had “perhaps understandably, if I may say so, given the recession and the difficulties that it faced over the past 18 months, pulled out of a lot of arrangements and cut back the spend on a lot of training aspects, not only within ITV but within the industry.” However, he said that ITV was now in the early stages of restarting discussions with projects such as Skillset to find out how it could get involved in the industry once again.

The cost of goods and services advertised

50. A further public interest consideration is the balance between funding original, diverse and innovative TV programmes for the benefit of viewers and the cost for consumers of buying goods and services advertised on TV. If television advertising becomes more expensive there are concerns that increased advertising costs will be passed on to the consumer through higher priced goods and services. Andy Jones from Universal Media said that “I think everybody would have a different point of view. Do they want worse television or cheaper products? I don’t know. I don’t think anyone could answer that objectively.”

51. Advertisers are themselves divided on the question. Michael Hutchings, Consulting Competition Lawyer to ISBA argued that product prices were bound to increase if the CRR undertakings in particular were removed. On the other hand, some advertisers did not believe that the cost of television advertising and the price consumers paid for goods and services were closely linked. Mary McGovern from Procter & Gamble said that if the price of television advertising was to increase, it was possible that advertisers would absorb this by, for example, cutting back on advertising budgets in other areas: “Obviously the more money we invest in advertising, although we are hoping to build business, the more costly that is. Because we are always looking at our cost bases, the more we have to spend in one area, the more impact it has in other areas and we have to make sure that that matches up. We can’t just take a direct correlation that, if we are going to spend more on advertising, therefore that immediately gets translated into product cost. It’s not as simple as that”.

Indeed, as we note in Appendix 5 the cost of advertising has reduced significantly in recent years.

52. We do not consider a possible very slight increase in the cost of some goods and services which are advertised on television to be a significant

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69 Q 593  
70 Q 609  
71 Q 124  
72 Ibid  
73 Q 484  
74 Q 419  
75 Q 422
impediment to any revision of the television advertising industry regulations. It is in the public’s interest to increase investment in quality UK originated programming and this far outweighs the contested—and marginal—detriment that might follow from advertisers paying slightly higher prices to broadcasters.

The quantity of advertisements on television

53. The quantity of advertisements on television, in particular on commercial public service channels, matters to the viewing public. Ray Snoddy, a media commentator, suggested to us that there was no appetite for the UK to follow the example of commercial television in the United States with a significantly higher number of advertising minutes.\textsuperscript{76} We discuss this in more detail in Chapter 4.

\textsuperscript{76} Q 557
CHAPTER 3: CONTRACT RIGHTS RENEWAL

The current advertising airtime trading system

54. Approximately 80% of television advertising airtime is traded during the annual deal round when media agencies, each representing several advertisers, negotiate contracts with the broadcasting sales houses (which represent one or more commercial broadcasters). Media agencies either negotiate on behalf of all of their clients collectively in what is known as an “umbrella deal”, or they negotiate separate terms and conditions with broadcasters on behalf of individual advertisers. Certain large advertisers (most notably Procter & Gamble) negotiate contracts directly with broadcasting sales houses, rather than going through a media agency.

55. These deals are not negotiated in financial terms, but rather a media agency or advertiser will agree to commit a share of its overall television advertising budget to a particular broadcaster in return for a discount off the “station average price” (SAP) for a particular demographic group. The higher the percentage of its television advertising budget which a media agency or advertiser commits to a particular broadcaster, the greater the discount it is likely to receive off SAP.

56. The other 20% of airtime is traded during in-year trading, which mainly comprises of “burst deals” which are used to negotiate airtime for one-off advertising campaigns.

57. We received evidence that the system of trading television airtime (both in annual deals and burst deals) is an outdated system which is overly complicated but which has evolved over a number of years and to which several players in the market remain committed, despite its lack of transparency to those outside the industry. Ofcom described the system to us as “very complex and arcane” and Ed Vaizey, the Minister for Culture, Communication and Creative Industries agreed that the system was “byzantine and complex.” More detail on how television airtime is traded is included in Appendix 4.

The Contract Rights Renewal undertakings

58. In 2003 the owners of the regional channel 3 licences of Carlton and Granada applied to merge to form into a single commercial broadcasting body—ITV plc. In order to assess what impact this would have on competition in this market, the Competition Commission was asked by the Office of Fair Trading to conduct an inquiry under the provisions of the Fair Trading Act 1973.

59. The Competition Commission considered whether there would be any “lessening of competition [for television advertising airtime] as a result of the merger.” In so doing the Commission considered whether, if the merger were to go ahead, it

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77 SAP is the average price per viewer (commercial impact) which a broadcaster charges for a specific audience demographic
78 The level of discount off SAP is also subject to other factors negotiated in the deal, for example whether programmes are shown during peak time, or where advertisements are placed during the break
79 QQ 455, 571–2
80 Q 455
81 Q 624
would operate, or be likely to operate, against the public interest. The Commission looked at the implications of the merger for other channel 3 licensees and for the future of commercial television in the UK in the context of likely developments in the market. It raised a number of concerns around the public interest: the production of television programmes; the availability of studio facilities in the North of England; the future competition for ITV licences; the impact on other channel 3 regional licensees; and the sale of advertising airtime.  

60. The Competition Commission concluded that the merger was not likely to have an adverse effect on programme production; the availability of studio facilities in the North of England; or future competition for ITV licences. However, the impact which the merger would have on Channel 3 licence holders which remained outside the merged company (STV, UTV and Channel TV) was cause for concern for the Commission as was the way in which advertising airtime was sold on ITV (now ITV1).

61. The Competition Commission found that its concerns could be addressed (thereby enabling the merger to take place) by undertakings made by ITV plc. These undertakings were given by Carlton and Granada in November 2003 in order to provide protection against the increased strength of ITV plc to other players in the market. Ed Vaizey MP, Minister for Communications, Culture and Creative Industries, told us that proponents of CRR also argued that it protects consumers, as it prevents higher advertising charges and therefore avoids these costs being passed on to consumers.

62. CRR applies only to ITV1 and not to the ITV digital channels of ITV 2, 3 and 4. Following a subsequent review of the CRR undertakings by the Competition Commission in 2010, the CRR remedy now also applies to ITV1+1 and ITV1 HD.

63. CRR committed ITV plc to the following measures in order to ensure that advertisers were no worse off after the merger than they had been before:

- CRR gave advertisers and media agencies the right automatically to reduce the share of television advertising spend which they committed to ITV1 proportionately if its audiences shrank, while continuing to receive the same discounts off station average price (SAP). This is known as the automatic ratchet mechanism.

- CRR gave advertisers and media agencies the right to renew their annual contracts with no increase in the share of their television advertising spend which they committed to ITV1 and no reduction in the discounts which they received, including the discount off the station average price. This enabled advertisers to either: roll over their 2003 contracts with an automatic ratchet mechanism applied; agree new contracts with broadcasting sales houses and nominate that this was used as the ‘protected contract’, which could be

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82 Carlton Communications Plc/Granada Plc: A report on the proposed merger, Competition Commission, October 2003, pp. 19–20
83 Ibid, p. 20–23
84 RTA 3
85 Q 625
86 Final Report on CRR, Competition Commission, May 2010, p. 11
rolled forward in subsequent years; or agree a new contract, under fair and reasonable terms, but to choose not to make this the protected contract. This would enable advertisers to return to a previous contract in subsequent years if they chose to do so.

- ITV plc is required under CRR to ensure that any terms included in any new contracts for ITV1 are fair and reasonable. CRR gave a right to advertisers and media agencies to bring any contractual disputes to the independent CRR Adjudicator (funded by ITV plc).

Previous reviews of CRR

64. In 2006, ITV plc asked the Office of Fair Trading (OFT) to review CRR. A review began in 2008 and included a consultation exercise.

65. The OFT came to an interim conclusion that circumstances had changed since 2003 and that a “less burdensome” remedy than CRR might be devised.\(^{87}\) It also suggested that the trading system for television advertising had wider problems and Ofcom was asked to investigate.

66. Ofcom provided assistance to the OFT review during the course of its review. It considered “other issues raised by stakeholders, which do not fall in the scope of the CRR review”\(^{88}\) including the market positions of ITV1 and Channel 4 as well as the general trading mechanism.

67. Ofcom considered whether the CRR undertakings prevented ITV plc from investing in quality programming. Ofcom was “sceptical CRR had distorted ITV’s programming decisions as significantly as it suggested.” It noted that “there would be no guarantee that if CRR were to be lifted any extra revenue would be reinvested in programming or specifically in public service programming”.\(^{89}\) The Ofcom review did not include a consideration of the wider interest of the television viewer, the advertiser, or the consumer of advertised products or services.\(^{90}\) Indeed Ofcom confirmed that “there was no broader consideration of how this would affect programming and whether it might be to the detriment of viewers”.\(^{91}\) The OFT reported in May 2009 and Ofcom reported in June 2009. Ofcom concluded that a wider market investigation would not be appropriate.\(^{92}\)

68. The OFT advised the Competition Commission to consider whether the CRR undertakings could be varied to take into account the decline in ITV1’s market position. The review was limited to considering those elements of the CRR undertakings which were no longer appropriate as a result of “any change of circumstances” since the original Competition Commission inquiry of 2003.\(^{93}\) The Competition Commission has acknowledged that their 2009–10 review was particularly narrow\(^{94}\) and that it did not consider additional public interest

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\(^{87}\) Review of the Contract Rights Renewal Undertakings, Office of Fair Trading, May 2009, p9

\(^{88}\) RTA 10

\(^{89}\) Ibid

\(^{90}\) QQ 440–441

\(^{91}\) Q 440

\(^{92}\) RTA 10

\(^{93}\) RTA 11

\(^{94}\) QQ 74, 85
concerns other than those that the CRR undertakings were designed to address; the competition interests.\textsuperscript{95} The wider public interest was therefore outside the Commission’s remit for its 2009–10 review. Ms Diana Guy, Deputy Chairman of the Competition Commission, confirmed that the Competition Commission was “not carrying out the CRR review with a wider public interest remit in mind”.\textsuperscript{96} The Competition Commission’s statutory remit is to focus on competition concerns from the specific perspective of consumer welfare and the welfare of the economy.\textsuperscript{97} In its review of the CRR undertakings the Competition Commission’s remit was to consider whether a review of the undertakings that were given at that time [2003] were still needed\textsuperscript{98} using the definition of public interest as defined in the “substantial lessening of competition” test in the Enterprise Act 2002.

69. The Competition Commission reported in May 2010. In contrast to the OFT and Ofcom’s findings it concluded that despite some changes in the sector since CRR was introduced there was still an ongoing need for a remedy to protect both advertisers and media buyers from ITV1’s competitive advantage. In its analysis of the effect of CRR, the Commission focused on the interests of advertisers, media agencies and other commercial broadcasters. The Competition Commission had a very narrow brief under the legislation, and its remit excluded consideration of the interests of viewers of television funded by advertisement revenues (and in particular, public service content shown on advertising funded channels).\textsuperscript{99}

70. However, Edward Davey MP, Minister for Employment Relations, Consumer and Postal Affairs at the Department for Business, Innovation and Skills, said that the Competition Commission had done an extremely thorough job and that it had considered the interests of consumers as well as ITV, its competitors and media agencies. He told us that the Commission “had to consider not just the particular company that has some undertakings as a result of a previous merger, but they’ve had to look at the interests of the wider group, the consumers, the competitors of, in this case, ITV and the other players in the market, the media buyers”\textsuperscript{100}.

71. Nevertheless we believe the narrow interpretation of the public interest within the remits of the competition authorities to be a weakness of the current regulatory system. Retention of CRR, a regulatory constraint, on such narrow grounds may act to the detriment of the television viewer and the UK television industry. We have identified the wider public interest considerations and in our own inquiry we have accordingly sought to examine the case for and against the CRR on this basis, as well as the competition concerns.
Does CRR adversely affect the advertising market?

72. CRR was created in order to prevent ITV plc from exploiting its strong market position. At the heart of ITV’s call for the removal of CRR is the assertion that it has directly contributed to the decline in the cost of advertising airtime on ITV1 which in turn has had an adverse effect on the whole of the television advertising market. Adam Crozier, CEO at ITV plc told us “our advertising revenue has fallen by around 22% since CRR was introduced, so we are operating in a declining marketplace. That has led us to invest less and less in programmes over time, as we chase our share of commercial impact. As we have done that, so has the market invested less money”.101

73. ITV plc claims that ITV1 no longer has a leading position in the market because its advertising share has increasingly been eroded by other television channels and the internet. It argues that its only competitive advantage is for campaigns which require fast and broad reach (such as a newspaper advertising on Friday and Saturday night television ahead of a scoop in the Sunday paper). Mr Crozier told us that such campaigns only accounted for about 1.65% of its total advertising revenue.102

74. Tess Alps, CEO of Thinkbox, agreed that advertisers seeking very rapid coverage, and certain fast moving consumer goods companies had a “disproportionate dependency” on ITV1. However, ITV1 is not the only channel which some advertisers find irreplaceable, as this depends on the products’ target audience. Ms Alps used the examples of Nike which might find it crucial to advertise on Sky Sports in order to target sports fans, or Diesel which might find it necessary to advertise its clothing products on Channel 4 in order to target younger demographic groups.103

75. John Billet, a media consultant, argued “of course, parts of the ITV audience are not substitutable” but that “you get to the point where you can now reach more people without ITV1 than you could with ITV1 at the time that CRR started for the same cost. Every time you do an analysis of audience, you have to introduce cost in order to be able to say, as I do, that for most circumstances ITV is fully substitutable. Of course, it’s not on an ‘X Factor’ night. Of course, it’s not with ‘Downton Abbey.’ But as your colleagues observed, that is under 2% of the schedule”.104

76. Although advertising revenues for ITV1 have fallen since 2003, ITV still retains its dominant position in the marketplace and is twice as big as Channel 4, the next biggest commercial broadcaster.105 ITV1 continues to attract large audiences and has an audience share of 17.8% of all homes (second only to BBC One with 20.9% share).106 ITV1 also continued to dominate the top-rating commercial TV programmes in 2009, as 982 of the top-rating 1,000 commercial

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101 Q 120. Commercial impacts are the number of television viewers who see an advertisement.
102 Q 130
103 QQ 22–23
104 Q 533
106 Ofcom CMR 2010, p. 164
TV programmes were shown on ITV1.\textsuperscript{107} Whereas ITV plc claimed that the consumer reach it offers on ITV1 could be substituted by advertising on other commercial television channels, the advertisers claim that this is not the case and they still rely on ITV1 as a means of achieving mass reach quickly, which helps to build brand awareness and boost product sales. Mary McGovern from Procter & Gamble highlighted this point to us when she said that, “for advertisers, there is only one place to get mass audiences, and that is ITV”.\textsuperscript{108} Ofcom told us that there is no standard definition for a “mass programme.” It would use a slightly broader definition than ITV as Ofcom believes that ITV1 accounts for a significant proportion of television advertising spend.\textsuperscript{109}

77. ISBA also argued that ITV remains the most important channel for advertisers seeking to reach and influence mass markets.\textsuperscript{110} Bob Wootton, Director of Media and Advertising at ISBA, told us that advertisers celebrate the success of commercial broadcasting channels such as ITV1, as its “success with viewers is our opportunity to reach and influence those viewers positively”.\textsuperscript{111} The Competition Commission, looking at the impact of internet advertising specifically on television, found that “although the internet provides possible alternatives for advertisers, it cannot yet replicate ITV’s ability to deliver such large audiences on ITV1”.\textsuperscript{112}

78. Martin Stott, Head of Regulatory Affairs at Channel 5, supported this view. He said that CRR was put in place because of ITV1’s unique access to mass audiences which is “what gives ITV its power”. He said that, without CRR, “ITV would be able to exercise that power to the detriment of its competitors.”\textsuperscript{113}

79. The Chairman of Channel TV, Mick Desmond, also supported the removal of CRR. He told us that the “Achilles’ heel” of CRR was that as a result of an “almost last-minute change” it was based on ITV1’s share of commercial impacts rather than on ITV1’s share of commercial viewing “and there is a fundamental difference.”\textsuperscript{114} Mr Desmond said that if CRR had been based against ITV1’s commercial viewing figures rather than share of commercial impacts, he thought that “ITV would have prospered more, because after CRR was introduced you had a plethora of channels that did two things: one, they weren’t selling all their airtime out, and suddenly they decided the best thing to do was to open all their airtime up even if they weren’t selling it, because it just withdrew money away from ITV. Secondly, you had more channels that were just as simply introduced into the system where again, their share of viewing wasn’t necessarily strong, so they may not have had as many people watching, but just by putting those channels into the system they created more commercial

\textsuperscript{107} RTA 16
\textsuperscript{108} Q 403
\textsuperscript{109} Q 429
\textsuperscript{110} RTA 6
\textsuperscript{111} Q 382
\textsuperscript{112} RTA 3
\textsuperscript{113} Q 314
\textsuperscript{114} Mr Desmond was referring to the automatic ratchet mechanism which ties the share of broadcasting budget which media agencies and advertisers commit to ITV1 to the channels share of commercial impacts
impact. I think there is a huge disparity between the former when it was introduced, and I think we have now seen how that has fundamentally changed the loss of revenue.”

80. We agree with the Competition Commission that ITV plc retains a competitive advantage as a legacy of the 2003 merger of Carlton and Granada. As a result we recognise that some form of regulation is necessary in order to curb ITV’s ability to exploit its competitive advantage to the detriment of the industry and the television watching public.

Addressing the competition issues

81. To ensure that the public interest would not be adversely affected by the removal of CRR, we considered the impact which this might have on the two competition concerns which the CRR undertakings were introduced to address: the sale of advertising airtime; and the impact on other ITV regional licensees. Later, we also consider the impact which the removal of CRR would have on the public interest from a viewers’ perspective and also its impact on other broadcasters.

82. There are divergent views within the television advertising industry about the impact which CRR has had on the sale of advertising airtime. There is broad consensus that CRR has kept the cost of advertising on ITV1 lower than it would have been without the undertakings. However, Robert Ditcham, the CRR Adjudicator, told us that the cost per thousand of advertising on ITV1 had fallen by 7.7% since the introduction of CRR, against a market-wide reduction of nearly 20%.

83. Channel 4 told us that CRR had been specifically designed to address public interest issues, and that CRR protected the wider public interest by ensuring that ITV plc was not able to generate excess profits.

84. Ofcom said that if CRR were relaxed and ITV took advantage of it, it would probably be able to increase its revenues, which might or might not flow through to investments and programming. Bob Wootton, from ISBA, told us that there was a “firm conviction” amongst advertisers that the cost of advertising on ITV1 would rise if CRR were removed.

85. ITV plc Chief Executive Adam Crozier said that, as a result of CRR, whereas other market-leading commercial broadcasters (both in the UK and internationally) had been able to increase their share of net advertising revenue, this had not been the case for ITV whose profit margin was around 10% compared to an international average of 20%. ITV plc argues that CRR has “artificially suppressed” its ability to gain advertising revenue, and that this had had a highly distorting impact on the UK media market.
called for CRR to be removed, stating that the regulation restricted its ability to invest in original programming which in turn has had a damaging effect on the UK creative industries as a whole.

86. However there are differing views within the industry on whether CRR has had an adverse effect on the cost of advertising on other channels as well. Ben Fenton, Chief Media Correspondent at the Financial Times, said that CRR had been responsible for a reduction in the budgets of PSBs. \(122\) Bob Wootton from ISBA said that if CRR was lifted, “ITV would attempt to stiffen their prices by at least 10%”. \(123\) Geoffrey Russell, Director of Media Affairs at the IPA, told us that if CRR were to be removed ITV plc would raise the cost of advertising on ITV1, and as the budgets of advertisers were unlikely to increase as well and this would “suck money away from Channel 4 and Channel 5”. \(124\) Anne Bulford, Chief Operating Officer at Channel 4, supported this view saying that if ITV was unconstrained it would “potentially use its power in the market to increase price” and that as there was no evidence that an increase in price would result in an overall increase in the market, “it would simply be a re-division of existing revenues, which would be at the expense of other players”. \(125\)

87. Channel 5’s view was that the removal of CRR had both negative and positive features. Kelly Williams, Director of Sales at Channel 5, told us that the unintended consequence of CRR was that it bound ITV plc, and therefore the industry, to trading in share-of-broadcast contracts and that this had had a negative effect on the overall market. However, Mr Williams also expressed concern that an unregulated ITV plc would have a negative impact on the market overall. \(126\) Channel 4 agreed that if ITV plc were to be unconstrained, it would potentially use its power in the market to increase the cost of advertising on its channels to the expense of other players in the market. \(127\)

88. The Minister for Culture, Communication and Creative Industries, Ed Vaizey, told us that there was “no settled view” on what impact CRR was having on the cost of television advertising as a whole, other than its particular impact on advertising airtime on ITV1. \(128\)

89. We found little consensus amongst players in the industry about what would happen to the total amount of advertising revenues if CRR were to be removed. Some, like ITV plc, argue that if CRR were removed the total amount of advertising revenues would increase, thus enabling all broadcasters to charge more for their advertising airtime and if they chose to do so, to be able to invest more in programming. \(129\) Channel 5 agreed with ITV plc that it was possible that if CRR were to be removed then the total amount of advertising revenues available might increase. \(130\) However, it noted that although ITV1’s share might
increase the share of other channels such as Channel 5 were likely to remain the same or even decrease. Kelly Williams, Head of Sales at Channel 5, told us that “completely unshackling the market or allowing ITV to be unrestrained will, we think, have a detrimental effect on our revenue”.  

90. Other broadcasters, both PSBs and non-PSBs, (including the Independent Licensees on channel 3 (STV, UTV and Channel TV) and those represented by the Satellite and Cable Broadcasters Group (SCBG)) agreed that if CRR were removed ITV plc would increase the cost of advertising on ITV1 and this would have an adverse effect on other channels as less advertising revenues would be available to them in contrast to ITV.  

91. Channel 4 and Channel 5 highlighted the impact which this would have on their ability to invest in programming.  

92. Advertisers and media agencies argue strongly against the removal of CRR. They believe that if CRR is removed, then the cost of advertising on ITV1 will significantly increase. Media agencies and commentators also expressed concern that the removal of CRR would enable ITV to raise the cost of advertising on ITV1.  

93. In its review of the CRR undertakings the Competition Commission examined the impact of the undertakings on other players in the market. It concluded that ITV1’s enhanced market position following the merger of Carlton and Granada was “still sufficiently strong that absent appropriate remedies it would have an adverse effect on media buyers.” In particular, the Commission was concerned that without an effective remedy “ITV might be able to worsen terms overall through seeking higher SOB [share of television advertising budget] commitments, reducing discounts or worsening terms and conditions.” The Competition Commission believed that if ITV plc used its enhanced market position to increase the commitments which media agencies and advertisers made to ITV sales, “this would reduce the amount advertisers would spend on other commercial channels.”  

94. Beyond the wider market issues concerning CRR we also considered the changes within the media agency sector of the market. In 2003, the four main media agencies accounted for 36% of all media deals. By 2009, the four main agencies accounted for over 72% of all television advertising expenditure. We sought to

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131 Ibid  
132 RTA 21, QQ 200, 687  
133 RTA 13, RTA 16  
134 Q 306  
135 QQ 376–378  
136 QQ 469, 471, 520, 527, 547  
137 Review of ITV’s Contracts Rights Renewal undertakings, Final Report, Competition Commission, May 2010, p. 64  
138 Ibid  
139 Ibid  
140 Q 132
determine whether the balance of power in negotiating advertising contracts had shifted due to the significant consolidation of media agencies in the years since 2003. ITV plc told us that CRR was no longer necessary as a protection for media buyers because in recent years their buyer power had increased significantly as a result of consolidation. Ben Fenton, Media Correspondent at the Financial Times, said that the consolidation of advertising sales houses represented “more of a threat to ITV than the multiplication of channels” as a result of the increased take up of multichannel television.\footnote{Q 18} ITV plc argues that it is also now at a disadvantage compared to its position in 2003 when negotiating with powerful advertising agencies, which each contribute significantly to its overall revenue.\footnote{Q 132}

95. Mick Desmond, Chairman of Channel TV, also highlighted the increased strength of media agencies since CRR was introduced in 2003. He said that, due to consolidation of media buying agencies, “nearly 85% of ITV’s revenue” comes from one of the five main media buyers\footnote{Q 673} and that a single media buyer, WPP Group, “probably accounts for nearly 25% to 30% of ITV’s advertising.”\footnote{Q 674} This provides large media agencies such as WPP Group with a strong position when negotiating a discount from the station average price with ITV Sales in the annual deal round. Mr Desmond also said that ITV’s position had been further weakened as a result of consolidation in other broadcasting sales houses. He referred to both Sky and Channel 4’s broadcasting sales houses as “much bigger beasts” than in 2003 as a result of consolidation, with Sky Sales having taken over the sale of advertising airtime on Virgin Media’s channels, and Channel 4 Sales now selling airtime for UKTV.\footnote{Q 676} Mr Desmond therefore called for CRR to be removed, saying that the world had turned “quite dramatically” since it was introduced.\footnote{Q 430}

96. In Ofcom’s evidence to the OFT in 2009 it put forward the argument that, given that the market had changed and evolved since 2003, there were now more opportunities to obtain impacts elsewhere than ITV. It found that the consolidation of media agencies had increased their negotiating strength and that as a result CRR should be, at the very minimum, relaxed. However, Ofcom found that additional safeguards would be needed because of the continued strength of ITV1 in terms of delivering mass audiences.\footnote{Q 673}

97. On the other hand, the Competition Commission found that the increased concentration of media agencies did not necessarily mean that they had a greater buying power, as this would depend on whether media agencies could threaten to switch away from ITV1 if they were not content with the terms on offer and advertisers remain reliant on ITV1 as a means of reaching large audiences quickly.\footnote{Ibid, p. 61–62}
98. Bob Wootton from ISBA also argued for the retention of CRR as a protection for advertisers against ITV’s strong position in the television advertising market. However, he told us that, in his opinion, “CRR may be for now, but it isn’t forever”.\(^{149}\)

99. Ed Vaizey acknowledged that it was very hard to get a clear view on this issue, given the diverse range of opinions on CRR within the industry. However, on balance, he thought that the general consensus is that “CRR is liveable with”.\(^ {150}\)

100. Ben Fenton, Chief Media Correspondent at the Financial Times, said that he believed that CRR as it stood was clearly flawed and that it did restrict ITV plc. He concluded that “it probably should be rewritten” but that as there would be “such unhappiness in the advertising community and among rivals if it were completely lifted”, he believed that CRR would need to be replaced by something else.\(^ {151}\)

101. We are persuaded that in the light of changes in the market for television advertising the CRR undertakings appear to be overly detrimental to ITV plc. They should be abolished. However, although ITV1’s competitive advantage has reduced since 2003 as a result of the increase in the number of broadcasters within the industry, it has not reduced to the extent that the CRR undertakings could be abolished without the provision of alternative binding undertakings.

102. Having analysed the evidence submitted to us we have accepted that CRR has reduced the amount of advertising revenues which ITV plc has been able to generate from the sale of advertising airtime on ITV1. Despite consolidation of media agencies in recent years, ITV plc has a strong position when negotiating deals with buyers because of its ability to attract the mass audiences on ITV1 which advertisers need. Therefore, were the CRR undertakings to be removed (other things remaining equal) we expect that the cost of advertising airtime on ITV1 would rise.

103. ITV submitted evidence to us, commissioned from independent consultants Oliver & Ohlbaum, that ITV1’s net advertising revenue fell by £262m from 2003 to 2007 (the year before the recession affected TV advertising) and that “it might reasonably be suggested” that this decline represented the negative impact of CRR.\(^ {152}\) However, other analysts’ estimates on the removal of CRR were very different from the ITV figures. In a May 2010 Financial Times article on the Competition Commission’s final report on CRR media analysts estimated that ITV would “benefit to the tune of between £40 million and £55 million if CRR was scrapped altogether.” Toby Syfret from Enders Analysis is quoted in the article saying that the net gain to ITV plc of the removal of CRR would be £30 million annually.\(^ {153}\) One possibility for the disparity between the figures is that the £262m estimate by ITV’s consultant assumes that ITV1 had lost viewing share only at the same rate as the typical top commercial network in other countries. In reality, ITV1’s viewing share fell significantly faster than this:

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\(^{149}\) Q 382

\(^{150}\) Q 626

\(^{151}\) Q 52

\(^{152}\) RTA 22, Annex 1

\(^{153}\) Regulator rejects changes to ITV ad rules, Financial Times, 12 May 2008
partly because CRR reduced its revenue and therefore its ability to invest in content; and partly because its strategy of focusing resources elsewhere (its portfolio channels and online activities) reduced its willingness to do so. It is difficult to estimate what ITV1’s programme budget and resulting viewing share would have been in the absence of CRR. While it is therefore extremely difficult to predict how much ITV plc would stand to gain from the removal of CRR, the available evidence suggests figures of around £30–£55 million, equating to roughly 5%–10% of ITV1’s current investment in original UK content (£540 million in 2009).  

104. ITV plc’s broadcasting sales house sells national advertising airtime across the network on behalf of the three other licensees who operate on channel 3 (the ‘non-consolidated licensees’ of STV, UTV and Channel TV). This selling arrangement was put in place at the time of the 2003 merger of Carlton and Granada. Undertakings were put in place to protect the position of the non-consolidated licensees including an agreement that sufficient transparency had to be provided to them by ITV plc. 

105. There is a concern that if CRR is removed there would be greater confusion and complexity when determining how much revenue goes to ITV plc in comparison to STV, UTV and Channel TV, especially if ITV plc’s sales house was permitted to include airtime for its digital channels (for example ITV2) as well as airtime on channel 3. ITV plc might benefit from increasing the cost of advertising its airtime on digital channels whilst keeping ITV1’s channel 3 airtime at a lower price, to the detriment of STV, UTV and Channel TV (as their prices are linked to the ITV1 price). There would be nothing preventing ITV plc from specifying that airtime on ITV1 was sold only as part of a bundle with ITV plc’s digital channels. This concern was highlighted by Rob Woodward, CEO at STV: “if the CRR was to be removed or if there was to be a change to the CRR, one of the key points that we would want to see addressed is to ensure that there is sufficient transparency for us to see how ITV plc represents and sells ITV1 in isolation from the other family of channels”. 

106. Until September 2010 all broadcasters were prevented from selling airtime in their portfolios together without also selling airtime for individual channels; thereby saving media agencies from being forced to purchase a bundle of advertising airtime across multiple channels. This was known as the ‘conditional selling’ rule and it was one of the two Airtime Sales Rules which were rescinded by Ofcom in 2010. The non-consolidated channel 3 licensees told us that, as long as CRR remains in place, there is no incentive for ITV to use conditional selling “by virtue of the fact that it would cut across the CRR contracts, which are ruled on a different basis”. However, if CRR were removed, the non-

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154 ITV plc Report and Accounts 2009, p. 19
155 Q 672
156 Ibid
157 Ibid
158 The other Airtime Sales Rule was the ‘withholding rule’ which stated that all airtime on ITV1, Channel 4 and Channel 5 had to be sold and that these channels could not hold back some of their advertising slots in order to decrease supply and push up the cost of advertising airtime on these channels
159 Q 694
consolidated licensees were concerned that “there could be greater obfuscation as to what value ITV1 represents in any sale inclusive of digital channels”.160

107. ISBA called for the reintroduction of the conditional selling rule as “advertisers balance the mix of channels they use to deliver optimal coverage and frequency at the keenest price. In practice, this means using ITV, and perhaps Channel 4, as the principal coverage building channels, and numerous other stations with relevant audience profiles to deliver frequency and cost effectively.” ISBA believe that without the conditional selling rule in place, advertisers could be “asked to pay higher prices for weaker stations’ airtime in order to access prime airtime on stronger channels”.161 ISBA also called for the reintroduction of the withholding rule, particularly if CRR was removed as it believed that whereas the continued presence of CRR acts as ‘sufficient economic incentive’ for ITV not to withhold airtime on ITV1, but that were CRR to be removed, ITV and other broadcasters would try to force their prices up by withholding airtime.

108. Tom George, CEO at Media Edge, agreed. He suggested that both airtime sales rules should be reintroduced if CRR is removed. He told us that “in a CRR environment there is no incentive for any broadcaster to depress the amount of commercial impacts by reducing minutage. We would have a different point of view under a non-CRR environment” and “on conditional selling, the honest answer is of course that we support the principle that airtime should not be conditionally sold. On a practicality, it is just the thrust of trading. It’s the ebb and flow of trading that airtime is conditionally sold. We conditionally buy as well”.162

109. In order to address the concerns of the non-consolidated channel 3 licensees (STV, UTV and Channel TV) and ISBA on the bundling and withholding of ITV plc’s advertising airtime we recommend that if CRR is removed the airtime sales rules, recently revoked by Ofcom, be reintroduced.

The wider public interest and CRR

110. When assessing the potential impact of the removal of CRR, we believe it is necessary to consider the impact which this would have on viewers as well as considering the competition concerns. This is not an aspect which has explicitly been considered in previous reviews.

111. As we discussed in Chapter 2, ITV plc told us that in order to prevent media buyers from lowering their share of broadcasting commitments on ITV channels it has had to seek high audience ratings on ITV1. This is because CRR ties media agencies and advertisers’ budget commitments to ITV sales to ITV1’s total share of commercial impacts, making no allowance for differences in the audience ratings in different demographic groups. In order to do so, it has moved away from the sort of programmes which have a strong cultural importance and often attract lower audience ratings and prioritised popular programme formats ahead of other content such as children’s and arts programming. We were told that because of CRR ITV plc needs to ensure that

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160 Ibid
161 RTA 6
162 Q 513
ITV1 retains its high audience share in order to retain the budget commitments from buyers at the levels which have been agreed to in the annual deal round. These commitments are linked to ITV1’s audience performance by the automatic ratchet mechanism under CRR.163

112. Professor Sylvia Harvey, Chair of the Citizens’ Coalition for Public Service Broadcasting noted that ITV plc had almost entirely withdrawn from children’s programming on ITV1, and that, over the past three or four years, it had very significantly cut back on its investment in regional news and current affairs programming at great loss to viewers in the nations and the English regions.164 However, Professor Harvey noted that it was important not to assume that programmes that have large ratings were of poor quality. On the contrary, she said that higher ratings prove that a programme is popular with the public, and therefore could be considered to be “very good work”.165

113. The Producers’ Alliance for Cinema and Television (PACT) told us that investment by UK broadcasters in original programming had steadily declined in recent years, and this was largely due to pressure on the commercial public service broadcasters’ advertising revenues.166 Figures published by Ofcom show that commissioning on first-run original content by public service broadcasters fell 20.9% in nominal terms over five years, from £3.05 billion in 2004 to £2.41 billion in 2009.167 PACT also highlighted the importance of the independent production sector, which produces a significant number of the original UK programmes shown on television. Independent producers invest up to £200 million per year in UK television content; more than some of the major broadcasters. This had contributed to an increase in the worldwide export of UK television programmes in recent years.168 However, in 2009 the PSBs reduced their funding of independent producers by 7.5%. PACT explained that broadcasters might compensate for this by showing a greater number of cheaper, imported programmes, or moving away from programmes that are expensive to produce (such as drama and news) towards cheaper genres (such as reality TV), as a result reducing the range and diversity of programmes available to the viewing public.169

114. Dinah Caine, Chief Executive of Skillset, said that in order to boost the UK production sector, it was necessary to have the “skills, the talent, the management, the leadership, the entrepreneurship and the flair”, and that an integral part of that was for there to be sufficient investment in training skills, education and new talent in order for the industry to be able to grow.170 Ms Caine said that there was an intrinsic link between the desire to create original content and the desire to remove mechanisms that apparently get in the

163 Q 126
164 Q 565
165 Q 567
166 RTA 7
167 Ofcom CMR 2010, p. 129
168 RTA 7
169 Ibid
170 Q 593
way of that; and ensuring that there is investment in skills and talent for those who produce original programmes.\textsuperscript{171}

115. ITV plc assured us that were CRR to be removed, it would be prepared to consider giving an undertaking that it would invest the additional revenue raised into original content, and possibly training. Adam Crozier, Chief Executive of ITV plc told us that “were we not to have CRR in place and therefore not to have to chase volumes of impacts, that would allow us to have a much more diverse schedule.”\textsuperscript{172} He continued that: “not chasing audiences would open up things like the arts, more drama and more factual programmes, which would give us a real opportunity going forward. The truth is that the advertisers would like us to target more unique viewers rather than just reaching the same people again and again with the same programmes, but the system works against that at the moment.”\textsuperscript{173}

116. This was suggested to us by the Producers’ Alliance (PACT) and also by Don Foster MP and Baroness Bonham Carter, the Co-Chairs of the Liberal Democrat Parliamentary Policy Committee on Culture, Olympics, Media and Sport. Mr Foster and Baroness Bonham Carter noted the decline in investment in UK original content, particularly by ITV in recent years. They argued that, if ITV plc were to commit to increasing its investment levels, then there would be a case for the removal of CRR.\textsuperscript{174} Similarly, Ms Caine from Skillset said that were CRR removed she would support undertakings from ITV plc to commit to invest more funding in the future on training both within ITV and the broader industry.\textsuperscript{175} Martin Stott, Director of Regulatory Affairs at Channel 5, told us that, without CRR, there was no guarantee that ITV would spend any more money on original content.\textsuperscript{176} Indeed if CRR were to be removed without conditions or formal undertakings by ITV plc there would be nothing to prevent any additional revenues being used to increase staff salaries or shareholders’ dividends. We welcome ITV plc’s recommitment to public service broadcasting in the light of a possible removal of the CRR undertakings. It is essential that ITV plc are accountable for the commitments which they made to us on increasing investment in programming; in particular on the provision of funding for additional quality UK originated programmes and a new focus on investing in training.

117. ITV plc initially proposed the CRR undertakings\textsuperscript{177} and is now calling for their removal. We recommend that ITV plc puts forward a proposal to the Competition Commission and the Secretary of State for Culture, Olympics, Media and Sport for alternative undertakings to meet the Secretary of State’s approval. These should address any competition

\textsuperscript{171} Q 579
\textsuperscript{172} Q 123
\textsuperscript{173} Ibid
\textsuperscript{174} RTA 7, RTA 20
\textsuperscript{175} Q 612
\textsuperscript{176} Q 306
\textsuperscript{177} In 2010 ITV plc also put forward proposals to the Competition Commission for revisions to the CRR undertakings. These proposals, referred to as Rules for the Protection of Advertisers (RPA), are outlined in Appendix J of the Competition Commission’s final report on CRR. The Competition Commission did not accept ITV plc’s proposal.
concerns which would remain if CRR were to be removed and include a commitment by ITV plc to invest an appropriate proportion of any additional revenue raised following the removal of CRR in quality UK original programming and training. The proposed undertakings should be binding on ITV plc, and on any other future owners of the channel 3 licence. The new undertakings should be as simple as possible. ITV plc would then be accountable to Ofcom for complying with the undertakings.

An appeals process

118. Once CRR is removed, we consider that an appeals process remains necessary to address any complaints against the way that advertising airtime is sold on ITV plc. At present, advertisers and media agencies have the right to bring disputes on the fairness and reasonableness of terms offered by ITV plc to an independent adjudicator—the CRR Adjudicator. The role of the Adjudicator is to rule whether ITV plc has responded fairly and reasonably to the demands of the advertisers and media agencies. The number of disputes considered by the CRR Adjudicator might be a measure of ITV plc’s competitive advantage.

119. The current CRR Adjudicator is Robert Ditcham. The Adjudicator is funded by ITV plc and its budget is approved by Ofcom. Mr Ditcham told us that a total of fifteen disputes had been brought to the CRR Adjudicator since 2003. The last was in February 2008. However, the appeals process acted as an important deterrent to ITV plc, encouraging it to comply with selling its advertising on fair and reasonable terms. A letter from the IPA to the CRR Adjudicator published in the Office of the Adjudicator’s report of October 2010 states that, although there had not been any complaints brought to the CRR Adjudicator recently, ITV plc continued to play “a robust game exploiting its strengths as far as it [could] under the rules.”

120. When asked why few complaints had been brought to the Adjudicator by advertisers or media agencies, the Committee questioned whether it was possible that media agencies were wary of so doing in case it prejudiced their dealings with ITV in the future.

121. Mick Desmond, Chairman of Channel TV, told us that whether there was CRR or not, having an adjudicator was a good thing for the industry. This was reiterated by Mr Woodward, Chief Executive at STV, who told us that STV would welcome the opportunity of having an adjudicator to whom it and the other non-consolidated licensees (UTV and Channel TV), could bring complaints. Mr Desmond and Mr Woodward agreed that if CRR were removed, it would be useful to have someone with a high level of expertise about

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178 Q 349
179 QQ 361–363
180 Letter from Mr Geoffrey Russell, Secretary and Director for Media Affairs at the IPA to Mr. Robert Ditcham, CRR Adjudicator, 7 October 2010. Published in the Office of the CRR Adjudicator Periodic Report, October 2010, pp. 19–20
181 Q 359
182 Q 702
183 Q 704
the television advertising industry who was able to act as an independent adjudicator. In their opinion, it was sensible for this person to sit within Ofcom and to have the power to technically adjudicate not just against ITV plc, but across the industry.

122. We recommend that an appeals process for handling disputes between advertisers and commercial television broadcasters should be maintained.

How might CRR be removed?

123. The CRR undertakings were introduced under the terms of the Fair Trading Act 1973 and powers for their enforcement were transferred from the Secretary of State for Business to the competition authorities (the OFT and the Competition Commission) under the Enterprise Act in 2004. ITV plc called for powers over CRR to be returned from the Commission to the Secretary of State for Business, Innovation and Skills.184

124. The Government noted that it “would not be feasible” under the current regulatory regime to transfer responsibility for the CRR undertakings from the Competition Commission to the Secretary of State, or to create a power for Ofcom to accept and monitor any new undertakings by ITV plc.185 The Ministers responsible for CRR (Ed Vaizey MP and Edward Davey MP) told this Committee that no single piece of competition regulation could be extracted from the Enterprise Act 2002, as this would undermine the efficient functioning of the competition regime.186 Ed Vaizey MP also stressed that whilst he believed that it was “good, where possible, to deregulate” and that it was “certainly good where possible to get rid of byzantine and incestuous rules”,187 it was important not to think about CRR in isolation, but to consider it in the round in terms of how any changes to CRR would impact policy making. This will next be considered as part of the drafting of the new Communications Act, on which the Government hopes to begin consulting later this year (see timeline at Appendix 6). However we suggest that this ought to be considered as part of the legislation which will be required in order to merge the Office for Fair Trading and Competition Commission which is expected shortly.

125. We recommend that binding undertakings are sought from ITV plc on the investment in quality UK original content and training before CRR is removed.

126. We note that the Government believes that primary legislation would be required in order to remove the CRR undertakings. However, if a means of doing so is possible, it would be desirable to address the issue of CRR before the next Communications Bill (which is expected to be in draft in late 2012).

184 RTA 15, 20
185 RTA 25
186 QQ 627, 642–645
187 Q 626
CHAPTER 4: CODE ON THE SCHEDULING OF TELEVISION ADVERTISING (COSTA)

The Code

127. In 2008, Ofcom published a Code on the Scheduling of Television Advertising (COSTA). This Code (revised in May 2009) sets out the rules which television broadcasters, licensed by Ofcom, must comply with when carrying advertising.188 “The European restriction on total advertising permitted is a maximum of 20% (12 minutes) within a given clock hour.”189 Within that restriction Ofcom has specified further restrictions for UK PSB channels.

128. The COSTA rules govern the maximum number of advertising airtime minutes which may be scheduled in any one hour of television. The rules are more restrictive for the three main commercial public service broadcasting channels (ITV1, Channel 4 and Channel 5) than for the other commercial channels, including the “portfolio” channels owned by the commercial PSBs (eg ITV2, E4).

The rules for the three main commercial PSB channels allow the following number of advertising minutes per hour:

- Up to seven minutes on average over the broadcast day;
- Up to eight minutes on average between 6pm and 11pm (peak-time);
- A maximum of twelve minutes in any one hour.190

The rules for all other commercial channels are:

- Up to nine minutes on average over the broadcast day;
- No additional restrictions at peak-time;
- A maximum of twelve minutes in any one hour.

129. The commercial PSBs believe that this system strongly favours their rivals as they have limited airtime available to sell to advertisers on all their channels at all times of the day compared to the non-PSB channels.

130. In January 2010 Ofcom launched a review of COSTA which is ongoing.

Harmonising the rules

131. Ofcom told us that “the original thinking behind the disparity [between the main commercial PSB channels and the other commercial channels] was that the then regulator felt that it was incumbent on it to regulate the quality of the viewing experience provided by public service broadcasters. Therefore, it limited the amount of advertising that commercial public service broadcasters could..."

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188 Some changes to both the Rules on the Amount and Distribution of Advertising (RADA) and the Code on the Scheduling of Television Advertising (COSTA) have been in response to changes at the European level brought in by the Audiovisual Media Services Directive (AVMS). The further changes to COSTA considered in this report are all compliant with the European rules. The COSTA rules are a simplification of the earlier RADA rules first introduced in 1954 and amended to take the TWF Directive into account in 1991. For more information, see Ofcom’s Review of television advertising and teleshopping regulation, March 2008, pp. 40–41


190 Article 23 (1) AVMS
show”\(^\text{191}\). In 1991 when implementing the EU Television without Frontiers Directive the Independent Television Commission “argued that it had no remit to secure the quality of the non-PSB channels [but] concluded that it [had] an obligation to protect the quality of the viewing environment on PSB channels … and that this would be adversely affected by ‘too frequent advertising’.”\(^\text{192}\)

132. There appear to be other reasons why PSBs had greater limits to the number of advertising minutes permitted at all times. In particular, this distinction encouraged new entrants to what was a nascent multi-channel television market. Ofcom believe that the distinction “was really based on the PSBs’ privileged access to the analogue spectrum.” With this privilege coming to an end in 2012 (with the completion of digital switchover) this was an area which it believed needed further consideration before the end of the licence period.\(^\text{193}\) We note that, although we are still a year away from digital switchover, 92.6% of households in the UK already have access to digital television.\(^\text{194}\)

133. Channel 4’s view was that “the difference was to encourage the take-up of multi-channel television.” Anne Bulford, Chief Operating Officer, told us that that was “rather superseded now” and that Channel 4’s view is that to have this sort of intervention maintained when it had become out of date was unnecessary and the regulation should be set aside.\(^\text{195}\)

134. Martin Stott, Head of Regulatory Affairs at Channel 5 told us that the original reason for the differential between PSBs and non-PSBs was quite difficult to establish and may be “lost in the mists of time”.\(^\text{196}\) However he agreed that the reason for having differential rules for PSBs and other channels when the rules were established in the 1990s was to help the multichannel sector in establishing itself.\(^\text{197}\) Steve Williams, CEO of the media agency OMD Group Ltd, told us that the rationale for awarding commercial non-PSBs a “leg-up for the multi-channel environment”\(^\text{198}\) no longer applied. ISBA agreed that the differential between PSBs and non-PSBs was “no longer defensible”.\(^\text{199}\)

135. Toby Syfret, Media Analyst at Enders Analysis, told us that “a lot of people accept the idea that once you have got analogue switch-off and you no longer have the old privileges that there were in the past, it makes no sense to keep giving one lot an advantage of more audience at the expense of the others … Why not have a proper level playing field now that we can?”\(^\text{200}\) However Dr Syfret also argued that any changes to COSTA should not occur without a consideration of the consequences of the changes to advertising revenues and the impact if, at the same time, CRR is retained.\(^\text{201}\)

\(^{191}\) Q 458  
\(^{192}\) Ofcom Review of television advertising and teleshopping regulation: Proposals on advertising distribution, and options for the amount of advertising and teleshopping", March 2008, pp40–41  
\(^{193}\) Q 458  
\(^{194}\) Ofcom Digital TV Progress Report, Q3 2010  
\(^{195}\) Q 263  
\(^{196}\) Q 269  
\(^{197}\) Ibid  
\(^{198}\) Q 514  
\(^{199}\) Q 413  
\(^{200}\) Q 29  
\(^{201}\) Q 43
136. John Billett and Ray Snoddy agreed that the rules should be changed so that all broadcasters were able to show the same quantity of advertising per hour.\textsuperscript{202} This is known in the industry as “harmonisation”. However Mr Billett added a caveat that, if the rules were harmonised, then “there should also be a requirement for the media owners to sell all of their minutage and allow market forces to determine the price, rather than what has happened in the past”, when ITV withheld some of its airtime in order to decrease its supply thereby increasing advertising prices.\textsuperscript{203} Mr Billett’s support for harmonisation of the COSTA rules is therefore conditional on the withholding airtime sales rule (which prohibited the commercial PSBs from holding back some of their advertising airtime) being reintroduced.

137. In contrast, the Satellite and Cable Broadcasting Group (SCBG) do not support harmonisation.\textsuperscript{204} Victoria Read, Executive Director of SCBG, told us that the disparity between the advertising minutes on PSB and non-PSB channels should remain as there was no “unlevel playing field” between PSBs and other commercial channels. She argued that the reason why different advertising limits were set for PSBs was that they had a greater responsibility to viewers. These greater responsibilities were in exchange for the benefits (such as a prominent position on the electronic programme guide) and formed part of their licences. Ms Read told us that one of the PSB obligations “was to have less advertising.”\textsuperscript{205}

138. The number of advertising minutes was not considered to be part of the PSB obligations by Ofcom. It told us that the obligations placed on PSBs in return for the benefits of holding a PSB licence (which include a prominent position on the electronic programme guide and guaranteed capacity on the digital terrestrial network,\textsuperscript{206} essentially took the form of programme quotas.\textsuperscript{207} It is difficult to find any historical evidence to support the view that differentials in advertising time were imposed as part of the public service programming obligations.

139. David Wheeldon from BSkyB also said that as the differential rules formed part of a PSB obligation, and that “the right time to look at whether or not that obligation is still valid is at the point at which you review the licences, which is 2014”.\textsuperscript{208} In response to the point Channel 5 told us that a number of rules and licence requirements had been amended in the period since the licences were issued in 2004 and the rules on advertising minitute could also be changed.\textsuperscript{209} Ms Bulford from Channel 4 said that the playing field between PSBs and non-PSBs would be levelled in 2012, when “the disadvantage of digital channels in terms of their not reaching all UK homes goes away”.\textsuperscript{210}

\textsuperscript{202} QQ 556, 557
\textsuperscript{203} Q 556
\textsuperscript{204} RTA 21
\textsuperscript{205} Q 181
\textsuperscript{206} QQ 272–273
\textsuperscript{207} Q 425
\textsuperscript{208} Q 190
\textsuperscript{209} Q 265
\textsuperscript{210} Q 271
44 REGULATION OF TELEVISION ADVERTISING

140. The rationale for the COSTA rules—whether it be the quality of the viewing experience, privileged access for commercial public service broadcasters to spectrum, a boost for the multi-channel sector, or greater coverage of UK homes for the commercial PSBs—no longer applies. As a result, a differential between the number of advertising minutes shown on PSB and non-PSB channels is no longer appropriate. **We recommend that the COSTA rules should be harmonised at analogue switch off so that all commercial television channels should be allowed to show the same average number of advertisements in any given clock hour.**

The effect of harmonisation on the cost of television advertising

141. Harmonising the COSTA rules is likely to lead to an increase or decrease in the total number of occasions when a viewer has an opportunity to see a television advertisement (commercial impacts) which will in turn lead to a decrease or increase in the price (cost per thousand viewers) of television advertising.\(^{211}\) If the total volume goes up the price will go down and vice versa.

142. Last year Ofcom published an econometric study,\(^ {212}\) conducted by Analysys Mason, on the likely impact of harmonisation under different scenarios. The scenarios under consideration can be summarised as “harmonising up” (in which the amount of airtime the main commercial PSB channels are allowed to sell would be increased to the current level allowed to the other channels); “harmonising down” (in which the number of advertising minutes allowed to the other channels would be reduced to that of the main PSB channels); and other intermediate options.

143. The main technical issue investigated was the “price elasticity” of television advertising. In other words, whether a small increase or decrease in the number of adult viewers per advertisement (commercial impacts) created by harmonising the COSTA rules up or down would lead to a more or less than proportionate decrease or increase in the price of airtime (cost per thousand viewers) and therefore what the net impact on total TV advertising revenue would be.

144. The study concluded that the price of advertising airtime would increase or decrease (depending on whether the rules were harmonised down or up respectively) more than proportionately to the decrease or increase in commercial impacts. Therefore, it argued that harmonising down would increase total advertising revenue, while harmonising up would reduce total revenue.

145. Stuart McIntosh, Ofcom Competition Partner, told us that there were some uncertainties about what would happen in terms of the relative balance between ITV plc and other broadcasters if the COSTA rules were changed.\(^ {213}\)

146. Therefore it is difficult to predict what impact any changes to the COSTA rules would have on the total revenue of television advertising. However, we understand that Ofcom is currently undertaking further analysis.

147. Ed Vaizey, the Minister for Culture, Communications and Creative Industries, noted the need to consider the effect which changes to the COSTA rules would

\(^{211}\) Q 29

\(^{212}\) An econometric analysis of the TV advertising market, Analysys Mason final report for Ofcom, 11 March 2010

\(^{213}\) Q 433
have on channels that broadcast Europe-wide from London, such as MTV. Viasat and SBS, which both own channels licensed by Ofcom but which do not broadcast in the UK, told us that harmonisation down would have a negative impact on their advertising revenues. They told us that such losses were “unsustainable” and that they would “most likely force both companies to consider seriously the viability of continuing their operations from the UK”.215

How the rules should be harmonised

148. Whilst we are convinced the COSTA rules should be harmonised, we are less certain about how that should be done. In assessing how the rules might be harmonised, we considered the effect which harmonising up or down would have on advertising revenues on PSBs and non-PSBs. We also considered how any changes might affect viewers.

149. The public service broadcasters unanimously called for the COSTA rules to be harmonised down so that all channels would show an average of seven minutes of advertisements per hour. Archie Norman, Chairman of ITV plc, told us that he favoured harmonising down for two reasons: first, because it is in the viewers’ interest for there to be fewer advertisements on television; and secondly, because it meant that the price of airtime would not be further deflated. Mr Norman told us that this would benefit the quality of content not just on ITV1, “but across the industry”, as the PSBs are the channels which “supply basically the weight of programme content and the investment in creative Britain”. Channel 4 agreed strongly that any adjustment to advertising minutage should take investment in programme production into account. We have already noted that the commercial PSBs spend a much higher proportion of their revenues on original UK content than the cable and satellite broadcasters.

150. The PSBs all agreed that it was in the viewers’ interest for there to be fewer advertisements on television. Channel 4 said that “increases in advertising minutage [were] likely to have an impact on viewer enjoyment”. In support of this claim, it submitted quantitative consumer research which showed that viewers would not like more advertisements on television. The research, run by Ipsos Media CT on behalf of Channel 4, found that 78% of viewers did not want more advertising on PSB channels, with over a third of respondents (35%) saying that there was already more than they were happy with.

151. Channel 4’s research also suggested that increasing the minutage on the main PSB channels would lead to reduced viewing of those channels and increased advertising avoidance by viewers using digital video recorders. This is contrary to the conclusions of Analysys Mason’s study for Ofcom that changes in the number of advertising minutes (in either direction) would have a negligible impact on

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214 Q 657
215 RTA 14
216 Q 157
217 QQ 157, 158
218 Q 261
219 QQ 261, 262
220 RTA 13
221 Ibid
222 RTA 24
viewing habits. In Channel 4’s survey 55% of respondents said that they would record television programmes on a DVR in order to be able to fast forward the advertisements and over a third (36%) said that they would watch other channels if the quantity of advertisements on the commercial PSBs were to increase.

Channel 4’s research also found that 78% of viewers of non-PSB channels did not support an increase in the amount of advertising shown on these channels, and that in fact, many viewers (42%) believed that there was already too much advertising on these channels.

Professor Sylvia Harvey, Chair of the Citizen’s Coalition for Public Service Broadcasting, pointed to further Ofcom research which confirmed Ipsos Media CT’s conclusions for Channel 4. She told us that “if we look at the research conducted by Ofcom on the views of the users, of the public—both in relation to non-PSB channels and PSB channels—I think it’s fair to say that people would certainly not want to see any more advertising.”

Data from Ofcom’s most recent media tracking survey also supported this claim (Figure 5).

FIGURE 5
Viewer attitudes towards television advertising

![Graph showing viewer attitudes towards television advertising]

Source: Ofcom Media Tracker Survey 2009, Q111 & Q112

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223 An econometric analysis of the TV advertising market, Analysys Mason final report for Ofcom, 11 March 2010, p 7
224 RTA 13
225 RTA 24
226 Professor Harvey was referring to research published in Ofcom’s Second Public Service Broadcasting Review Phase 2: preparing for the digital future, September 2008
227 Source Ofcom Media Tracker 2009. Q111: As well as providing companies with the opportunity to communications their products and services, advertising also provides revenues and income for the TV channels on which they are shown. Some of this revenue may be used to pay for new programmes. Bearing this in mind, which of these statements best describes how you feel about the amount of advertising on ITV1, Channel 4 (S4C in Wales) and Channel 5? (base: 2050 homes with TV) and Q112: Which of these statements best describes how you feel about the amount of advertising on satellite, cable and digital channels? (base: 1887 multichannel TV homes)
154. We believe that viewers would prefer there to be no increase in the amount of advertising shown on television channels (both PSBs and non-PSBs), and indeed that many viewers would welcome a reduction. In reaching this conclusion, we have taken into account Steve Hewlett’s caution that there may be a discrepancy between viewers’ attitudes expressed in consumer research and actual viewing behaviours. Mr Hewlett told us that “if you ask people what they want, they’ll say they want fewer adverts. If you look at what they do, I think it’s a bit less clear, to be honest”. 228

155. Media commentators John Billett and Ray Snoddy called for the COSTA rules to be harmonised down. Mr Snoddy confirmed a lack of desire for more advertisements on UK television “in New York where television—I’m sure all of you who’ve been there will know—is almost unwatchable because everything is routinely interrupted by advertising. If it takes regulation to make sure that that doesn’t happen in the UK, I’d very happily have that regulation”. 229 Mr Billett also stressed that viewers prefer shorter rather than longer advertising breaks, 230 Mr Billett said that if the volume of advertisements were to increase, then their effectiveness would decrease as a result of excessive “advertising clutter”. 231 ISBA agreed that an increase in the quantity of television airtime would deflate the market. 232

156. In contrast, the Satellite and Cable Broadcasting Group (SCBG) warned that harmonising COSTA so that the non-PSB channels advertising minutes are reduced to the level permitted for the main commercial PSB channels would result in “very heavy financial losses for [non-PSB] commercial broadcasters”. 233 SCBG told us that, according to research conducted for it by Oliver & Ohlbaum, harmonising up to an average of nine minutes for all broadcasters would result in the commercial broadcasters losing £64 million per annum, whereas Analysys Mason estimate that harmonising up would result in a loss of £44 per annum to commercial broadcasters. Oliver & Ohlbaum’s figures submitted by SCBG showed that harmonising down, to an average of seven minutes for all broadcasters would result in a loss of £80 million per annum for commercial broadcasters. Analysys Mason’s equivalent estimate was £17 million. 234 SCBG’s extreme case led to their conclusion that some niche channels which depend on advertising revenues would have to close if the COSTA rules were harmonised down. 235 Martin Heaton Cooper, VP Commercial Development, Discovery Communications Europe, outlined the cable and satellite broadcasters’ concern that the loss of minutes if the COSTA rules are harmonised down would “not be countered by an increase in price” and that therefore cable and satellite channels would “lose substantially”. Mr Heaton Cooper stressed to us that “if you take away minutes you take away revenue”. 236

228 Q 558
229 Q 557
230 Q 558
231 Q 556
232 Q 413
233 RTA 8
234 Ibid
235 Ibid
236 Q 184
157. Kelly Williams, Director of Sales at Channel 5, reminded us that “as PSB channels, we also have our own digital channels” and so the PSB broadcasters would also be affected by harmonisation down: “we are suggesting that we harmonise down on our digital channels as well. So it is not just PSB versus digital; we have our own digital channels that have nine minutes per hour, which will go down”.

158. We do not believe that harmonising up would be the most appropriate option, either for viewers or for the industry. On balance we believe that it would be preferable to harmonise down to an average of seven minutes per hour for all broadcasters as market research suggests that this is the viewers’ preference.

159. We do not believe that the effect of harmonising down would be as significant as has been suggested to us by SCBG. This is partly because the main source of revenue for satellite and cable channels is subscription, which would not be affected by any reduction in the number of advertisements allowed. Also, it is far from clear that harmonising down would in practice reduce these channels’ revenue more than harmonising up. It would appear that only a very small number of non-PSB channels would be likely to be at risk from these changes. These account for only a small proportion of viewing, even among the minority of viewers who watch them.

160. Given that the commercial PSBs currently invest a significant proportion of their revenues in quality original UK programming we would expect a small shift in revenue from the satellite and cable broadcasters to commercial PSB channels will lead to an increase in investment in original UK content production and provide a much-needed boost to this sector.

161. We expect that even with harmonising down, the number of commercial impacts across all channels will still be much higher and the price of advertising (cost per thousand viewers) much lower in real terms that ten or twenty years ago. Research published by ITV plc as part of its ongoing ‘Response TV’ survey shows that the cost per thousand viewers of television advertising has not been cheaper since 1997 and that therefore, “TV is the best value it has ever been”. Thinkbox, the marketing body for commercial television in the UK, agreed with this claim. It noted that “buying 100 ratings today costs 13% less than in 1999 and in real terms, TV prices are at 1988 levels”.

162. Finally, we note that harmonisation up (to an average of nine minutes per hour over the broadcast day) and down (to an average of seven minutes per hour and eight minutes during peak time) are not the only options. Both ISBA and the IPA suggested to us that a compromise of eight minutes per hour might be a suitable alternative. ISBA said that harmonising to an average of eight minutes

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237 Q 258
238 An econometric analysis of the TV advertising market, Analysys Mason final report for Ofcom, 11 March 2010, p. 63
240 See paragraph 37
241 A copy of Response TV’s chart showing the change in the cost per thousand viewers on ITV1 is included in Appendix 5 (figure 10)
242 TV’s affordability, Thinkbox, http://www.thinkbox.tv/server/show/nav.1342
for all broadcasters would ensure that the cost of advertising did not rise as much as it would if the rules were harmonised down to seven minutes,\textsuperscript{243} and that “something in the middle” would be “very unlikely to be offensive to viewers”.\textsuperscript{244} Steve Williams, CEO of OMD Group Limited (a media agency) agreed that harmonising to an average of eight minutes was a suitable alternative. He said that harmonising down to an average of seven minutes would “artificially suppress the market”\textsuperscript{245} but that the public would be content with an increase up to eight minutes for all.\textsuperscript{246}

163. We acknowledge that, as expressed by Channel 4, changes to the COSTA rules would cause a change in the “ecology” of UK broadcasting.\textsuperscript{247} We therefore believe it is important that any changes to the COSTA rules are considered both in terms of the impact which they are likely to have on broadcasters, and on how any increase or decrease in the length of advertising breaks will affect the viewer experience.

164. As there is no appetite from the general public for an increase to the quantity and frequency of television advertising, especially on PSB channels, we recommend that a lower figure be applied across all channels. We recommend that, subject to further detailed research by Ofcom on the impact of any changes, the Code on Scheduling of Television Advertising should be amended after the completion of digital switchover in 2012 so that the number of permissible minutes of advertising is harmonised down to an average of seven minutes per hour on average across all channels. This would ensure that the viewer experience was not impaired by lengthy advertising breaks during and between programmes. It is important that an appropriate peak time limit should also be determined on the same basis following further Ofcom research.

\textsuperscript{243} Q 413
\textsuperscript{244} Q 414
\textsuperscript{245} Q 514
\textsuperscript{246} Ibid
\textsuperscript{247} RTA 13
CHAPTER 5: THE REGULATORY FRAMEWORK IN THE FUTURE

The case for a wider market review

165. The trading of airtime is highly opaque and confusing. It involves discounts and percentage shares of budgets rather than fixed prices. The price of airtime is determined only after the viewing figures are available but this price then influences contracts made in future years. In Appendix 4 we describe the advertising trading system used for selling commercial advertising airtime in the UK. The consolidation of media agencies has prompted further concern that the agreements made within this club of broadcast sales houses and media agencies may not benefit viewers, advertisers, or smaller media agencies.

166. This report has argued that a wider definition of the public interest should be taken into account when assessing the appropriate regulatory structure for television advertising. Recent reviews have considered the industry competition issues with a very narrow remit and have failed to take account of the interests of the viewer and consumer. The Competition Commission, when conducting its review of CRR, called for a wider review of the industry. The OFT agreed and have suggested that Ofcom should carry out the review.248 Guy Phillipson, Chief Executive of the Internet Advertising Bureau (IAB) agreed that a trading review for television would be welcomed.249

167. Edward Davey MP, Minister for Employment Relations, Consumer and Postal Affairs, noted the Competition Commission’s “concerns about the opaqueness of the market and the workings of this market, the wider advertising market”.250

168. Steve Hewlett noted that this was not the first time that the Competition Commission had called for a wider review of the television advertising market. In fact, it had been doing so for some time. “The Competition Commission has been saying since 2000—it’s said it three times now to my knowledge and probably more often than that if ever it’s been asked—that there needs to be a proper review of the television advertising system. It’s so complicated. It has so much history built into it, so much established practice and, as a result, so many vested interests”.251

169. In contrast Adam Crozier, the Chief Executive of ITV plc explained that “although the market looks fairly opaque from the outside, the reality is that those involved in the market know very well how it works”.252 We consider this argument, which was similarly used by some outsiders discussing the British banking system before 2007, to be unpersuasive.

170. We have found little consensus between witnesses on the need for a wider market review, except for the suggestion from broadcasters and the regulator that a review of the UK television advertising market would take too long and be destabilising for the industry at this time.253

248 Q 108
249 Q 52
250 Q 656
251 Q 561
252 Q 133
253 QQ 133, 249, 251, 301, 452–54, 561
171. Ofcom, in response to the OFT’s suggestion that it should conduct a wider review of the television advertising market, said that any review would have to be conducted under the Enterprise Act and, with follow-up consultations and referrals, that this was likely to take between one and two years to complete.\textsuperscript{254}

172. Media commentators Steve Hewlett and Ray Snoddy both recommended a short review of the market. Mr Hewlett suggested a workable review of the system based on earlier reviews within the industry\textsuperscript{255} should be undertaken. Mr Snoddy suggested that a small expert panel, from different sides of the industry, could explore whether there was a more flexible way in which television advertising could be traded. He recommended that this review take no more than 3 months.\textsuperscript{256}

173. We agree with the Competition Commission and the Office of Fair Trading that it is time for a wholesale review into the television advertising trading market. The Competition Commission called for a wider review of the television advertising market as long ago as 2000 and a review is even more essential today. A more transparent method of trading television advertising airtime is needed and it is unfortunate that the industry has been unable to produce their own solution. Under those circumstances we call on the Secretary of State for Culture, Olympics, Media and Sport to initiate this review before the end of March 2011.

What a wider review might consider

174. The television advertising industry needs a transparent trading system which enables fairness, flexibility and certainty. We therefore recommend that a review of the television advertising market considers the following issues:

- the efficacy of current television advertising regulations.
- how the advertising trading system might be made more open and transparent, including the possibility of an online auction as a trading mechanism.
- whether any best practice can be transferred from television advertising trading systems in other countries.
- the appeals process for television advertising airtime trading to ensure that all players in the market have a remedy if they believe they have been unfairly treated.

175. Professor Patrick Barwise from London Business School has suggested that some television advertising, especially those within the top-rating programmes on ITV1 which provide very fast reach, may well be most suitably traded using an alternative system which provides a fair market price, such as an online auction. Some airtime in other countries, such as the USA and France, is already traded in that way.

176. The Competition Commission has explored the idea of some of the airtime on ITV1 being sold by auction but it did not pursue this because it found that there

\textsuperscript{254} Q 452
\textsuperscript{255} Q 561
\textsuperscript{256} Q 562
was “little appetite” for it within the market. Gill Pritchard, Director of Strategy at Channel 4, told us that Channel 4 had also looked at the idea of an online auction trading system. However, it found that the models currently available could not give adequate planning certainty to advertisers to enable them to build campaigns in advance. Channel 5 was supportive of the idea of an online auction as a means of trading specific programmes for one-off events. A review might explore this issue further to assess whether it might be viable in the future.

177. A review of the current trading system would benefit from some international comparisons showing how other countries set prices and trade television advertising airtime. The role of television advertising is very similar in different countries—in fact, many of the biggest advertisers are the same multinational companies. International comparisons have been provided to us by Ofcom.

178. There is a need for a robust, transparent appeals system in the television advertising market. A wider review into how television advertising airtime is traded should therefore also consider how such a process should be established, what the appeals process should be, and how an adjudicator should be funded. This review should be conducted in a short time frame of months, rather than years, in order to provide certainty for players in the market and to ensure that the findings can feed in to the Government’s green paper on the next Communications Act, which is due to be published by the end of this year.

Who might carry out a review of the television advertising market?

179. We do not believe Ofcom is the most appropriate body to conduct a review of the television advertising market. Rather, we recommend that a focussed review is conducted by a small expert panel.

180. Despite the broad remit of this inquiry we see no reason why such a review should be unduly protracted and we recommend that the panel be given no more than six months to report. This is to ensure that the advertisers, broadcasters and media agencies are not faced with a lengthy period of uncertainty while the review is taking place. It would also ensure that any conclusions from this review could be fed in to the policy development process around the next Communications Act.
CHAPTER 6: SUMMARY OF RECOMMENDATIONS

181. We believe that there is a strong public interest in supporting and promoting investment in UK originated content on television. It is therefore essential that the commercial PSBs’ revenue potential is maintained and that revenue is reinvested in quality original UK television programmes (para 39).

182. We were encouraged by ITV plc’s desire to re-invest revenue in more diverse programmes which were not necessarily aimed at securing the highest rating. However, we are conscious of the pressures of commercial realities and if the television advertising regime is to be changed, we would wish to see binding undertakings in place. These undertakings would ensure that ITV plc invests an appropriate proportion of any additional ITV1 advertising revenue in moving beyond its basic contractual obligation to public service broadcasting by developing a range of high quality UK-produced programmes. This should be rigorously enforced by Ofcom (para 47).

183. We do not consider a possible very slight increase in the cost of some goods and services which are advertised on television to be a significant impediment to any revision of the television advertising industry regulations. It is in the public’s interest to increase investment in quality UK originated programming and this far outweighs the contested—and marginal—detriment that might follow from advertisers paying slightly higher prices to broadcasters (para 52).

184. We agree with the Competition Commission that ITV plc retains a competitive advantage as a legacy of the 2003 merger of Carlton and Granada. As a result we recognise that some form of regulation is necessary in order to curb ITV’s ability to exploit its competitive advantage to the detriment of the industry and the television watching public (para 80).

185. We are persuaded that in the light of changes in the market for television advertising the CRR undertakings appear to be overly detrimental to ITV plc. They should be abolished. However, although ITV1’s competitive advantage has reduced since 2003 as a result of the increase in the number of broadcasters within the industry, it has not reduced to the extent that the CRR undertakings could be abolished without the provision of alternative binding undertakings (para 101).

186. In order to address the concerns of the non-consolidated channel 3 licensees (STV, UTV and Channel TV) and ISBA on the bundling and withholding of ITV plc’s advertising airtime we recommend that if CRR is removed the airtime sales rules, recently revoked by Ofcom, be reintroduced (para 109).

187. We welcome ITV plc’s recommitment to public service broadcasting in the light of a possible removal of the CRR undertakings. It is essential that ITV plc are accountable for the commitments which they made to us on increasing investment in programming; in particular on the provision of funding for additional quality UK originated programmes and a new focus on investing in training (para 116).

188. We recommend that ITV plc puts forward a proposal to the Competition Commission and the Secretary of State for Culture, Olympics, Media and Sport for alternative undertakings to meet the Secretary of State’s approval. These should address any competition concerns which would remain if CRR were to be removed and include a commitment by ITV plc to invest an appropriate
proportion of any additional revenue raised following the removal of CRR in quality UK original programming and training. The proposed undertakings should be binding on ITV plc, and on any other future owners of the channel 3 licence. The new undertakings should be as simple as possible. ITV plc would then be accountable to Ofcom for complying with the undertakings (para 117).

189. We recommend that an appeals process for handling disputes between advertisers and commercial television broadcasters should be maintained (para 122).

190. We recommend that binding undertakings are sought from ITV plc on the investment in quality UK original content and training before CRR is removed (para 125).

191. We note that the Government believes that primary legislation would be required in order to remove the CRR undertakings. However, if a means of doing so is possible, it would be desirable to address the issue of CRR before the next Communications Bill (para 126).

192. We recommend that the COSTA rules should be harmonised at analogue switch off so that all commercial television channels should be allowed to show the same average number of advertisements in any given clock hour (para 140).

193. As there is no appetite from the general public for an increase to the quantity and frequency of television advertising, especially on PSB channels, we recommend that a lower figure be applied across all channels. We recommend that, subject to further detailed research by Ofcom on the impact of any changes, the Code on Scheduling of Television Advertising should be amended after the completion of digital switchover in 2012 so that the number of permissible minutes of advertising is harmonised down to an average of seven minutes per hour on average across all channels. This would ensure that the viewer experience was not impaired by lengthy advertising breaks during and between programmes. It is important that an appropriate peak time limit should also be determined on the same basis following further Ofcom research (para 164).

194. We agree with the Competition Commission and the Office of Fair Trading that it is time for a wholesale review into the television advertising trading market. The Competition Commission called for a wider review of the television advertising market as long ago as 2000 and a review is even more essential today. A more transparent method of trading television advertising airtime is needed and it is unfortunate that the industry has been unable to produce their own solution. Under those circumstances we call on the Secretary of State for Culture, Olympics, Media and Sport to initiate this review before the end of March 2011 (para 173).

195. The television advertising industry needs a transparent trading system which enables fairness, flexibility and certainty. We therefore recommend that a review of the television advertising market considers the following issues:

- the efficacy of current television advertising regulations.
- how the advertising trading system might be made more open and transparent, including the possibility of an online auction as a trading mechanism.
• whether any best practice can be transferred from television advertising trading systems in other countries.

• the appeals process for television advertising airtime trading to ensure that all players in the market have a remedy if they believe they have been unfairly treated (para 174).

196. We do not believe Ofcom is the most appropriate body to conduct a review of the television advertising market. Rather, we recommend that a focussed review is conducted by a small expert panel (para 179).

197. Despite the broad remit of this inquiry we see no reason why such a review should be unduly protracted and we recommend that the panel be given no more than six months to report. This is to ensure that the advertisers, broadcasters and media agencies are not faced with a lengthy period of uncertainty while the review is taking place. It would also ensure that any conclusions from this review could be fed in to the policy development process around the next Communications Act (para 180).
APPENDIX 1: SELECT COMMITTEE ON COMMUNICATIONS

The Members of the Committee which conducted this inquiry were:

- Lord Bragg
- Lord Clement-Jones
- Baroness Deech
- Lord Dixon-Smith
- Baroness Fookes
- Lord Gordon of Strathblane
- Bishop of Liverpool
- Lord Macdonald of Tradeston
- Earl of Onslow
- Lord Razzall
- Lord St John of Bletso
- Lord Skelmersdale
- Lord Stevenson of Balmacara (appointed on 15 November 2010 and resigned on 21 January 2011)

Lord Clement-Jones chaired the Committee in place of the Earl of Onslow for the duration of this inquiry.

Steven Barnett, Professor of Communications at Westminster University, and Patrick Barwise, Emeritus Professor of Management and Marketing at London Business School acted as Special Advisers for this Inquiry.

Declarations of Interest

The following relevant interests were declared:

**BRAGG, Lord**

- *Shares in ITV*
- Independent programme maker, working for BBC and Sky TV
- Employee of BBC and ITV in various capacities, 1961–2010
- Editor and master of ceremonies for the Sky Arts Awards.

**CLEMENT-JONES, Lord**

- Employee of London Weekend Television, 1980–84

**DEECH, Baroness**

- Governor of the BBC, 2002–06
- Daughter a BBC journalist
- Family shares in WPP (about £50,000), Reed Elsevier, Walt Disney

**GORDON OF STRATHBLANE, Lord**

- Shares in Johnston Press
- Chief Executive of Radio Clyde and Scottish Radio Holdings, 1973–96
- Chairman of Scottish Radio Holdings, 1996–2005

**LIVERPOOL, Lord Bishop of**

- Fees for religious broadcasting for ITV, BBC and Sky TV

**MACDONALD OF TRADESTON, Lord**

- Adviser to Macquarie Group (which manages Funds with significant investments in the transmission company Arqiva and the broadcast services company Red Bee Media)

A full list of Members’ interests can be found in the Register of Lords’ Interests: [http://www.publications.parliament.uk/pa/ld/ldreg/reg01.htm](http://www.publications.parliament.uk/pa/ld/ldreg/reg01.htm)
APPENDIX 2: LIST OF WITNESSES

Oral Evidence

19 October 2010
Enders Analysis, Financial Times, Internet Advertising Bureau and Thinkbox
Supplementary written evidence, Enders Analysis (RTA 23)

26 October 2010
Competition Commission and Office of Fair Trading
Written evidence, Competition Commission (RTA 3)
Written evidence, Office of Fair Trading (RTA 11)
Supplementary written evidence, Competition Commission (RTA 18)

2 November 2010
ITV plc
Written evidence (RTA 15)
Supplementary written evidence (RTA 20)
BSkyB, Discovery Communications Europe, MTV Networks UK and Ireland, Satellite and Cable Broadcaster’s Group (SCBG) and Turner Broadcasting
Written evidence, SCBG (RTA 8)
Supplementary written evidence, SCBG (RTA 22)

9 November 2010
Channel 4 and Channel 5 Broadcasting Limited
Written evidence, Channel 4 (RTA 13)
Written evidence, Channel 5 Broadcasting Limited (RTA 16)
Supplementary written evidence, Channel 4 (RTA 24)

16 November 2010
CRR Adjudicator
Incorporated Society of British Advertisers (ISBA) and Procter & Gamble
Written evidence, ISBA (RTA 6)

23 November 2010
Ofcom
Written evidence (RTA 10)
Supplementary written evidence (RTA 19)

30 November 2010
Institute of Practitioners in Advertising (IPA), Mediaedge: CIA, OMD Group and Universal McCann
Written evidence, IPA (RTA 5)
Mr John Billett, Mr Steve Hewlett and Mr Ray Snoddy

8 December 2010
Skillset and Professor Sylvia Harvey
Ed Vaizey MP, Minister for Culture, Communications and Creative Industries, Departments for Business, Innovation and Skills (BIS) and for Culture Media and Sport (DCMS), and Edward Davey MP Minister for Employment Relations, Consumer and Postal Affairs (BIS)

Written evidence (RTA 4)
Supplementary written evidence, DCMS (RTA 25)
Further supplementary written evidence, DCMS (RTA 26)

14 December 2010
Channel Television and STV

Written Evidence
Evidence marked * is associated with oral evidence and is printed. Other evidence is published online at www.parliament.uk/holcommunications and available for inspection at the Parliamentary Archives (020 7219 5314).

Numerical Order
  British Heart Foundation (RTA 1)
  Children’s Food Campaign (RTA 2)
  * Competition Commission (RTA 3)
  * Department for Culture, Media and Sport, and Department for Business, Innovation and Skills (RTA 4)
  * Institute of Practitioners in Advertising (RTA 5)
  * Incorporated Society of British Advertisers (ISBA) (RTA 6)
  Pact (RTA 7)
  * Satellite and Cable Broadcasters’ Group (RTA 8)
  Food and Drink Federation (RTA 9)
  * Office of Fair Trading (RTA 10)
  * Office of Fair Trading (RTA 11)
  Royal College of Physicians (RTA 12)
  * Channel 4 (RTA 13)
  Viasat and SBS joint submission (RTA 14)
  * ITV plc (RTA 15)
  * Channel 5 Broadcasting Limited(RTA 16)
  Don Foster MP and Baroness Bonham-Carter of Yarnbury (RTA 17)
  * Competition Commission supplementary letter (RTA 18)
  * Ofcom supplementary letter (RTA 19)
  * ITV supplementary letter (RTA 20)
  UKTV (RTA 21)
  * Satellite and Cable Broadcasters’ Group (RTA 22)
  * Enders Analysis supplementary evidence (RTA 23)
  * Channel 4 supplementary evidence (RTA 24)
  * Department for Culture, Media and Sport supplementary evidence (RTA 25)
* Department for Culture, Media and Sport further supplementary evidence (RTA 26)

Alphabetical Order

- British Heart Foundation (RTA 1)
- Channel 4 (RTA 13 and RTA 24)
- Channel 5 Broadcasting Limited (RTA 16)
- Children’s Food Campaign (RTA 2)
- Competition Commission (RTA 3 and RTA 18)
- Department for Culture, Media and Sport, and Department for Business, Innovation and Skills (RTA 4, RTA 25 and RTA 26)
- Enders Analysis (RTA 23)
- Food and Drink Federation (RTA 9)
- Don Foster MP and Baroness Bonham-Carter of Yarnbury (RTA 17)
- Institute of Practitioners in Advertising (RTA 5)
- Incorporated Society of British Advertisers (ISBA) (RTA 6)
- ITV plc (RTA 15 and RTA 20)
- Ofcom (RTA 10 and RTA 19)
- Office of Fair Trading (RTA 11)
- Pact (RTA 7)
- Royal College of Physicians (RTA 12)
- Satellite and Cable Broadcasters’ Group (RTA 8 and RTA 22)
- UKTV (RTA 21)
- Viasat and SBS joint submission (RTA 14)
APPENDIX 3: CALL FOR EVIDENCE

Regulation of television advertising

The House of Lords Select Committee on Communications is announcing today an inquiry into the regulation of television advertising with particular reference to the Contract Rights Renewal mechanism.

During 2008/09, there was a sharp fall in the revenues earned by commercial television companies from the sale of advertising. This was in part a reflection of the general economic downturn, but it was also due to other developments, including the migration of advertising from television to the internet. There has been some recovery of advertising revenues in 2010, but this is not expected to wipe out the losses of the last two years. If the advertising-funded model is in irreversible decline, this has serious implications for the future of public service broadcasting.

Television advertising in the United Kingdom is subject to regulation in its scheduling and its sales arrangements. The latter has been the subject of a recent consultation by the Office of Communications (Ofcom). The former is regularly reviewed by Ofcom and is likely to be the subject of a consultation later this year. Commercial references in television programming (product placement) are currently not permitted for UK-produced programming, but this is the subject of a current Ofcom consultation.

There is a further set of rules, the Contract Rights Renewal (CRR) undertakings, which regulate what ITV can charge for advertising. These undertakings were required by the Competition Commission in 2003 as part of the arrangements for the Carlton/Granada merger to proceed, in order to protect advertisers and other broadcasters. The Competition Commission confirmed in May this year that the CRR rules should remain in place.

The inquiry will consider the prospects for television advertising revenues. The Committee would particularly welcome written submissions on the following points:

- How much of the recent decline in television advertising was due to migration to the internet and how much was due to the economic recession?
- Can television compete successfully in the medium-term with the internet and other media for advertising?

The inquiry will investigate what difference regulatory changes—to scheduling and sales of advertising and to product placement—might make to advertising revenues of commercial broadcasters and thus to the viability of the advertising-funded broadcasting model. The Committee would welcome written evidence on any of the following issues:

- Whether the current level of regulation of television advertising is appropriate.
• What the financial impact might be on television companies if changes are made to the regulation of scheduling and sales of television advertising or if product placement is introduced.
• The extent to which the CRR undertakings limit ITV’s ability to compete in the production of quality programming.
• The extent to which the reduction or removal of the CCR undertakings would affect the commercial public broadcasting sector.
• The extent to which current arrangements reflect the public interest.

20 July 2010
APPENDIX 4: THE TELEVISION ADVERTISING TRADING SYSTEM

This appendix provides an overview of how the television advertising system is traded in the UK. A more detailed explanation of television advertising campaign terms is available in Appendix C of the Competition Commission’s Final Report on the CRR undertakings.

How the television advertising market works

As part of the annual planning process, top management within a company will agree its business objectives, typically for the year, which will include marketing objectives and resources. Marketing management may then plan a series of more detailed objectives, programmes and campaigns through the year and, where possible, allocate people and money to deliver these.

The marketing budget is likely to cover many activities including media advertising (on television, newspapers or online); sales promotion; digital marketing; traditional direct marketing (for example mail, telephone); PR; events and market research. A proportion of this overall marketing budget is then allocated to television advertising, ultimately broken down by month and/or campaign.

There would then be the question of how to allocate the television budget across the different television channels, usually through negotiations between the media agencies (who often negotiate advertising deals on behalf of many individual advertisers) and broadcasting sales houses (who sell advertising on behalf of several broadcast channels). From the advertiser’s perspective, the main aim is typically to maximise the reach or coverage within the target market of each campaign. This is usually defined in demographic terms, for example age, gender, and socioeconomic status. A television advertising campaign’s effectiveness is measured in terms of target audience ratings (TVRs). This is based on the proportion of viewers within a target audience who watch the advertisement (known as coverage) and the number of times which they each watch it (known as frequency).

Many players are involved in the television advertising market value chain, as shown in Figure 6 below.

FIGURE 6
The television advertising value chain

Source: Ofcom

Television airtime is traded in different ways. The majority of airtime (approximately 80%) is traded as part of agency deals. This includes ‘umbrella deals’ where a media agency negotiates a contract with a broadcasting sales house on behalf of all of its advertising clients collectively. In addition, certain advertisers can have their own specific terms within the overall umbrella deals. These are known as ‘line-by-line’ deals.

Although the majority of advertising airtime is negotiated annually as part of this process, around 20% is sold during in year trading. This is how advertisers secure airtime for campaigns which are not planned in advance and this type of trading is known as ‘burst deals’. Burst deals are popular with seasonal advertisers, for example companies wishing to advertise barbeques or ice-creams during the summer months.

Figure 7 is a flow chart summarising how the television advertising trading system works.

**FIGURE 7**

How advertising is traded in annual deal rounds

As shown in the chart above, most advertisers engage a media agency to negotiate deals on their behalf. One exception to this rule is Procter & Gamble. It chooses to negotiate its television advertising contracts directly with broadcasting sales houses, rather than going through a media agency.

**How television airtime is traded**

Each year there is an annual deal round, usually in the autumn, when media agencies (on behalf of the advertisers they represent who are likely to represent a wide range of goods and service manufacturers from a cross section of industries) will negotiate an ‘umbrella deal’ which forms the basis for booking specific advertising campaigns for the year ahead. However, these negotiations do not start with a blank sheet of paper each year. Rather, the starting point each year is likely to be what was agreed to in the previous year, which means that there is likely to be considerable consistency over time in the deals which are made.

In broad terms, media agencies agree to commit a proportion of their television advertising spend to a particular broadcaster and in return the broadcasting sales house gives them a discount off the station average price (SAP). The SAP is the price (calculated after the advertisements have been broadcast) which the broadcaster charges for a particular target audience or demographic group, for example men aged 16–34. During the course of the year, within the terms of the annual contracts which

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263 Q 387
media agencies or advertisers have negotiated with broadcasters, advertisers then negotiate terms to reach certain target audiences for particular advertising campaigns. SAP is calculated after the advertisements have been aired and it varies month-by-month depending on the viewing ratings delivered by a broadcaster for a particular demographic group. The audience viewing figures for each advertisement are measured using an independent industry metric provided by BARB264 and the overall revenues which it received. SAP is calculated using the equation in Figure 8 below.

FIGURE 8
Calculating the station average price

Station Average Price (SAP) is the average cost of advertising per impact (viewer) charged by a broadcaster for a specific audience type (e.g. families or under-35s). SAP is calculated on a monthly basis using independent BARB data, and is a metric used for calculating how much each commercial impact was worth, based on how many viewers watched the programme at that time.

SAP is calculated using the following equation:

\[
SAP = \frac{\text{Total gross advertising revenue received across all audiences}}{\text{Total impacts delivered to a specific audience}}
\]

A discount off SAP means that a media agency will receive more commercial impacts in return for the same proportion of expenditure that it committed to the broadcaster in the annual deal round. For example, a 20% discount off SAP would mean that if the deal was set for 100 commercial impacts for a given level of spend and a 20% discount was given then the media agency would receive 120 commercial impacts whilst committing the same proportion of its television advertising spend to the broadcaster, thereby receiving more television audience viewers for the same proportion of its budget.

Within the context of the terms agreed between a media agency and a broadcasting sales house during the annual deal round, media agencies distribute the discount which they receive off the SAP between their different advertising clients. The level of discount off SAP which each advertiser receives is likely to be influenced by factors such as the size of the advertiser’s contract with the agency and whether their contract is due for renewal in the near future.

As well as negotiating umbrella deals for all of their clients collectively, media agencies also often negotiate special terms for particular clients (particularly large advertisers or clients that have specific needs) in ‘line by line’ deals during the annual deal round. Examples of the particular terms negotiated in these types of contracts

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264 BARB is the Broadcaster’s Audience Research Board. It provides the industry standard television audience measurement service for broadcasters and the advertising industry
can include where advertisements are placed during an advertising break and the proportion of advertisements shown during peak-time programmes.

Once annual deals are put in place (either as umbrella deals or with special line by line terms for particular advertisers) media agencies and broadcasters then negotiate terms for specific advertising campaigns as they are required and the broadcaster, which is responsible for the programme schedule, makes the decision about where to place the advertisements.

Although the majority of television advertising is traded during the annual deal round, it can also be purchased during the course of the year through a process of in year trading. These one-off deals between an advertiser or media agency and a broadcasting sales house are known as ‘burst deals’.

Advertisers, by and large, are not able to choose which programmes they would like their products to be advertised around. The exceptions to this rule are if the inclusion in a specific programme has been negotiated into the terms and conditions of a specific line by line deal, or if they are one of a handful of specific programmes each year which the broadcaster predicts in advance is likely to deliver high audience ratings. For example, the X Factor final results show, or FIFA World Cup football matches. Advertising breaks during these programmes are typically sold separately a couple of weeks ahead of broadcast as ‘specials’ using an auction system to the highest bidder. Programmes which attract mass audiences are extremely appealing to advertisers as they enable them to achieve broad reach in a very short timeframe. For this reason, broadcasters are often able to generate high prices for airtime sold during specials. For example, it is reported that each 30 second advertising slot during the recent X Factor final results show was sold for £250,000—generating approximately £25 million for ITV.265

International comparisons

There is no standard international model for trading airtime, although there are similarities and some features which are common to the way in which airtime is traded in several countries, including the UK. Ofcom submitted a note to us in written evidence which sets out its understanding of some of the key similarities and differences between the television trading system in the UK compared with other countries.266

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265 X-Factor is ITV’s £25M ‘SuperBowl’ moment, The Daily Telegraph, 12 December 2010
266 RTA 19
APPENDIX 5: REASONS FOR THE DECLINE IN THE TELEVISION ADVERTISING REVENUES

There has been a clear and well-documented decline in the television advertising revenues in recent years. There are three primary reasons for this:

- The economic recession and resulting downturn;
- Increased competition from online advertising; and
- Increased supply of television advertising airtime through the creation of new channels.

The impact of the economic recession

The economic recession has had a major impact on most UK industries and the television industry has not been immune. We have found the recession to be the main reason why the television advertising market has declined in recent years.

Figures show that the UK advertising market fell by 12.5% in 2009\textsuperscript{267}, although it is predicted to have risen by 6.6% in 2010.\textsuperscript{268} In fact, television advertising appears to have outperformed the overall advertising market during this period. Research published by Ofcom shows that television NAR fell by 9.6% between 2008 and 2009\textsuperscript{269}, almost 3% less than the advertising market as a whole.

Enders Analysis believe that television revenues have increased as the UK’s economic outlook has improved. They predict that the upturn in advertising revenues will continue in the fourth quarter of 2010 and that full year-on-year growth between 2009 and 2010 will be around 12.5%; more than reversing the 11% fall seen in 2009. However, revenues in 2010 remain at about 5% lower than 2007 levels, and even further behind 2005 levels, which “may never be matched again in real terms.”\textsuperscript{270}

ITV plc made a similar forecast. Its CEO, Adam Crozier, told us that despite being up 18% year-on-year in the third quarter of 2009, this is an increase “on a fairly dreadful year last year.”\textsuperscript{271} Mr. Crozier noted that “over the past 10 years, the television advertising market has been in relative decline” and that the rise in advertising revenue in 2009 was merely bringing them back up to 2008 levels—which still represented a significant decline on previous years.

Competition from online advertising

Over the past five years classified press advertising has fallen from 18% to 9%,\textsuperscript{272} largely as a result of the direct competition it now faces from internet advertising, 80% of which is either search (using key-word searches) (60%) or classified (advertising listed by category) (20%). This is because there often “may be direct

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{267} Ofcom CMR 2010, p. 98
  \item \textsuperscript{268} UK adspend growth strongest in six years, Advertising Association at WARC news release, 17 December 2010
  \item \textsuperscript{269} Ofcom CMR 2010, p. 122
  \item \textsuperscript{270} RTA 4
  \item \textsuperscript{271} Q 129
  \item \textsuperscript{272} Q 5
\end{itemize}
\end{footnotesize}
substitution” between online advertising and print classified advertising (for example, in advertising cars for sale).\textsuperscript{273}

In contrast, there is little direct substitution between internet advertising and television. All television advertising is display rather than classified advertising. Television’s share of display advertising is as high as it was in 1995.\textsuperscript{274} Therefore, rather than substitution, the main impact of internet advertising on television advertising revenue has been indirect—capturing budget from television and other display advertising media. In June 2009 internet advertising (which had a market share of 23.5\%) overtook television advertising (which had a market share of 21.9\%) in terms of its overall share of the advertising market for the first time.\textsuperscript{275}

However in the first six months of 2010, television was marginally ahead once again with a 26\% market share, compared with internet advertising at 24\%.\textsuperscript{276} During this period total UK advertising industry spend rose by 6.3\% to £8.1 billion.\textsuperscript{277} David Lynn, Managing Director, MTV networks UK and Ireland, supported this claim, saying that there had been “a deep advertising recession” in the last two to three years, but that it was now seeing a “strong recovery across all channels” and that they were “recovering all of the losses that [they] suffered in 2009 as a sector.”\textsuperscript{278}

Internet advertising has grown “exponentially” in the past 10 years.\textsuperscript{279} However, this form of advertising is unlikely to directly substitute television advertising as it is mainly based on a key-word searches which, unlike display advertising, can be tailored much more effectively to individual needs. As internet advertising has become increasingly sophisticated, advertisers have been shifting away from display towards more targeted consumer initiated advertising, such as search and classified.

Notwithstanding the growth in internet advertising television is considered to be particularly important for advertisers because it combines visual imagery with sound and movement,\textsuperscript{280} thus emphasising a message and because television is an extremely popular leisure activity\textsuperscript{281} with extensive audiences. Geoffrey Russell from the Institute of Practitioners in Advertising (IPA) told us that although there had been a transfer of business from TV to online advertising, “certain media have been more vulnerable” and other media, particularly radio and regional press, had been more affected by the growth in online internet advertising than television.\textsuperscript{282}

The increased supply of television airtime

The other big structural change in the television advertising market since 2003 has been the huge increase in the total time given to television advertising driven by the
growth of multichannel TV. Andy Jones, CEO of the media agency Universal McCann London told us that “over the last six, seven years or so commercial impacts have increased by something like 35%, due to the extra channels that have come on board primarily. So, the price of airtime has deflated overall by about 16%.”

As there are now 490 channels on air in the UK and the number of channels available (the supply) has grown at a faster rate than the demand for advertising airtime, the cost of television advertising airtime (calculated as the cost per thousand viewers, CPT) has naturally decreased.

Channel 5 told us that this has resulted in television airtime now being cheaper than it has been since the 1980s. The chart below shows that TV net advertising revenue has fallen significantly since 2003, when reflected in 2000 prices.

FIGURE 9
Changes in UK Net Advertising Revenue (NAR) and Adult Impacts 2000 to 2009

Source: Channel Five

Research published by ITV plc from its ‘Response TV’ survey also confirms that the cost per thousand viewers of television advertising has fallen, and that it has not been cheaper since 1997. Figure 10 below shows this change. Both Thinkbox and ISBA agree that television advertising is cheaper now than it has been since the 1980s.

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283 Q 463
285 RTA 16
286 Simplistically this can be considered to be the number of adults watching a particular advertisement on television
288 Q 368
FIGURE 10
Changes in the cost per thousand of television advertising over time

Source: ITV plc ‘Response TV’ survey, slide 28. Research findings available at:
http://www.itvmedia.co.uk/insights-and-effectiveness/insights/response-tv

It is clear that advertisers are now able to buy advertising airtime which provides many more adult viewers for each commercial at a much lower average price than before. In effect, this means that the big advertisers in particular are getting a much better deal now than in 2003.

289 QQ 367–8, 375, RTA 13, 20
APPENDIX 6: TIMELINE FOR CHANGES IN THE TELEVISION INDUSTRY

FIGURE 11
Historical timeline of the regulation of television advertising

1954
Commercial TV established by Television Act. Act established Independent Television Authority (ITA) which established rules for television advertising.

1972
Independent Broadcasting Authority (IBA) replaces ITA regulator

1982
Channel 4 & STC begin broadcasting

1985
First cable TV franchises

1990
Broadcasting Act gave regulators power to determine frequency and length of advertising breaks

1991
Independent Television Commission (ITC) replaces IBA as regulator

1995 – 1962
ITV network of 15 regional TV licences completed (each region was owned by a different company and aired on a regional basis)

1997
Launch of Channel 5

2002
Freeview launches on digital terrestrial television

2009
Ofcom revises COSTA rules & reviews CRR

2007
Digital switchover begins

2008
Ofcom amends some of the advertising rules and RADA is replaced by Code on Scheduling of Television Advertising, COSTA

2010
Competition Commission publishes final report on CRR undertakings

2011
Product placement allowed on UK television

Sources: History of ITV, ITV plc: http://www.itvplc.com/about/history/
Key data in the history of commercial TV, Ofcom: http://www.ofcom.org.uk/static/archives/itslab_television_sector/overview/key_data.asp.html
Ofcom Review of television advertising and teleshopping regulation, March 2008
**FIGURE 12**

Possible future dates for changes to the regulation of television advertising

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>November 2011</td>
<td>Completion of short market review of television advertising market</td>
</tr>
<tr>
<td>By end of 2011</td>
<td>DCMS green paper on next Communications Bill</td>
</tr>
<tr>
<td>Late 2012</td>
<td>Completion of digital switchover</td>
</tr>
<tr>
<td>2014</td>
<td>Renewal of commercial public service licences</td>
</tr>
<tr>
<td>By May 2015</td>
<td>Communications Bill completed by end of this Parliament</td>
</tr>
<tr>
<td>2017</td>
<td>BBC licence fee settlement expires</td>
</tr>
<tr>
<td></td>
<td>Charter review to be completed before this date</td>
</tr>
</tbody>
</table>
APPENDIX 7: GLOSSARY

4 on Demand (4oD)
An internet catch-up service which enables viewers to watch programmes which have recently been shown on Channel 4 or other digital channels owned by Channel 4 television corporation, such as E4 or More4.

Advertising airtime
Breaks during television programmes in which advertisements are shown.

Airtime Sales Rules (ASRs)
Two rules (the ‘withholding rule’ and the ‘conditional selling’ rule) relating to how television airtime is sold. The ASRs were removed by Ofcom in September 2010.

Audiovisual Media Services Directive (AVMS)
A European law which was implemented in the UK in 2010, updating the Television Without Frontiers Directive to take account of technological developments and changes in the structure of the audiovisual market.

Automatic Ratchet Mechanism (ARM)
A competition remedy in the CRR undertakings which ties the share of television advertising spend which a media agency or advertiser commits to ITV1 to ITV1’s audience ratings.

BBC iPlayer
An internet catch-up service which enables viewers to watch or listen to programmes broadcast on BBC television channels or radio stations within seven days from the date of the original broadcast.

BCAP Code
The television advertising standards code which governs television advertisements (and programme sponsorship) on any radio or television service in the UK licensed by Ofcom.

BIS
The UK Government Department for Business, Innovation and Skills.

Broadcasters’ Audience Research Board (BARB)
The organisation responsible for providing the official measurement of UK television audiences.

Burst deal
A one-off deal made at any time during the year between a media agency or advertiser and a broadcasting sales house to purchase television advertising airtime.
Broadcasting sales house
Companies which sell advertising airtime to media agencies and advertisers on behalf of one or several broadcasters.

Communications Act 2003
A UK Act of Parliament which overhauled the UK’s regulatory framework in communications, in particular giving Ofcom powers to regulate the whole sector.

Competition Commission
An independent competition regulator with a remit to investigate mergers, markets and the regulation of companies in the UK.

Commercial impacts
A measure of viewing figures for television advertisements. One impact is equal to one member of the target audience watching one 30 second advertisement.

Conditional selling rule
One of the airtime sales rules which was removed by Ofcom in September 2010. It prohibited broadcasters from selling bundles of advertising airtime from across its television channels without also allowing advertisers to buy airtime on these channels separately.

Cost per thousand (CPT)
The cost of one thousand commercial impacts for a television advertisement’s target audience.

Code on the Scheduling of Television Advertising (COSTA)
The rules set by Ofcom which govern the quantity of advertising that can be shown on commercially-funded public service broadcasting channels and other commercial channels.

Contract Rights Renewal (CRR)
A set of undertakings which determine the way in which ITV plc is able to sell advertising airtime on ITV1.

Coverage
The proportion of the target audience with at least one opportunity to see a particular advertising campaign. Sometimes referred to as “reach”.

CRR Adjudicator
The person appointed to adjudicate on disputes between ITV plc and its television advertising customers.

DCMS
The UK Government Department for Culture, Media and Sport.
Digital channels
Television channels which are only broadcast on digital television platforms (including cable, satellite and free-to-air). After digital switchover all television channels will be digital.

Digital switchover
The process of switching over the analogue television system in the UK to digital (also referred to as analogue switch-off). This is due to be complete by the summer of 2012.

Digital video recorder (DVR)
A digital TV set-top box which enables viewers to record television programmes and to pause, rewind and fast-forward live television. This is sometimes referred to as a “personal video recorder” (PVR).

Discount off SAP
The greater the discount off the station average price (SAP, see below for definition), the more commercial impacts a broadcaster will commit to deliver over and above that which would be implied by the SAP.

Enterprise Act 2002
A UK Act of Parliament which made major changes to UK competition law particularly with regards to mergers. The Act transferred powers for the CRR undertakings from the Secretary of State to the Competition Commission.

First-run programming
Television programmes which are produced either by an independent producer or a broadcaster specifically for the channel on which they are aired.

Frequency
The average number of times viewers in a target audience group have an opportunity to see a television campaign.

IAB
The Internet Advertising Bureau is the trade association for online advertising.

IPA
The Institute of Practitioners in Advertising is the UK trade body for advertising and media agencies.

ISBA
The UK trade body for advertisers. Formerly known as the Incorporated Society of British Advertisers.

ITV plc
The company formed from merger of Carlton Communications plc and Granada plc.
ITV network
The ITV network is the biggest commercial television network in the UK. It comprises of 15 regional channel 3 television broadcasting licences. Eleven of the licences in England and Wales are owned by ITV plc; SMG owns the two Scottish licences (the broadcaster is known as STV); UTV owns the channel 3 licence for Northern Ireland and Channel Television owns the licence for the Channel Islands.

ITV1
ITV1 is the biggest commercial public service broadcasting channel in the UK.

Line by line deals
Advertising deals between media agencies or advertisers and broadcasting sales houses which include specific terms and conditions for particular advertisers.

Media agencies
Companies which negotiate deals to buy advertising airtime on behalf of their clients, which often include several advertisers from a variety of different industries. Also referred to as media buyers.

Multichannel television
Television services including channels other than the five main free-to-air television channels of BBC One, BBC Two, ITV1, Channel 4/S4C and Channel 5).

Net advertising revenues (NAR)
The total amount of money paid by a media agency or advertiser to a broadcasting sales house (minus the agency commission).

Non-consolidated licensees
The channel 3 licence holders which do not form part of ITV plc. These are STV, UTV and Channel TV.

Ofcom
The Office of Communications is the independent regulatory body for the communications industry.

OFT
The Office of Fair Trading is the economic regulator in the UK which enforces both consumer protection and competition law.

PACT
The Producers
Alliance for Cinema and Television is the UK trade body for independent film and television production companies.

Portfolio channels
Digital television channels other than a broadcaster's core channel.
Product placement
The paid-for placement of products, services and trade marks in television programmes.

PSB
Public service broadcasting or public service broadcaster. The main public service broadcasters are the BBC, ITV, Channel 4, S4C and Channel 5.

RADA
Rules on the Amount and Distribution of Advertising. These rules pre-dated the Code on the Scheduling of Television Advertising (COSTA).

RTA
Written evidence submitted to us for this inquiry is published in this report as RTA X. RTA stands for the Regulation of Television Advertising.

SCBG
The Satellite and Cable Broadcasters Group is the trade body for satellite and cable programme providers.

Share of Broadcast (SOB)
The proportion of television advertising spend which a media agency or advertiser has committed to a broadcasting sales house in return for a given discount.

Share of Commercial Impacts (SOCI)
A television channel or broadcasting sales house’s percentage share of all commercial impacts in a particular period.

Sponsorship
A sponsored television programme is one which has had some or all of its costs met by a sponsor with a view to promoting its brand.

Station Average Price (SAP)
The average price per commercial impact, calculated after the event, and charged by a broadcaster for a specific audience type.

Target audience
A group of viewers, often defined in terms of a particular demographic group, at which an advertising campaign is specifically aimed.

Target Audience Ratings (TVRs)
The measurement used to calculate the television ratings of an advertisement by comparing its target audience reach compared to the population as a whole. One TVR is numerically equivalent to one percent of the target audience.
Television Without Frontiers (TWF) Directive
A European law passed in 1989 which was designed to coordinate the legal, regulatory and administrative frameworks in television broadcasting of the different member states of the European Union.

UK originated content
Television programmes which are wholly produced in the UK.

Umbrella deal
An agreement negotiated between a media agency on behalf of all of its advertising clients, and a broadcasting sales house. The media agency commits a share of its television advertising airtime to the broadcasting sales house in return for a discount off SAP (and other terms and conditions) which it will then distribute amongst its advertising clients.

Withholding rule
One of the airtime sales rules which, until it was removed by Ofcom in September 2010, prohibited ITV1, Channel 4 and Channel 5 from holding back some of their advertising slots in order to decrease supply and push up the cost of the remaining airtime.
Minutes of Evidence
TAKEN BEFORE THE SELECT COMMITTEE ON COMMUNICATIONS
TUESDAY 19 OCTOBER 2010

Present

Lord Clement-Jones
(Acting Chairman)
Lord Bragg
Baroness Deech
Lord Dixon-Smith
Baroness Fookes

Lord Gordon of Strathblane
The Lord Bishop of Liverpool
Lord Macdonald of Tradeston
Lord Razzall
Lord St John of Bletso
Lord Skelmersdale

Examination of Witnesses

Ms Tess Alps, CEO, Thinkbox, Mr Ben Fenton, Media Correspondent, Financial Times, Mr Guy Phillipson, Chief Executive, Internet Advertising Bureau, and Dr Toby Syfret (Media Analyst, Enders Analysis).

Q1 The Chairman: I welcome everybody to the first public session of the Communications Select Committee and, in particular, our expert witnesses today. I will ask them to introduce themselves very shortly. I apparently have to declare an interest first of all, as all our Committee members do when they speak in the Committee for the first time. Mine is a very old interest—Melvyn may remember. I worked for LWT between 1980 and 1984, which is barely an interest at this distance, but since we are all declaring our antecedents, that is some kind of a precedent. I should first explain why I am in the chair today. Our chairman, the Earl of Onslow, is temporarily unavailable to chair the Committee because of ill health. He remains a member of the Committee. He has asked me to chair this inquiry, which will take place until Christmas, and the Committee has agreed. He is very confident that he will be able to return to the chair in January. In the meantime, he will remain a full member of the Committee, and we very much hope that he will be able to come along and take part in our proceedings. We all wish him extremely well.

Perhaps I could ask Toby Syfret to introduce himself briefly. We are going to be pretty snappy today. We have got something like 23 questions to get through in two hours, so this is going to be a rapid-fire occasion today.

Toby Syfret: I started life as an academic lecturer in psychology. I joined advertising in 1980 and spent about 10 years working for J Walter Thompson and then Ogilvy & Mather. Most of that time, I was in the media department looking at advertising trends in a lot of countries, among other things. I then spent about 13 years from 1990 to about 2003 working as an independent consultant with special expertise in audience measurement. I have written a couple of books on the subject, done masses of audits in different European countries and have been out to places such as Saudi Arabia where it was fascinating to see how it works. I still kept up the other side, which was writing about media trends and developments, and in 2003 I joined Enders Analysis.

I have known Claire Enders since the 1980s. I am now specialising more on media trends, especially in the United Kingdom, but I obviously keep up with quite a lot of what goes on elsewhere. Advertising and pay television are important subjects that we deal with the whole time.

The Chairman: Thank you, and thanks for the initial Enders analysis, so to speak.

Guy Phillipson: Good afternoon, Lord Chairman, my Lords. I am Guy Phillipson, the Chief Executive of the Internet Advertising Bureau, the trade association for digital advertising in the UK. I have been chief executive since 2005. We measure online advertising spend as well as research the medium and help advertisers use it. Before joining the IAB, I was head of advertising for Vodafone, a major advertiser in the UK, from 2000 to 2005.

Tess Alps: Hello everybody. I am Tess Alps. I am Guy’s counterpart for television. I have been at Thinkbox since 2006. Television was the last of the media to have a marketing body for the industry as a whole. My shareholders include ITV, Sky, Channel 4 and everybody apart from, at the moment, UKTV and Virgin. Virgin is going into Sky and UKTV will be joining from January, so at that point we will represent all of television. Apart from four years doing this, before that I spent 13 years at PHD, a large media agency, and was latterly the chairman. Before that, I spent 10 years in television and was an ITV sales director.

Ben Fenton: I am Ben Fenton. I am the chief media correspondent for the Financial Times. I have been there for four years covering the whole range of
media. Before that, I was senior reporter at the Daily Telegraph, Washington correspondent of the Daily Telegraph and a number of other odds and sods doing that job. I do not have the expertise of the people sitting to my right, but I hope I have a neutral position to act as a sort of referee if needed.

Q2 The Chairman: Thanks very much. The rules of the game are that we are going to ask quite a lot of questions. They will be taken in turn by a number of members of the Committee as we go through. There will be some wild cards as well, I have no doubt. Some questions are dolly catches, but some of them are rather harder, so do not be surprised if, at the beginning, they are just trying to elicit some of the facts and figures. They will get tougher as we go through. If you agree with the answer that has been given by a fellow panellist, there is no need to come in just to add something, but if there is something you disagree with, or you think there needs to be further elucidation, please do not hesitate to come in. Obviously, we want to move at a fairly fast pace if we possibly can as we go through this afternoon. I shall ask the first dolly question, which is, what have been the main trends in advertising in the UK over the last 10 years, both in terms of revenue and the share between the different advertising sectors? How accurately were these trends predicted in forecasts at the time? How much of the decline in advertising revenues in 2008-09 was due to the economic recession? What other structural factors were involved? Toby, is this something that you think you can answer?

Toby Syfret: I will try to recall each one. I think there are two levels. At a gross level, one of the big trends in the past few years has been the relatively static growth in the total advertising market, even when the economy has been expanding. In this sense, up to around 2001–02, we have always seen the two go together with a close correlation in terms of the change in one and the change in the other. What we have seen since then is that advertising growth has remained rather static while, prior to 2008–09, the economy has continued to grow. Within that more static advertising total—the “decoupling”, as we call it—there are two things. First, the balance has changed. There is now a huge rise in the internet share within the total. We may be looking at something like 25 or 30 per cent of money going into the internet. Most of it is search, but there is also display and classified. Each of the media has been rather suffering, so in real terms we have seen declines in everyone, in particular television, press and radio. The declines that we are getting there are slightly different due to what we call structural factors. In the press, there may be direct substitution with classified advertising. One of the structural factors in radio has been the declining commercial audience, and the nature of the way radio is bought makes that relevant. In the case of television, we have some evidence simply by looking at where internet has grown most strongly in online display, which is only one of the categories, but we think search is related to it. We find, on average, that categories that have done well in online are the ones that have performed weakest on television in the past few years. That is one, but there are others. In particular, we have had a market where ITV and Channel 4 are the premium channels. They still are, but they have been losing audience to cheaper channels. There are other possible structural factors. In the past year, for example, we have had the rise of client procurement departments and auditors, whereby an estimated 40 per cent of the money being spent on the display advertising medium in this country went up for repitch and retender last year. There is tremendous downward pressure by clients, increasingly with procurement departments, which is pushing down spend, so you can take your pick. Finally, one possible one, about which there is more dispute than others, is that unlike radio, which lost commercial audience, with television advertisers are getting more and more audience although they are spending less. The actual eyeballs watching commercials since about 2002–03 have gone up by about 30 per cent, so it is not the internet taking audiences away. That raises questions about the elasticity of supply and demand and whether it is possible that when advertisers want only a certain audience, demand does not rise to make up for the increase. I do not believe that this is a strong effect, but there is some evidence suggesting that this may be an additional structural factor for television. The idea is that the increase in viewing of commercials not only leads to weakening of demand, which reduces the price per thousand viewers purchased—which is the currency we talk about, the costs per thousand—but also it deflates the total revenues that result. That is a possible fourth factor, about which opinions are divided.

Q3 The Chairman: And the recessionary impact? You have talked about the structural impact.

Toby Syfret: As we have seen with all recessions, it is—I do not know whether this is the proper word—hypercyclical, meaning that when you get rapid growth or increase in the economy, you tend to get an even higher increase in advertising spend. Conversely, when the economy goes down, it is a double-whammy to the advertising spend. This particularly, probably applies in television, and it probably has something to do with the nature of airtime trading in this country.

1 The witness had added that this has resulted in lower overall average costs, which in turn has allowed money to flow out of television as advertisers have found they can purchase the same volumes of audience for less outlay.
Q4 The Chairman: Okay, we may come on to more detail on that later. Can I ask you to get out your crystal ball and say what your forecasts and expectations for advertising revenue are, particularly for television advertising, over the next five years?

Toby Syfret: I am glad you are not asking for the next year, because that is always the hardest, but over the long term my feeling is that if we do not suffer particularly several effects as we try to get out of this recession and there are no further negative effects next year, I would expect television to be more or less in line with real growth, possibly a little bit below. That is my best guess. It could grow a little bit ahead. I do not think the structural factors weigh on it quite so far as they have done up to now, but it will be basically stable, either a little bit up or a little bit down, but not really much change. That is what I would give as my best guess for the next five years.

Q5 The Chairman: Would any other member of the panel want to comment, in particular on the comments on internet advertising revenue growth and so on relative to television advertising? Guy, you are the expert in this area.

Guy Phillipson: I am very happy to comment on internet advertising. It is true to say that it has grown exponentially in the past 10 years. Ten years ago, online advertising in the UK was worth £150 million, which was between 1 and 2% of total advertising at the time. It is now worth around 24% of total advertising when you include direct mail, directories and classified advertising. It is still below television which in the first half was worth 26%. The key thing to note is the nature of the channels. As Toby Syfret said, it is dominated by search, which is 60% of online advertising. Classified is another 20% of the cake. Twenty per cent is display advertising, which if you were going to take a format that could compete with television, it would be that 20%. Display advertising online is about 5% of total advertising right now. The main point here is that online’s strengths, which are direct response and accountability, have certainly affected traditional direct channels, for example, direct marketing, which has reduced from 14% of total to 10% of total in the past five years. Press classified advertising in the past five years has gone down from 18% to 9%, so its share has halved. To an extent, it may be affecting press display, so all newspapers and magazine display advertising in the past five years has reduced from 21% to 18%. However, five years ago, television had a 24% share and now has 26%. It dipped a bit during the recession, but it has come back. Its losses in 2009 have already been regained in 2010. That may be because it is the key brand channel. Online brand properties are in display. Things like video and social are still quite a small part of total advertising.

The Chairman: Which I think brings us on Baroness Deech’s question.

Q6 Baroness Deech: Thank you, Chairman. I should declare an interest as one of the last governors of the BBC. My daughter works for the BBC and I and my family own shares in WPP, Reed Elsevier and Disney. I think my question is probably most in the field of expertise of Mr Phillipson. What are the particular advantages and disadvantages of television for advertising compared to other media, especially the internet? In relation to television, is it not less attractive because viewers can now use recording technology—on-demand viewing—and therefore bypass the advertising slots, if that is how they choose to download their material? It is about the relative merits of these media.

Guy Phillipson: Taking the first question about the advantages of television versus the internet, and speaking as a previous large advertiser, television provides excellent reach of the population. The internet has between 75 and 80% of the total population online, while television will have more than 99% penetration. It is audiovisual and is regarded as the prime medium for branding. Online’s key strength, as I mentioned before, is accountability, so the reason why it has grown so fast in this country is because it has a return path. Toby Syfret alluded to certain categories of advertisers, for example, finance, travel and telecoms, increasingly using online for their acquisitions, for selling their products. Search is traded on a pay-per-click basis so people click through to the site to do something. Classified speaks for itself. If you are thinking of buying property or a car, classified works in a similar way. In fact, half of display advertising, like banners or skyscrapers that you see on the page, is sold on a cost-per-click or cost-per-acquisition basis. About half of it will be sold on a cost-per-thousand basis, which was mentioned by Mr Syfret. We call it CPM in online-land. That gives you some comparison about the way it is traded. Increasingly, online is being seen as a branding medium with the emergence of video and social media. It has become an entertainment medium as we have got faster broadband. The reason why it grew so fast is linked to e-commerce. Last year, UK citizens spent over £50 billion shopping for products and services. To put that into context, our population is about one-fifth of that of the United States—300 million people—but the amount spent on shopping is 60% of the amount that is spent in the United States. We are online shoppers, and we are searchaholics. We use search. It is second nature in this country. When you click on a sponsored term, that generates cash for search engines, so 60% of the cake is search.
Q7 Lord MacDonald of Tradeston: I should declare my interest as an adviser to the Macquarie Group, which has funds invested in the transmission company Arqiva and the broadcast services company Red Bee Media. Also, I was employed by ITV for 30 years, including chairmanship of a sales house or two in that period. Online advertising is very unnaturally constructed at the moment with the dominance of Google. What happens in the natural process of competition when that begins to disintegrate and you can no longer deliver any great clumps as you do at the moment? What happens to the price of advertising then?

Guy Phillipson: The price of the advertising?

Lord MacDonald of Tradeston: Will that not come down?

Guy Phillipson: Search is a bid engine, so that is according to what the advertiser will pay. If you want to buy a term such as “Nokia mobile phone”, you bid a price and that is how it is traded. In a broader sense, with display on portals and so on and the increase in content and impressions—the number of pages viewed because it is a pretty infinite landscape as you can build as much real estate as you like online—that would produce downward pressure on what we call CPMs, or cost per thousands. The way that media owners could perhaps drive up the rate that they may charge would be to prove that the consumer stays on the page for longer—has a longer dwell time—and that the environment is a quality environment. In fact, many publishers in press and television have exactly that.

Q8 The Chairman: Tess, can I bring you in because I would be interested in whether you agree with what have you heard?

Tess Alps: In terms of the qualities of television advertising, I agree with everything that Guy has said. Fundamentally, it is very effective. It gives a tremendous return on investment, possibly not instantly, but it builds brands that last a long time. That is why advertisers use it. Many case studies, for example, Hovis and John Lewis this year, will prove that fact. Everything else is detail, although important detail. That is fundamentally why advertisers trust television. I would like to come back to Baroness Deech’s point about fast-forwarding advertising. We all fast-forward ads. I certainly do, and I am paid not to do that. The facts are very important and slightly counterintuitive, so I would like to take you quickly through them. You can fast-forward only what you record, and only 7% of our viewing is time-shifted. So, at the maximum, we could lose about 7% of ads. Those homes that have Sky +, Freeview + or V + record more. The latest figures show that that is going down, but it is not more than 15%. So in those homes with that technology, only 15% of their TV is time-shifted, but they watch more TV so, believe it or not, when you get one of those machines, you end up watching more ads at normal speed. Ads are not recorded unless they are watched at normal speed. BARB is a very sophisticated technique. A point that got missed on the first question about the general trends in advertising is that total advertising started to decline at the beginning of this decade as a percentage of marketing. That is much to do with retail circumstances in the UK. A tremendous amount of marketing budgets went to the major supermarkets and price cutting, not to advertising, not even Google or anything else. The second effect is an internet effect, but not internet advertising. If an advertiser has a brilliant website and a database, it can e-mail me, and I can just click on that link and go to a website. In fact, all advertising is being stressed, but within it display advertising is losing share steadily. That is quite significant for online display and television, whether online or linear. I represent both bits of it.

Q9 The Chairman: Because you can be that much more targeted in other ways than display?

Tess Alps: There has definitely been more one-to-one communication. I think those are the main points that have been missed.

The Chairman: Very briefly, because I want to come on to Lord Razzall’s question.

Toby Syfret: Just to assert a point again, the money and investment may have been going down, but in television people are watching far more display advertising than they were a few years ago. You have to separate the volume of watching from the price that advertisers are paying. It is not that advertisers do not love television or that the fame or the branding that is associated with television is not important, it is that they do not have to pay so much. Tess Alps: I think we ought to repeat that point. We have had hyperdeflation in television because the TV market is not allowed to control its own inventory. The Chairman: Ben, I am going to bring you in as soon as I can. We are getting through the thickets of the first bit.

Q10 Lord Razzall: I have no interests to declare, other than in the topic. We have had an interesting discussion and answers on the macro side of television advertising and online advertising, which I understand. Looking within the framework of what is happening in the advertising industry, is there any evidence that there is a quantifiable or permanent reduction in any specific area of television advertising which is shifting to online? I am aware that whereas five years ago Procter & Gamble and Unilever made no attempt at online advertising, they now do. Is there any indication of any particular area of television advertising within the macro sphere that
has shifted on to the online sector? I do not know who the best person to answer that is.

**The Chairman:** Ben, you have not answered yet, but it is probably a slightly unfair question.

**Ben Fenton:** You have probably chosen the wrong person for that one. My instinct would be that in the regions, local advertising has probably shifted more than others. I think Toby or one of the others would be better at answering.

**Toby Syfret:** I am happy to send you something that shows the main on-display categories later, but certainly things like finance have done very well on online display and have grown very strongly.

**Q11 Lord Razzall:** Have they shifted from TV?

**Toby Syfret:** Those are the ones that look weakest compared with all the others on television, so you get associations. The difficulty is that some of the evidence and the data are not always so easy to read and assess.

**Q12 The Chairman:** Can you identify sector by sector?

**Toby Syfret:** You can say that. Telecommunications in one or two things and some of the leisure have not done so on the whole. I may be wrong. There may be exceptions in one or two cases. Sectors that have shown strong online display growth in the past few years are on average well below the other lot. Although there is a lot of noise made about P&G investment in online video and things, it is very small indeed within its total. Looking at Nielsen data, we found that of the people who have shown biggest growth on the internet, roughly 95% of online display is accounted for by companies that have 55% of television display advertising. The other 5% is by the P&Gs, Univers and Reckitt Benckiser and others who are 45%. They are the traditional, fast-moving consumer goods categories on television. On the whole, they have been much more stable in their growth or their changes in the past few years than the categories associated with heavier online display advertising spend—

**The Chairman:** It would be very interesting to see that in hard copy.

**Toby Syfret:** I can deliver that.

**Q13 Lord Skelmersdale:** I am another lay member of the Committee, so I have no interest to declare. There could be two reasons for the shift from television advertising to internet advertising. You mentioned financial companies. Television is a very bad medium for thinking about, say, insurance because you do not have time in the 30 seconds or 90 seconds when the thing is on the screen to think about it. It can be done only by constant repetition. Would you accept that the internet is rather different? You can study the thing for as long as you like.

**Toby Syfret:** Yes, I would say this, and maybe Tess will want to comment on it. Fame and branding are still important for financial services. The difficulty is that you get other parts of the message, particularly where you get into more transactional applications, such as reading through the policy. You may take a decision on the internet and do it. What Guy said about e-commerce was absolutely right. Those things will drive extra investment in online advertising, and it may cause people to think, “Well, we don’t need to do quite so much on the television side because these others are doing a better job in this area for us.” It does not mean to say that they want to leave completely. You only have to look at advertisements for people such as Go Compare. They know that if they want people to go on the internet to look at them, they need to get the fame and branding from television. This is what Tess’s organisation has been doing. It is not absolutely about one replacing the other. Online may for example be a lot better for some of the promotional tasks that an insurance company may want to get through, hence you use it. It does not, however, mean to say that television is not important in terms of branding.

**Q14 Lord Skelmersdale:** So what would you expect interactive television to do to this equation?

**Toby Syfret:** If you are talking about interactive television in terms of what is now being commonly called connected TV, where people chose stuff over their broadband, there are quite a lot of things. There are some extreme measurement issues that have yet to be confronted. The potential role of precise targeting, which people talk about, partly for the reasons you are suggesting—that you need to read things and think about them—is, in my opinion, considerably lower than many people think. The value of television is that you reach the general public. I think broadcast television will remain very important for a long time to come. One of the difficulties you will have with interactive, on-demand television is that so far we have seen people showing much greater resistance to seeing lots of ads. You might have two or three minutes, but you will not put up with nine minutes, as people will with broadcast. Once it becomes your choice and you become more active in fiddling around and getting to something which did not happen to be on at that time, your tolerance of ads goes down. It might be quite a good environment, but it is a smaller environment, so it will have a relatively minor impact over the next 10 years.

**Q15 Lord St John of Bletso:** I also have no interest to declare. With the proliferation of television channels—there are 500 channels available on satellite and cable and 50 on Freeview—advertisers have a far greater choice of channels on which to
place their advertisements. On what basis do they decide which channels to use?

The Chairman: Ben, I am very happy for you to answer, but I realise that this is not your patch.

Ben Fenton: It is not quite my patch. It would be on their normal, basic marketing principles of what type of audience they are trying to reach, so if it is a younger age group, they would clearly be more inclined to use online advertising, and if it is an older one, they would be a lot more inclined to use television. Then the choice of channels is equally segregated by the social distinctions. That is a very general answer.

Tess Alps: I will try not to get too far into media planning, but there are demographic issues to consider. Within television, you can now have MTV and I watched a Rameau opera on Sky Arts 2 this morning over breakfast, so now there is truly a channel or a programme for any advertiser on television. It is more to do with the task and what you are trying to do. Are you trying to generate a response or build a brand? That is at least as important as the targeting aspect.

Toby Syfret: Plus price.

Q16 Lord St John of Bletso: With the fragmentation of channels, does that mask the fact that there is potential for media monopolies to develop?

Toby Syfret: There were media monopolies before. Essentially, we have seen a transference from one state of monopoly, or oligopoly or whatever you like to call it. All the channels now want to get a sizeable audience, whether it is BBC—I know it does not have advertising—ITV, Channel 4, Five, and then you have the ones owned by Time Warner and the ones owned by News Corp, or part-owned in the case of BSkyB, and then you have the UKTV channels from the 50/50 joint venture between the BBC Worldwide and Virgin Media. These account for the vast majority of the total TV audience. We had oligopolies back in about 1980 and we have simply seen a transference. When we talk of audience fragmentation, ITV1 has lost audience as others have gained ground, but if we look at the ITV family, including ITV2, 3 and 4, it has made up practically all of the lost ground in the last 10 years. It is extraordinary in some ways, because there has been such a digital shift. There has not been much change in the overall ITV group viewing share.

The Chairman: Thank you Toby. I think that leads very neatly into the next question.

Q17 Lord Gordon of Strathblane: First of all, I have a declaration of interest. I still have some shares in Johnston Press, of which I was a director for 10 years or so, and I was first of all chief executive and then chairman of Scottish Radio Holdings for 30-odd years. On this business of multi-channel, is the threat purely the fragmentation of audience, or is it actually taking revenue that would otherwise have gone to ITV?

Tess Alps: Yes, if you look at the threats to original programming, I think we are perhaps overplaying the competitiveness of television and the internet. Television’s share of display advertising is as high as it was in 1995. The display total is an issue. The single biggest change for television in the last decade has not been the rise of the internet, which has been spectacular and fantastic; it has been the spread and fragmentation of that viewing and therefore the money. That has been the single biggest change, particularly for PSBs. As they have lost audience, so they have lost money. So we are spreading that money—the same money, the same share—much more thinly.

Q18 Lord Gordon of Strathblane: Do the smaller extra channels represent any kind of alternative to ITV? My impression is that a lot of them do not make any money at all.

Toby Syfret: I will say no. They are very different, because ITV delivers the massive audiences and the very high reach. If you go back to about 2003, before CRR was introduced—I know you will talk about that later—the ITV family had something like a 51% share of the net advertising revenues, largely through ITV1. It is now about 47%. It has actually gone back up a bit recently. So you are not talking about very big shifts in terms of where the overall money goes, even if the cake has changed.

Ben Fenton: It is the consolidation of the advertising sales houses that represents more of a threat to ITV than the multiplication of channels.

Q19 Lord Gordon of Strathblane: Right, so it is the consolidation on the buying side rather than fragmentation on the selling side, you would argue?

Ben Fenton: That is certainly a strong factor in what is happening, yes.

Q20 The Chairman: That is extremely interesting. The balance of competition, in a sense, has changed, has it?

Ben Fenton: If it has not yet changed, it is in the process of changing.

Q21 Lord Gordon of Strathblane: Does ITV still attract a premium over other channels?

Tess Alps: It does, but that premium has been frozen, I suppose. I am not legally or contractually able to talk very much about CRR—or even politically. As you have seen with Channel 4 and Five, as they have lost audience they have not lost revenue at the same rate. That has not happened to ITV because it has been frozen back in 2003.
Q22 Lord Gordon of Strathblane: Another way of asking the same question is, are there some advertisers who simply have to advertise on ITV no matter what the price because there is no alternative? 

Tess Alps: Lots of channels have that appeal. If you are Nike, you have to advertise on Sky Sports. If you are Diesel, you have to advertise on Channel 4.

Q23 Lord Gordon of Strathblane: If you are a Sunday newspaper trying to advertise a major scoop? 

Tess Alps: If you want very rapid coverage, certain categories and certain very large FMCG advertisers have a disproportionate dependency.

Ben Fenton: Car manufacturers have been queuing up since the return of money into advertising budgets generally to get on to ITV for launching new models, and so on. Those are the kind of things where you need a rapid reach to a very large audience.

Q24 Lord Gordon of Strathblane: Apart from CRR, do you think that that premium will still always apply to ITV? Or in what circumstance might it not? 

Tess Alps: I would like not to be channel-specific, but if you have a large share of any audience and you can deliver it quite quickly, that will always generate you a premium. Those are qualities that advertisers value.

Q25 Lord Skelmersdale: While this discussion has been going on, we have been very insular. Can you tell me anything about the comparison with other countries in both the rise of the internet sales of advertising and television? 

Guy Phillipson: I can supply details on internet share across Europe.

The Chairman: And cost of airtime. In a sense, it is the general competitive situation that we are searching for.

Guy Phillipson: I cannot do costs for television, but I can do share of internet within the media markets in European countries and within the US. These figures are advertising only. Earlier on I talked about direct mail and directories. This is the above-the-line media competitive set, which is television, press, radio and online. It includes search and classifieds and so on. That is an important point to make. These figures are compiled by PricewaterhouseCoopers and IAB Europe. The UK has the largest share of online advertising within total advertising. Within the main media it is 27.3%. The countries in the 20% club for last year—for comparison, the United States has about 15% share of advertising on the internet versus other media—tend to be in the Nordic area. For example Denmark has 25.5%, Norway has 23.4%, Sweden has 22.6%, the Netherlands has 21.8%, Germany has 17.8%, France has 15.3%. You go right down to Greece, which has 4.1% and Romania, which has 1.8%. So, it appears that the UK is a success story in terms of share for online media versus main media, but I am not sure how television compares in all those markets.

Tess Alps: The significant thing about television is that in the UK, the BBC takes roughly a third of viewing and therefore, compared to markets where every channel can take advertising that makes a big difference. That is why the Nordic countries have a relatively high share for the internet, because a lot of their channels have restrictions on advertising.

Q26 Lord Skelmersdale: As we understand it, and from what you have just said, digital marketing in this country has grown at an astronomical rate compared with a lot of EU countries. Why do you think this is? 

Guy Phillipson: I mentioned the e-commerce angle in the UK. We are big on shopping and big on search. It is also true to say that the advertising categories alluded to by Toby Syfret, for example finance, travel, technology and mobile phones, have products that are relatively high ticket—automotive is another one—and people are therefore going to take longer to make a decision about buying a car or going on a long-haul holiday. Online advertising draws people in to find out more and maybe even buy it online, for example a holiday, a credit card or an insurance deal. Those categories very much caught on to the idea that if they do not advertise in this space, as Capital One or Barclaycard or whatever, they are going to lose share to a competitor. Over the last five years we can see those categories growing. It is therefore significant that the FMCG or packaged goods advertisers who sell low-cost things, and have to sell millions of them in Sainsbury’s, Tesco or Boots, have not necessarily been fast to advertise online as the return on investment equation has not been quite so apparent to them. That is changing now, but the reason why it has grown so fast up to now is because of those early adopter advertisers for high-ticket items where people take time to consider what they are going to buy and they could buy it online.

The Chairman: I think we have to move on. We are chasing time and are going to have to start plunging into CRR very shortly. 

Q27 Lord Bragg: I have some shares still in ITV and I am an independent now and work for BBC and maybe a bit for Sky. I worked for ITV and BBC for long chunks of time. There is a double feeling around. One is, why have we lost the best of what most of us felt was ITV, which was regional television? It worked extraordinarily well, as you know, in terms of audiences. Why have we not been able to find a way to replace it commercially? And why is there a feeling that this can be done through the cities when there is evidence against that from other countries? There is
a very confused picture there. There is a perceived lack and the solution is a perceived dud. Where do you stand on that?

Toby Syfret: That is a difficult one. I shall try to put one or two things down. Regional television produced a great variety of things in the past, but in recent years there have been changes in the total sum spent on advertising, as we have seen. But under the current rules it is getting less economic. We have had a model where it has always been recognised that the cost of regional television exceeds the advertising income that you can get around it. In the past it has always been the model, “You have got all that analogue capacity covering the whole country; other people don’t. This is a huge privilege and it is worth a lot of money, therefore you have the obligation.” So you get the benefits of gifted spectrum, and nowadays you can add the EPG position too, versus the cost of the obligations. In the past it was reckoned to be such a good deal for the television companies that you also had very considerable licence fee payments in addition to the public service broadcast obligations. They are now down to about £10,000 a year for 13 of the licence fees, I see in the latest Ofcom release of a week or two back, because, quite simply, as the digital world has grown, increasingly the gifted value diminishes, now possibly somewhere in the order of £50 million calculated. Regional news alone costs over £70 million, and of course you have the substitute programming, but that just about takes up all of that. Then you have other public service obligations and you are getting into a dangerous area where, in order to produce, Channel 3 is having to give away more than it is getting back in the way of any benefits. So we have had a system that, in terms of the money underpinning it, has broken down or is coming to an end. That is the one that is causing the puzzle. That is why ITV has considered reducing its investment in regional news.

Ben Fenton: I was just going to add that if you look at the pattern in radio advertising, just recently both of the major radio brands in the country have started to appeal to advertisers on the basis that they are national brands. Advertisers are taking more interest in national branding. Looking at the character of advertising at a local, regional level, although it is display advertising, it has a bit more of the classified aspect to it and is therefore more vulnerable to rivalry from the internet. That is another aspect to it.

Q28 Lord Bragg: Can I just ask one little follow-up? Is this nothing to do with advertising being a sort of cabal, where it is too expensive? I was chairman of Border Television for a few years. For local firms to get on was almost impossible, yet they wanted to. It was just too expensive. You are talking about old models, and you are completely right, but you are talking as if the old model were sacred. The old model failed in many ways. It failed to bring in the local business community, which wanted to advertise and could not get on because it was too expensive. Why is this happening in other countries and not ours? They have city and local television. Every time you say something, people come up with this great barrage of, “Oh, it can’t happen here”. I am not so sure about that.

Ben Fenton: I think you will find that local television models do not really work on an economic basis in any European country. Most of them are subsidised to one degree or another.

Q29 The Chairman: Thank you. I want to get on to CRR in the next minute or so, but I would like to ask you to respond to a very quick question about the harmonisation of the scheduling of television advertising under the COSTA code. Is that familiar territory for everybody? Do you favour creating a level playing field? I gather that PSB gets seven minutes and others nine, and so on. Could you give us a quick view across the panel about the merits of that?

Tess Alps: I am afraid that this is a question that I am going to have to say I cannot possibly answer. I am very sorry. You can appreciate my position, with shareholders having very divergent views.

Toby Syfret: The views are diverse. Almost anybody I have talked to, whether it is ITV, Channel 4, Five, Sky or anybody else, has different views. In principle, we are all in favour and a lot of people accept the idea that once you have got analogue switch-off and you no longer have the old privileges that there were in the past, it makes no sense to keep giving one lot an advantage of more audience at the expense of the others. In one sense, why not have a proper level playing field now that we can? The difficulty is that it affects everyone differently. There are two issues. One is those who are more resistant to it, who think that, say, ITV will benefit most, so they are rather against it. The second question, which has not been clearly answered by anybody at the moment, is whether you harmonise up or down. If you harmonise everyone up to a clock average of nine minutes throughout the day, versus the seven minutes, with adjustments in peaks, you have the risk of up to 10% further increase in impact delivery. The question is whether that is...
deflationary on total revenues. It will knock the costs per thousand down, but does it also knock down the total revenues?

Q30 The Chairman: And what is the audience impact, too? Toby Syfret: The audience impact is that they see more ads. P&G, or somebody, will say, “Well, we still only want 400 TVRs or GRPs” (gross rating points) which has an impact on the price. That is the fear. I am not totally convinced with some of the evidence I have seen that this is the case, but if you harmonise the other way (i.e. less advertising), the others scream out that they do not want to go. The PSBs, on the whole, want to harmonise at the lower level or in the centre. Of course, the others do not want to lose their advertising.

Ben Fenton: Deflation, I think, is the great fear of the whole industry.

Q31 Lord Gordon of Strathblane: Surely the non-PSBs would conversely see an inflation? If they had less airtime to sell, arguably the cost would go up, would it not? Tess Alps: One thing I think I can say is that the system of trading at the moment depends on your share of commercial impact. Nobody wishes to change their share negatively.

Q32 Lord Bragg: We are going to talk about CRR. Do you think it has worked? Has it done what it set out to do?

Toby Syfret: Yes, I do think it has worked within the terms that it set itself at the beginning, which is to prevent the ITV premium from rising. By the way, depending on how you measure it, you could say that Channel 4 has a similar high premium. So in the eyes of many people, certainly if you talk to the advertisers, it has given them protection.

Q33 Lord Bragg: But the producers think they are operating on the same budget they operated on many years ago because of this holding back, and it is to the detriment of expensive and ambitious programmes. Toby Syfret: That is the other side. There is a side, too, that as long as you have something like CRR in place, it affects a lot of things in sales strategy and ultimately in programming strategy, which may not be such great benefits for the public. As was said earlier, there are a number of possible factors that have led to this structural decoupling, or the flatness of television advertising spend, such as the internet, the procurement departments and other things, and the fact that, with the digital to analogue shift you have money going from the more expensively priced to the cheaper priced. So it is difficult in the end to say that it has been having this effect, although common sense suggests that CRR will be deflationary because it is your share of budget, which is where you get your deal, but it has nothing to do with volume. You can take as much out as you like, but provided you keep your budget share at the same level, you get the same level of discounts. It makes it easy for the medium to deflate, so it is a possible factor.

Ben Fenton: I spoke to somebody from ITV this morning, I spoke to somebody from Channel 4, I spoke to somebody from Sky, I spoke to somebody from a media buying company. They all have different views on what should happen about CRR. Applying a common journalistic technique, that suggests that it is quite a good idea. I certainly would agree with you that it has probably been responsible for a reduction in budgets. We know it has been responsible for a reduction in PSB budgets. The corollary, I suppose you would ask, is if CRR was relaxed, would that put more money into independent producers’ pockets? I suspect the answer to that would be no. The company that has suffered most from CRR is the one that owes most to its shareholders, in terms of their patience in watching their share price collapse—that might be too dramatic a word, but decline—since the formation of ITV.

Q34 Lord Bragg: One complaint from the people who run ITV was that CRR meant that they could not run their own inventory or their own budgets. They were controlled by this. In a capitalist system, this was insupportable. That was their argument. They were being given schedules to meet all the time and they did not control their own budgets, which is very difficult when you are running a business. Tess Alps: I think I can say that, although CRR has achieved perhaps its primary aim in the sense of constraining ITV, there have been lots of unintended consequences. One of those has been that if ITV1 is not run their own inventory or their own budgets. They were being given schedules to meet all the time and they did not control their own budgets, which is very difficult when you are running a business.

Q35 The Lord Bishop of Liverpool: I need to declare an interest. I have received fees for religious broadcasting from the BBC, ITV and Sky. Can we imagine for a moment that the CRR undertakings are removed? What would be the immediate impact and the long-term impact on ITV and then on the other
two commercial broadcasters? And what would the impact be on the revenues for commercial television?

Ben Fenton: You are probably asking us to predict what is going to happen to the advertising industry which, as Toby said earlier, is relatively easy over the long term, but over the short term is very hard to say. Some people think that CRR might even act in favour of ITV this year because of the increase in its share. Overall, the last figure that I heard on the impact of CRR for ITV as a company was, I think, in the region of £30 million to £40 million additional revenue, most of which would drop through to their profit line.

Q36 The Chairman: Guy, do you have a dispassionate view as seen from the internet? Guy Phillipson: Indeed, yes. That is my point, really. In a soft market, that could be the case.

Toby Syfret: I do not quite think it is really working in favour of ITV. ITV has improved its share. Purchasing and selling advertising is a very person-to-person business. You can have rules and ban conditional selling, but you can never stop it, because trading can take any number or variety of forms. That is simply the nature of trading. From what I can see looking at the figures, the salespeople at ITV have been doing quite a good job of overcoming some of the limitations of CRR from their point of view. That is part of the benefit. My belief is that if you were to get rid of CRR it would be helpful overall; it would help rather than hinder total revenues. We do not know how much they would go up.

The Chairman: You do not necessarily agree with that £30 million to £40 million?

Toby Syfret: Within that it would allow ITV to have some upward adjustment, but we have seen this in other countries. Recently I have been looking a lot at Ireland and the impact of RTE sales practices on the other channels. All right, because ITV is bigger it can perhaps has been to the advantage of ITV.

Q37 Lord Macdonald of Tradeston: I know this is an extremely difficult question for you to answer, but if ITV did get more money, do you think there is an imperative for it to spend that money on improving the variety of its programming to strengthen the breadth of its audience appeal, or do you think it would simply go out to the shareholders, who are pretty long-suffering?

Lord Razzall: Before you answer the question, you should be aware that that is the substance of the ITV case for removing the undertaking—that they will spend more on programming.

Toby Syfret: I think they would be foolish if they did not invest at least some of it back in programming. When I look at what they are doing at the moment, I am nervous as to whether they are not going to precipitate further audience decline at ITV1. If they want a path to the future in overseas content sales, which is outside ITV, of course, but it is part of their total business, and if they want to be doing better on the internet, and if they are going to own their content, they need to invest in strong programming ideas, wherever they put them in. Whether it is all the money or some of the money, I expect them to improve their investment.

Q38 Lord Macdonald of Tradeston: Are you saying that their investment in what we might call more upmarket drama, expensive drama, is not delivering the audiences for them?

Toby Syfret: No, what I am saying is that they have been cutting their budgets and if you look at the audience shares of ITV versus BBC1—which has not had to cut so much, but has cut it simply because it benefits from reduced talent costs, which is quite nice—BBC1 has been going stronger. That is reflected in the changing share balance between BBC1 and ITV1—forget about everybody else—over the last few years. I believe that relates to programming issues. There is a question about if you put another £x million in, do you get the relative % increase in audience and opportunities to sell on that yields the extra £x+ million increase in total revenues, and so on. I personally believe that they do not want to go very much lower than they are now for the kind of company that they are.

The Chairman: I am sure Ben could write several columns on this subject.
Ben Fenton: I shall just add a minor point. To answer your question, it is slightly conditional on what happens to the BBC. If the BBC is about to be asked to pay for licences for the over-75s or to fund the World Service, it is clearly going to have significantly less money to invest in programming and therefore pressures on ITV, which the BBC aggressively schedules against at very important times, may decline. Similarly, you may be aware that Channel Five has recently started to change its attitude to suppliers—I think that is the diplomatic way of putting it. If that continues, ITV could both return money to its shareholders and increase its relative investment in production, but again I am afraid it is the poor old indies who are going to lose out.

Q39 Lord Macdonald of Tradeston: The other aspect of this, and I put this to Toby, is that if they spent more money on quality drama that was less formulaic and they did not spend it on common denominator light entertainment, that might reduce their audiences, but would it perhaps put their premium up? I know that sounds a bit paradoxical, but they could have a lower audience and get more value out of that kind of investment, could they not?

Toby Syfret: Yes, but it is hard to say short of actually working out what the drama is and where the higher premium comes from. People will pay a premium for younger adult audiences if you go in that direction or for the more upmarket AB audiences if you go in that direction. Those are the areas where ITV has tended to lose most in recent years, so that should certainly help them more than simply being in the mass common middle. The total audience ought to rise with either form of programming, so it is difficult to say exactly what the best decisions are to optimise the potential benefits. You would obviously have to look at it in detail.

Q40 The Chairman: Tess, I am very conscious that we have not brought you in, and yet there are all your clients bursting to produce more drama. I am sure.

Tess Alps: The one thing I can say is that the CRR mechanism is a very commoditised mechanism. If ITV gained a share of audience in Downton Abbey, that is no better than gaining a share in Jeremy Kyle. That is unfortunate.

The Chairman: That is very interesting.

Q41 Lord Dixon-Smith: The second of my questions has more or less been answered already, but there you go. The first one that matters is that the price of television advertising seems generally to have fallen over the past decade. Has the cost of advertising on ITV declined specifically at a greater rate than advertising in the sector in general? If so, to what extent might that be due to the CRR undertakings, or is it more related simply to the increased volume of all types of advertising opportunity?

Tess Alps: The price of advertising has fallen dramatically because of the supply of audience, mainly. Then also in recent years there has been weak demand. TV is priced on an absolute supply-demand equation. That is why the overall pricing has dropped to the 1990s prices in real terms. ITV’s price has not dropped any faster; in fact is has dropped very slightly slower. But compared to the other PSBs, Channel 4 and Five, they have dropped a lot less slowly. They are the example of a natural, undistorted market where the bigger share of the channel and perceived quality might naturally create higher and higher demand, even as audience shares fall away. That is what CRR has stopped in ITV, if that makes sense.

Q42 Lord Dixon-Smith: So in fact you are arguing that it is almost a defence mechanism for ITV?

Tess Alps: No, I am saying that their price would have dropped as slowly as Channel 4’s or Five’s. It has not dropped any faster than the overall price drop, but in an undistorted market it would not have dropped as fast. As has happened in every market in the world, although the main broadcaster loses share as multi-channel comes along, it drops its revenue at a much slower rate. Although ITV has dropped at a slower rate, it is marginal. In an actual market, its premium would have gone up.

Toby Syfret: I absolutely agree. If you had not got CRR and ITV1, which still has the big audiences, was losing share, looking at other countries you would normally expect the premium to rise relative to the average, but CRR has kept it pretty constant over the years, although there has been a slight rise recently. That is what people sometimes refer to as trading above CRR. ITV has been able to offer things and has been creative about how it sells and has gone slightly ahead. The point about CRR is that it basically fixes it relative to the rest of the market, so they all trend in a relatively similar way.

The Chairman: I think Lord Razzall’s question has been asked. Do you have a supplementary on CRR before I ask the £64,000 question of the panel?

Q43 Lord Razzall: No, I think the crux of the issue is what the money would be spent on and what would actually happen. We will obviously have a lot of evidence given to us on what would happen were the CRR undertakings to be removed. It is not on the list, but it may be worth asking the panel, there is some suggestion from the OFT—to the extent that it still exists—that we were minded to recommend the abolition of these undertakings, that should be done in the context of an overall review of how television advertising is marketed. I do not know whether the panel have any views on that and whether that is an
issue, were we to recommend the abolition of CRR. Ought we to be looking wider at the whole issue of the marketing of TV advertising?

**The Chairman:** Can you do it as a discrete issue or do you have to deal with a full review?

**Toby Syfret:** If you are going to abolish CRR, we have to take it in conjunction with the Ofcom regulatory view of the ASR (Airtime Sales Rules) and COSTA (Code on Scheduling of Television Advertising rules). The ASR review has covered the rules on 100% sales of advertising inventory for PSBs and conditional selling. Changing them without changing CRR does not seem to make any difference. You can say that you do not have to sell 100%, but CRR encourages everybody to. It forces a certain behaviour in the total market and then you have a little complication when it comes to COSTA. If you are harmonising the amount of advertising one way or another, you may have to make an adjustment in CRR for the effect on the ITV1 share, or not, as the case may be. That is not affected so much, but the actual trading behaviours, which is more what ASR covers, would be. It is very difficult to see doing one without the other. If you are looking, you need to do the advertising scheduling rules and CRR together.

**Q44 Lord Razzall:** I think they are also thinking about the consolidation of the buying agencies, which is going on apace. We are likely to be down to four shortly.

**Lord Gordon of Strathblane:** Are we not at four already?

**Toby Syfret:** We are more or less at the end of that particular one, unless Five suddenly wants to give up its position, which I doubt. Yes, the market has changed and it may be that looking at sales shares of Channel 4 with UK TV channels and Sky, now that it has purchased the Virgin Media channels, you might decide that also affects the need for having CRR to keep the number one oligarch in place.

**Q45 The Chairman:** So, in summary, your view? You have a few considerations in there. Would you say that you could take it as a discrete issue, or do you think that all these other considerations mean that you really ought to look at the whole picture, in view of the fact that the ASR rules no longer apply?

**Toby Syfret:** I think you could probably now look at CRR independently of COSTA. I do not think those two are related. If I were making a decision, I would also be looking upon it in the overall context of ITV creative content strategy. I would regard that as important. I do not think that getting rid of it would make such a big difference as has sometimes been suggested.

**Q46 Lord Macdonald of Tradeston:** Just in terms of the overall market, is there not something inherently unhealthy about the fact that you have three big sales houses representing ITV, Channel 4 and Sky, up against three or four big airtime buyers, which artificially constrains that whole market in the UK and shuts out the small advertisers who might make city television or regional television viable in the United Kingdom? Should we not be thinking of how we deconstruct the whole system of which you are an inbuilt part?

**Ben Fenton:** It is very difficult for anyone who wants to advertise on television to ignore one of the sales houses now. Whereas in the past they would possibly have taken the view that to negotiate they would say, “Well, we are not going to spend any money on you in this period,” realistically it is very difficult for them to do that any more. That would appear to support your view.

**The Chairman:** But everything is so consolidated now, both on buyer and seller sides, so to speak.

**Toby Syfret:** Mind you, am I not right in thinking that television is not the only consolidated medium?

**The Chairman:** That is true, but that goes to the arguments about CRR in terms of competitiveness.

**Q47 Lord Macdonald of Tradeston:** In terms of public interest, the influence of television culturally, socially and politically is extremely important—more important, perhaps, than the concentration of power in advertising being maintained.

**Toby Syfret:** But I think you could also argue from another point of view that it creates a lot of efficiencies in the buying and selling, which is very desirable for the business. I do not personally believe that having three or four national sales points or half a dozen major buying groups is the reason why local television will or will not work. I do not think that has anything to do with the structure of national advertising sales.

**Q48 Lord Macdonald of Tradeston:** I accept that there is a fractional advantage to the consumer in terms of greater efficiency in the sales process, but on the other hand the service of television to the viewer would take priority there. I am simply saying, should we not be looking at your system and reconstructing that rather than seeing the traditional public service television being degraded?

**Toby Syfret:** You are talking about the traditional system being degraded. I do not know that that is a fair way of describing it. There has been a change in the traditional system, because the funding economics no longer work.

**Q49 Lord Macdonald of Tradeston:** I would have thought that in the areas of current affairs, regional television and regional news, surely that would have...
been a public interest to have been sustained. Obviously the search for city television by the new Government is perhaps partly to redress that growing imbalance.

Toby Syfret: Well, then you have two choices. You can look at it and work out whether you think there is a possible commercial funding model. I do not agree from what I have seen of local television in other countries in Europe. They have not worked on any commercial models. Then you get into the question of whether the state wants to subsidise.

Q50 Lord Macdonald of Tradeston: The Minister is maybe looking to America for its city television as a parallel.

Toby Syfret: America has a very much higher level of advertising spend per capita and the cities have a significance in a way that here they do not.

Baroness Deech: Can I just ask something, because I do not come from this commercial background? What is actually in the public interest in this whole issue? We hear about more funding for ITV and marketing efficiency, but I wonder what the actual public interest is. For example, I have always had a query in my mind about the value of city TV or regional TV. We are a very small country and it can be a fragmenting influence and not a good one. If you want to know who has been run over in the road next door, you can get that on the computer or in your local paper. Coming back to my BBC experience, the awful truth was that the more the BBC pursued quality, the headcount went down. If you give ITV more money, will you get what we round this table call quality? What is actually for the good of the viewer? Why should we disturb anything to get regional TV?

Lord Macdonald of Tradeston: Does that apply to Scotland, Northern Ireland and Wales?

Baroness Deech: It was always a struggle keeping it going. I was not sure who really wanted this stuff.

The Chairman: We could debate that internally for some period. We need to ask the question about the effect on the price of airtime if CRR was abolished.

Q51 Lord Dixon-Smith: I had the view that Mr Syfret answered it in response to an earlier question. The question is, if the CRR undertakings were removed, what do you think would be the effect on the price of airtime on ITV and how might that compare with the free market price, if the airtime was sold by auction?

The Chairman: Could I just have that in a nutshell, and then I am going to ask the $64,000 question, which we will have 10 minutes left for.

Toby Syfret: As I indicated earlier, I think there will be a small increase, but the balance would just adjust slightly between ITV and its competitors.

Q52 The Chairman: So, basically I am going to ask the panel their view: on balance, do you think that the CRR undertakings should be removed and if so, why? I will start with Ben.

Ben Fenton: Thank you. I have to think about this, because it could ruin my contacts with ITV.

The Chairman: It is all within these four walls.

Lord Razzall: That is why it is all being recorded.

Ben Fenton: You can’t pull that one on me. I think the CRR as it stands is completely flawed in some ways and it does restrict ITV. Anything that was written even as short a time ago as 2002-03 is outdated. That is a fundamental truth. I think it probably should be rewritten, but I think there would be such unhappiness in the advertising community and among rivals if it were completely lifted that I am inclined to think it should be replaced by something else. It is not my position to tell you what I think that might be, but I am sure that others will talk to you about various manifestations of a son of CRR, but something that does not allow ITV the full freedom to exploit what is still a powerful position, but gives it at least a greater ability to cope in an age when advertising is becoming increasingly dominated by a completely different medium.

Tess Alps: I am sorry, I am again unable to comment.

The Chairman: You are under a vow of silence.

Tess Alps: I did warn you. I suggested I should not come.

The Chairman: We will do a write-in, in that case.

Guy Phillipson: I am surprised it has lasted so long in a soft market. If it is true that CRR were removed and ITV could enjoy a small increase under the current conditions, one would hope that they would reinvest that into programming and their digital infrastructure. ITV seemed to have a strategy to do so. However, I would agree that a trading review for television would be recommended, so if one removes CRR, we should review the whole system of trading for television, including product placement.

Q53 The Chairman: So your view, contrary to Toby’s, would be that you cannot just look at CRR in isolation in that sense, even with COSTA?

Toby Syfret: I was talking purely about trading. Be careful. I am not talking about it in the context of other rules being looked at.

The Chairman: Right. I am not quite sure of the distinction there.

Toby Syfret: If you are changing advertising rules or reviewing them, like Ofcom at the moment with the scheduling rules or conditional selling or selling all of your inventory, affecting trading practices, it has very little effect if you still have CRR. You can decide that you want to get rid of CRR in those terms, one way or another, but if you are getting rid of the other rules and hoping to get some effect by it, there is no point doing it unless you do CRR. I feel that advertisers
have probably had a lot of benefit—I would say this as an ex-agency person. A few years ago, when prices were very high, they were still investing in television because, as Tess said earlier, they were getting a very good return on investment. Some of these advertisers are getting a very, very good return on investment now. So that is one thing that, from the point of view of protecting advertisers, makes me not so concerned whether CRR goes.

I am personally in favour of it going because I think all kinds of changes are coming in the next few years. It is very difficult for us to dream in advance about how the full range of connected television will develop. For a big broadcaster like ITV, CRR has some very limiting effects on the programming and general strategy of the company. That is possibly not in the viewer interest either, you could say. Now that we have a more consolidated airtime sales and purchasing environment, I do not think that its removal would make a huge difference to the market, but I think it would allow a certain extra freedom at a time when the stability of revenue streams in a disintermediating environment with the internet is noticeable. Therefore, I think it gives more of a chance for the future broadcasting system to flourish. If you decide that certain areas, such as independent producers or this and this, need certain protection or qualified things, I would certainly consider if there are particular issues that may need safeguards, but I would be in favour of scrapping the mechanism if at all possible.

Q54 The Chairman: Thank you. Can I just ask also the question that we did not ask as we moved swiftly on to CRR, but it is quite cognate to this? I gather Ofcom has decided to discontinue the airtime sales rules as of 1 December. Is that a sensible thing to have done? How does that link to the things we have been talking about this afternoon?

Toby Syfret: From what I have said, I do not think it makes any difference to start with. The nature of CRR, which I guess people here know, is that in airtime trading everything is done on a share of budget. You roll forward deals on a certain given share. If ITV’s share has gone down in terms of total audience, you can adjust your share of budget for that and give a level of discount accordingly. That means that other people, no matter what the rules are, whether they have a 100% sales rule on them or not—which Channel 4 and the ITV main flagship channels have—want to see 100% of their audience. They absolutely want to maximise audience delivery, because that is the way they can most hurt ITV. So it becomes a pure, out-and-out numbers game from everybody’s point of view. Whether that is good for the future creative economy, you can judge. Until you get rid of CRR, they will carry on. It is immaterial whether you say you don’t have to sell, or it makes a very small difference if you sell. Conditional selling is another issue. I think the Ofcom paper decided that had benefits and negatives.

The Chairman: Thank you very much. Does any member of the Committee want to ask a final question? I think we have reached the end. Thank you very much for responding so well to our quickfire questions. Thank you very much indeed to Tess for her restraint.

Tess Alps: It kills me. I have very strong opinions

Lord Gordon of Strathblane: You could sell your story.

The Chairman: We will find your evidence extremely valuable when we come to write our report. Thank you very much indeed.

Supplementary evidence from Enders Analysis (RTA 23)

Total TV funding by revenue stream in 2015

- In 2004 advertising was still just about the main source of TV funding, but by 2005 a clear gap had opened up as pay revenues surged ahead
- The next five years will see major growth in pay TV revenues, with Sky especially benefiting from HD demand
- Advertising has rebounded after a trough year in 2009 and even at current prices 2015 will slightly be better than the peak year of 2005 – in real terms still a very substantial fall, and with plenty of downside risks in the forecasts
- Following the increase in the licence fee from £142.50 to £145.50 in March 2010, the rate is now frozen for six years and TV budget cuts appear inevitable as the BBC takes on the funding of the BBC World Service, BBC Monitoring and S4C through its licence fee income
- Other sources of revenue will rise to about £900 million chiefly through growth in iPTV VOD and online video advertising, but offset by transfer of S4C funding (currently about £100 million per annum) to the BBC
- Other category includes net TV shopping revenues, sponsorship, product placement, interactive (Including premium rate telephony), programme sales and S4C grants from the DCMS
UK structural: Impact of online display on TV ad spend

- Online display advertising trends indicate negative impact on TV
- Top ten growth categories in online display:
  - 95% share of total in 2004
  - 93% share of total in 2009
- Top 10 online categories also represented 56% of TV ad spend in 2009
- Other 44% share of TV ad spend includes all FMCG sector
- Negative online impact shows in much greater TV ad spend decline across top ten online categories (£403 million) versus other categories (£208 million)

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Source: Nielsen, Enders Analysis
INTRODUCTION AND SUMMARY

1. In this document we set out the Competition Commission’s (CC’s) response to the House of Lords’ Select Committee on Communications’ (the Committee’s) call for evidence on regulation of television advertising.

2. In the last 10 years, the CC has investigated a number of mergers in the market for television advertising. In 2000, the CC investigated three proposed mergers: the proposed merger between Carlton Communications Plc (Carlton) and United News and Media plc (UNM), and the proposal by Granada Group PLC (Granada) to make an offer for either Carlton or UNM. Subsequently, in 2003, the CC investigated the proposed merger between Carlton and Granada to form ITV plc (ITV). The CC recommended to the then Secretary of State for Trade and Industry that the merger be allowed to proceed subject to the giving of undertakings in the form a remedy known as the Contracts Rights Renewal (CRR). The CRR undertakings were given by Carlton and Granada in November 2003. The CRR undertakings relate only to ITV1 and not to any of ITV’s digital-only channels (ITV2, ITV3 and ITV 4).

3. In October 2006, ITV asked the OFT to conduct a review of the CRR undertakings, arguing that there had been significant changes in the market for the sale of television advertising airtime which meant that ITV should be released from the CRR undertakings. The OFT, in partnership with Ofcom, conducted its review between January 2008 and May 2009, and advised the CC to consider whether the CRR undertakings could be varied to take into account the decline in ITV1’s market position whilst still retaining effective protection against the remaining detrimental effects of the merger arising from ITV1’s strength in “mass audience” programming.

4. In May 2010, the CC completed its review of the CRR undertakings. In summary, we found that ITV’s unrivalled ability to deliver large audiences on ITV1 meant that the CRR remedy was still needed in some form to prevent the channel from exploiting its position to the detriment of both advertisers and other commercial broadcasters. We found that media agencies and advertisers continue to believe that ITV1 offers them something that no other commercial channel can give. The unique feature of ITV1’s large audiences coupled with the existence of share of broadcast deals between media agencies and broadcasters means that media agencies cannot credibly threaten to switch a sufficient amount of their expenditure away from ITV1 so as to constrain ITV.

5. Although the CC has a preference for solutions which encourage competition rather than regulation, we did not find that ITV’s alternative remedy proposals would be effective in preventing ITV from worsening the deals it offers to media agencies and advertisers. We found that media buyers would be likely to commit more of their budget to ITV1 in order to retain the same terms. This would have an adverse effect on other commercial broadcasters, who would consequently receive a smaller share of the media buyers’ budgets than they would otherwise.

6. Our findings were virtually unanimously supported by advertisers, media agencies, other commercial broadcasters and trade bodies.

7. During the course of our review we identified a number of aspects of the market for television advertising which might be seen to be anti-competitive. In particular, the use of share of broadcast deals inhibited switching. Our review was limited in scope to whether the current level of regulation of ITV1, in the form of the CRR undertakings, was appropriate in light of the change of circumstances identified by the OFT. We could not therefore address any matters beyond those affecting ITV1’s position. For this reason, we renewed our call (made previously in 2000 and 2003) for an overall review of the system for selling television advertising.
8. This response draws on the findings from our report. Our report ran to 104 pages and included eleven appendices, highlighting the extent of analysis that went into our review. Given the complexity of this market, we would encourage members of the Committee to read our report in order to understand in full the reasons for our decision.

**Response to Questions of the Committee**

9. In its call for evidence, the Committee has noted seven issues on which it would particularly welcome written submissions. Our response covers those issues in turn.

**Issues 1 and 2: The Internet**

*How much of the recent decline in television advertising was due to migration to the internet and how much was due to the economic recession?*

10. As part of our review, we examined whether the Internet provides a constraint on television advertising or would do so in the foreseeable future. Our assessment of the evidence is set out in paragraphs 2.5 to 2.8 and 5.16 of our report.

11. Between 2003 and 2008, television advertising’s share of all advertising expenditure in the UK fell from 23.6 to 22.1%. Over the same period, the share of Internet advertising (classified and display) increased from 2.9 to 19.3%. However, the Internet’s growing share of overall advertising expenditure was driven by classified advertising. Expenditure on Internet display advertising, which is closest in nature to television advertising, was only one-fifth of television advertising in 2009. We were not provided with any evidence that suggested that the sale of television advertising was constrained by Internet display advertising.

12. We found that, although the Internet provides possible alternatives for advertisers, it cannot yet replicate ITV’s ability to deliver such large audiences on ITV1. Although there is likely to be continued growth in Internet display advertising in the future, we could not rely on such growth constraining television advertising in the foreseeable future. This finding was consistent with that reached by Ofcom in its Airtime Sales Review statement, published in July 2010.

13. In our report, we did not assess whether, and to what extent, the decline in television advertising was due to the economic recession. We considered in paragraph 5.10 of our report whether we should take into account the possibility of a prolonged recession affecting the television advertising industry. We found that it was not clear how prolonged the effect of the economic recession on television advertising would be or whether it would have any greater effect on ITV than on any other sales house. We did not therefore take this into account in our review.

**Issue 3: Level of regulation**

*Whether the current level of regulation of television advertising is appropriate.*

14. The CRR remedy specifically addresses the CC’s 2003 concerns about the effect of ITV’s enhanced market position following the merger between Carlton and Granada. Carlton and Granada put forward the CRR remedy to address the competition concerns the CC had in the sale of television advertising. Among other things, the CRR undertakings allow buyers of advertising airtime to roll forward their pre-merger contracts, subject to annual adjustments by an audience ratchet mechanism (ARM). The ARM reflects the change in ITV1’s share of commercial impacts (SOCl). The CRR undertakings created the Office of the Adjudicator, which is responsible for determining disputes arising under the undertakings and which reports on compliance.

15. Our review was limited in scope to whether the current level of regulation of ITV1, in the form of the CRR undertakings, was appropriate in light of the change of circumstances identified by the OFT. We have therefore limited our comments to why we found that CRR in some form remains appropriate. This issue is considered in full in our report and here we touch on some of the main reasons for our findings.

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Changes to CRR

16. First, we found that CRR needed to be varied to take into account changes since 2003 in the delivery of ITV1, specifically high definition and a potential +1 channel. On 17 September 2010 we accepted undertakings varying the definition of ITV1. The changes made to the CRR undertakings allow impacts recorded on ITV1 HD and ITV1 +1 to be recorded as part of the SOCI measure in the ARM.

17. Second, we considered a number of proposed amendments to CRR put forward by ITV. These amendments were largely issues relating to the operation of the CRR undertakings. We suggested that such changes were most appropriately taken up with Ofcom or the Office of the Adjudicator and incorporated into the Adjudicator’s Technical Background Guide to Advertisers and Buyers’ rights under the CRR remedy.

Reasons for not changing CRR any further

18. We did not find that any other changes to CRR were appropriate.

19. We recognized that there had been significant changes in the television industry since 2003, in particular with an increase in the number and availability of channels. Although ITV1’s SOCI and share of net advertising revenue (NAR) had fallen since 2003, ITV1 had remained by far the largest commercial channel in terms of both SOCI and share of NAR. Channel 4 was the next largest channel with a share of NAR and SOCI less than half that of ITV1. We noted that over half of the decline in ITV1’s SOCI and share of NAR since 2003 had been absorbed by ITV’s digital-only channels.

20. ITV1 had also retained its relative advantage over other commercial channels in delivering large audiences. In 2009, ITV1 accounted for 982 of the top 1,000 most watched programmes on commercial television for all adults, compared with 995 in 2003. There continues to be widespread belief among media buyers that there is a qualitative difference between impacts on ITV1 and those on other commercial channels. In its sales and marketing communications to customers, ITV itself continues to suggest that ITV1 viewers engage with its programmes in ways such that other channels may be an imperfect substitute for ITV1 even if they replicate its coverage.

21. Although there had been increased concentration of media agencies since 2003, this had not resulted in them having countervailing buyer power. As in 2003, difficulties remain in switching advertising expenditure away from ITV1 because media agencies want and need access to ITV1’s large audience programmes for certain campaigns if they are to serve their clients’ needs. Media buyers that seek to reduce their share of broadcast (SOB) commitment to ITV1 are likely to be offered significantly less favourable terms on their remaining ITV1 advertising. As a result, media agencies are unlikely to switch a sufficient amount of their expenditure away from ITV1 so as to constrain ITV.

22. We considered whether alternative forms of protection could be provided to media buyers but none of the proposals put forward by ITV would prevent ITV from being able to worsen terms to media buyers.

Issue 4: Regulation of scheduling, advertising sales and product placement

What the financial impact might be on television companies if changes are made to the regulation of scheduling and sales of television advertising or if product placement is introduced.

23. This is not an issue that was part of the scope of our review of the CRR undertakings. We note, however, that Ofcom has recently published a decision in relation to these matters.

Issue 5: CRR and ITV’s programming

The extent to which the CRR undertakings limit ITV’s ability to compete in the production of quality programming

24. ITV made a number of arguments to us that CRR had prevented it from producing good quality programmes. It said that these “costs” of CRR outweighed any detrimental effects of the Carlton-Granada merger.

25. As part of our review, we examined whether the CRR undertakings affected ITV’s incentives to produce quality programmes on ITV1. As CRR does not apply to ITV’s digital-only channels it cannot affect programming on those channels. Our assessment of the evidence of the effect on programming on ITV1 is set out in paragraphs 6.19 to 6.28 and Appendix I of our report. We found it likely that, at most, only a small proportion of those “costs” cited by ITV should be attributable to CRR.

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5 http://www.adjudicator-crr.org.uk/crr_technical.htm
Effect on incentives

26. We considered ITV’s argument that the SOCI measure did not capture all the aspects that advertisers might take into account when deciding how and where to advertise their products and services. We noted that in the 2003 report, such problems were not anticipated by Carlton or Granada and indeed CRR was “fully expected . . . to incentivize the merged entity to maximize its investment in the ITV1 schedule”. We found that ITV remains incentivized to deliver what advertisers want in order to maximize profits: broadcasters increase their SOCI through producing good-quality programmes that appeal to audiences. Although the Audience Ratchet Mechanism that underpins CRR allows media buyers to reduce their SOB commitment in direct proportion to reductions in ITV1’s SOCI, it is not a one-way ratchet and subsequent improvements in ITV1’s SOCI could be expected to lead to increases in SOB commitment up to the cap in protected contracts. ITV is therefore faced with a choice of programming strategies similar to other commercial broadcasters.

Effect on strategy

27. We noted that different broadcasters follow different programming strategies at different points in time and that not all programming decisions can be expected to be successful. A report commissioned by ITV to examine the effect of CRR on ITV’s programming noted that ITV may have made some “poor programming decisions” since 2003.

28. We looked at how CRR had influenced ITV’s strategy for ITV1 since 2003. We found that decisions on strategy and programming were adopted for a wide range of reasons. We noted, in particular, that ITV had launched a change of strategy in September 2007 that focused on a content led strategy. These changes were made with CRR in place and made “no assumptions on CRR relief” according to ITV’s investor presentations at the time.

Issue 6: CRR and its effect on other broadcasters

The extent to which the reduction or removal of the CRR undertakings would affect the commercial public broadcasting sector

29. Removal of the CRR undertakings would give ITV the opportunity to exploit the market power that was created by the merger of Carlton and Granada. The adverse effects of this market power being unchecked were clearly set out in the CC’s 2003 report on the merger. These adverse effects were that ITV would be able to:

(a) “insist on terms that were generally less attractive to advertisers or media buyers. This might include demanding a greater level of commitment, however expressed, of advertisers’ and/or media buyers’ television advertising budgets for a given level of discount off the ‘station average price’, or obliging the advertisers or media buyers to accept worse terms and in particular reduced discounts;

(b) enhance the degree of price discrimination; and/or

(c) change the system under which television advertising airtime is sold to the advantage of the merged entity.”

30. In its 2003 report, the CC found that the “overall consequence of these adverse effects would be for Carlton and Granada together to achieve a higher level of revenue than if the merger had not gone ahead. This would be most likely to be to the detriment of advertisers and the other commercial broadcasters.”

31. We have set out under issue 4 the reasons for the retention of the varied CRR undertakings. In terms of adverse effects, we identified concerns in relation to both advertisers and other commercial broadcasters. We found that “absent an effective remedy, ITV might be able to worsen terms overall through seeking higher SOB commitments, reducing discounts or worsening terms and conditions.” Advertisers would therefore be likely to be worse off. Moreover, because airtime sales are conducted on the basis of share of each media buyer’s television advertising budget, an increase in ITV’s ability to increase ITV1’s share of media buyer’s budget commitments would have an immediate detrimental effect on the share of advertising budgets being committed to other commercial broadcasters.

7 “Protected contracts” are defined in the CRR undertakings. Advertisers have a right to roll forward the terms in their protected contract taking into account the audience ratchet mechanism. Broadly speaking, a protected contract can be either the 2003 contract or one which has been renegotiated since that time and nominated as the media buyer’s protected contract.

8 The station average price (SAP) is not a true average price: it is the price that would apply if all advertising expenditure, by every media buyer, were made against a particular demographic, and each advertising spot was valued by its ability to deliver that demographic and no other. SAP is calculated as total revenue committed to a station by all advertisers for all demographics divided by total impacts delivered for that demographic.

9 Paragraph 2.132 of 2003 report.
Issue 7: Public interest

The extent to which current arrangements reflect the public interest

32. The 2003 inquiry into the Carlton and Granada merger was conducted under the provisions of the Fair Trading Act 1973 (FTA). The FTA was based on a public interest test, and the public interest issue identified in the 2003 inquiry was a lessening of competition as a result of the merger.

33. The statutory remit of the CC in carrying out the review of the CRR undertakings was exercisable in the same circumstances and under the same terms and conditions as the power of the Minister under the FTA. The review of the CRR undertakings was based on a test as to whether, by reason of any change of circumstances, the undertakings were no longer appropriate and ITV could be released from the undertakings or the undertakings needed to be varied or superseded. This meant that our review necessarily focused on whether the CRR undertakings were still required to address the concerns that had been identified in the 2003 report. We did not consider broader issues of public interest in the review of the CRR undertakings as the CRR undertakings had not been put in place to address issues other than the impact of the merger on competition.

34. We did, however, recognize a number of characteristics of the market that we considered were potentially anti-competitive. These included the prevalence of SOB deals and media agency “umbrella” deals (ie media agencies committing a share of broadcast across all their advertising clients) which potentially inhibit the ability of media agencies to switch. As a result, we said that we believed it appropriate for there to be a wider review of the whole system of selling television advertising. In the 2003 report, we had also suggested such a review would be appropriate. Ofcom has since said that a market study into the television advertising airtime market is not a matter of administrative priority at this time.

24 September 2010

Memorandum by the Office of Fair Trading (RTA 11)

1. INTRODUCTION

1.1 This is the response from the Office of Fair Trading (OFT) to the call for evidence on regulation of television advertising by the Select Committee on Communications.

1.2 In 2009, the OFT reviewed ITV’s Contracts Rights Renewal (CRR) Undertakings which were imposed by the Competition Commission to remedy the detrimental effects of the merger between Carlton and Granada on purchasers of ITV’s advertising airtime. In that review, the OFT came to the conclusion that the detrimental effects of the merger may still be significant and that some form of protection for ITV’s advertising customers was therefore still required.

1.3 As set out in this response, the OFT remains of the view that if the CRR mechanism is removed, without any alternative to replace it, ITV may be able to increase the revenue it demands for airspace on ITV1, to the detriment of its advertising clients.

1.4 In the course of the review (and during the CC’s initial investigation), it was also suggested that there are wider problems with competition in the market for TV advertising which stem from the way that it is traded. These issues could be considered by way of a Market Investigation Reference (MIR) to the Competition Commission. At the time of the CRR review, we noted that in keeping with the normal principles of concurrency, the OFT considered that Ofcom would be best placed to make such an MIR.

1.5 As CRR is built around this trading mechanism it is inevitably linked to these issues. On the one hand, as the trading mechanism cannot be changed while CRR is in place, it may to some extent be entrenching any problems that do exist. On the other hand, if addressing any wider competition concerns required a change of the trading mechanism, a further review of the protection from the anti-competitive effects of the Carlton/Granada merger would have to be undertaken. If the Select Committee proposes to recommend any relaxation to the CRR mechanism, the OFT considers that it would be appropriate for this to be considered as part of a wider review of the market for selling television airtime.

10 Paragraph 16(3) of Schedule 24 to the Enterprise Act provides that the power of the CC to supersede, vary or release undertakings is exercisable in the same circumstances and under the same terms and conditions as the power of the Minister under the FTA. Section 88(4) FTA required the Director General of Fair Trading (the Director) to keep undertakings under review and from time to time consider whether, by reason of any change of circumstances, the undertaking is no longer appropriate and either the relevant parties (or any of them) can be released from the undertaking or the undertaking needs to be varied or superseded by a new undertaking. If it appeared to the Director that any person can be so released or that an undertaking needs to be varied or superseded, the Director was required to give such advice to the appropriate Minister as he considers may be proper in the circumstances.


2. Background

2.1 The Contract Rights Renewal remedy was applied to the sale of advertising on ITV1 in 2003 as a precondition for permitting the proposed merger of Carlton and Granada to form ITV. It was part of a package of undertakings designed to alleviate concerns that the Competition Commission (CC) had about the merger.

2.2 The CRR undertakings give purchasers of ITV1’s airtime the right to roll forward the contracts that they had before the merger—these are known as protected contracts—and, if a new contract is negotiated, to choose to protect this contract and roll it forward. This was intended to remedy the CC’s concerns that the merger would enhance the position of Carlton and Granada on the market for the sale of TV advertising airtime, enabling them to increase their revenue to the detriment of advertisers and other commercial broadcasters.

2.3 The OFT has a duty to keep undertakings under review and, in particular, from time to time to consider whether, by reason of any change of circumstances, existing undertakings are no longer appropriate so that either the relevant parties can be released from undertakings or the undertakings need to be varied or superseded. In October 2006, ITV asked the OFT to conduct a review of that part of the Undertakings relating to the CRR remedy. The OFT, with assistance from the Office of Communications (Ofcom), began its review on 30 January 2008. On 29 May 2009, we published our advice to the CC stating that changes of circumstance since 2003 meant that the CC should review the CRR Undertakings and consider variations to them.

2.4 The OFT recommended that, if the CRR remedy were to be retained in any form, the CC should change the definition of ITV1 to reflect new means of delivering ITV1’s programming such as +1 and High Definition (HD) channels. The OFT believed that there had been a decline in ITV1’s market position since 2003 but it’s continued strength in large audience programming meant that some form of protection was still required. We recommended that the CC consider whether the CRR remedy could be varied to impose fewer costs and distortions than the remedy in its current form but still provide effective protection against the remaining detrimental effects of the merger.

2.5 In May 2010 the CC published its final report. It agreed with the OFT that ITV’s unrivalled ability to deliver large audiences on ITV1 meant continued protection was still required. It believed that ITV’s alternative remedy proposals would not be effective in preventing ITV from worsening the deals it offers to media agencies and advertisers. It concluded that changing the definition of ITV1 in the Undertakings to include ITV1+1 and ITV1 HD services would address changes of circumstance whilst retaining the effectiveness of the remedy in addressing the adverse effects of the merger.

3. Competition between TV and Internet Advertising

3.1 The Select Committee asked for submissions on:

— How much of the recent decline in television advertising was due to migration to the internet and how much was due to the economic recession;

— Whether television could compete successfully in the medium-term with the internet and other media for advertising.

3.2 In 2003, the CC considered a range of evidence and concluded that TV advertising did not compete that closely with other forms of advertising in newspapers, on radio, outdoors and online. Television was considered a particularly powerful and important medium for advertisers, both because it combines visual imagery, sound and movement and because television viewing is an extremely popular leisure activity.

3.3 In our advice to the CC we noted that there has been a rapid growth of internet advertising since the CC’s 2003 report. However, we believed that competition between internet and TV advertising was still limited. We did however note that there was potential for further convergence in the future but we had limited information on which to assess the speed or significance of this change. Further details of the evidence for this is included in Section 4 of our final recommendation to the Competition Commission.

13 This advice is available at http://www.oft.gov.uk/OFTwork/markets-work/register-orders-undertakings/reviews/CRR-review.
14 In competition policy, the extent of competition between different products is considered in the definition of the “relevant market”. The relevant market is usually defined to be those products which are sufficiently substitutable such that a hypothetical monopolist of those products could profitably raise the price of those products by a small but significant amount, without customers switching to other products. In the case of the Carlton/Granada merger, the internet and other forms of advertising were not considered a sufficient constraint on TV advertising to be considered within the same relevant market.
4. LEVEL OF REGULATION OF TELEVISION ADVERTISING

4.1 The Select Committee asked whether the current level of regulation of television advertising is appropriate.

4.2 In our recommendation on CRR, we advised the CC that it was appropriate to change the remedy to account for the development of +1 and HD channels. But we believed that a significant number of purchasers of TV airspace still required ITV1 because of its unique position in supplying large audiences. We therefore considered that the concerns about the merger of Carlton and Granada resulting in increased prices for advertising on ITV1 may still hold and some form of protection for purchasers of TV airtime was still necessary. The CC’s final report echoed the view that the merger concerns were still valid. It did not think alternative forms of protection to CRR would be adequate to address their concerns. It therefore recommended that the CRR mechanism remained with only minor adjustments to account for HD and +1 channels.

4.3 The scope of the OFT’s CRR review was limited to considering whether circumstances had changed such that the CRR undertakings were no longer appropriate or required variation. Although a number of wider competition issues were raised in the course of that review, as we noted at the time, these fell outside the scope of the review. The review also did not address other general regulatory issues surrounding TV advertising.\(^\text{15}\)

5. THE EFFECT OF CRR ON ITV’S PROGRAMMING

5.1 The Select Committee asked for views on the extent to which the CRR undertakings limit ITV’s ability to compete in the production of quality programming.

5.2 It is inevitable that CRR will impose some costs on ITV. The CRR mechanism is an example of a behavioral remedy which seeks to address merger concerns by regulating the ongoing behaviour of the merged party. It is widely acknowledged that no behavioural remedy to merger concerns can perfectly replicate the working of a competitive market, and may create distortions in the market (this is why there is a preference for so called “structural” remedies to merger concerns such as divestments). In order to be reasonable and proportionate the CC will seek to select the least costly remedy, but the remedy must effectively address its concerns. The CC also states that, as the merging parties have the choice of whether or not to proceed with the merger, the CC will generally attribute less significance to the costs of a remedy that will be incurred by the merging parties than costs that will be imposed by a remedy on third parties, the OFT and other monitoring agencies.\(^\text{16}\)

5.3 During our review, ITV raised concerns that the CRR remedy has dulled its incentive to invest in high quality, diverse programming that advertisers and viewers value.

5.4 ITV’s arguments related to the audience ratchet mechanism (ARM) which was included in the CRR undertakings. The ARM was considered necessary because contracts for the sale of advertising airspace usually specify what share of the total amount a customer spends on TV advertising it must give to ITV1—this is referred to as the share of broadcast (SOB) commitment. If ITV1’s audience declines, purchasers of advertising airtime may want to reduce the share that they place with ITV1. The ARM therefore allowed purchasers to pull money away from ITV1, by reducing their SOB commitment, if there is a decline in ITV1’s share of commercial impacts (SOI).

5.5 ITV argued that the ARM provides it with an incentive simply to maximise the number of ITV1 viewers (ie ITV’s SOI) regardless of the quality of those viewers’ experiences. This is because the amount its advertising customers can withdraw from ITV1 through the ratchet does not depend directly on the quality of ITV1’s impacts (although higher impact programming may attract more viewers). Of course, ITV would have an incentive to increase SOI, even in the absence of CRR—even without CRR, the change in SOI would be one of the key metrics used in negotiations with media buyers. But ITV argued that, in the absence of CRR, it would also aim to maximise reach\(^\text{17}\) and “halo effects” ie positive association over and above ratings derived, for example, from more desirable demographics and programming or brand-investment. Such investments are not rewarded under CRR.

5.6 Section 6 of our recommendations to the CC considers the distortions created by CRR. It discusses how the CRR remedy may have had some effect on the programming choices made on ITV1, ITV’s digital channels, and also on other channels, but little evidence by which to judge the significance of these effects was presented to us.

\(^{15}\) The Select Committee also asks for views on what the financial impact might be on television companies if changes are made to the regulation of scheduling and sales of television advertising or if product placement is introduced. We have no views on this as we have not explored the wider issues relating the regulation of TV advertising.

\(^{16}\) For further details of the CC’s approach to remedies see Merger Remedies: Competition Commission Guidelines, November 2008.

\(^{17}\) Reach refers to the percentage of the target audience seeing the advert at least once.
6. **THE EFFECT OF THE REDUCTION OR REMOVAL OF CRR**

6.1 The Select Committee asked for views on the extent to which the reduction or removal of the CRR Undertakings would affect the commercial public sector broadcasting sector.

6.2 Our review concluded that removing CRR may increase ITV’s revenue, to the detriment of its advertising customers. We did not consider whether or not that increased revenue would be re-invested in programming, the launches of new services such as Pay-TV or on-line VOD, or simply redistributed to ITV’s shareholders. This was not part of the CC’s original analysis and the scope of our review does not allow us to revisit or go beyond the CC’s original analysis—we are only permitted to consider whether the circumstances facts underpinning the CC’s analysis have changed such that the undertakings are no longer appropriate in their existing form.

6.3 Our advice to the CC did consider whether, in the absence of CRR, any attempt by ITV to worsen terms to media buyers and advertisers might prompt competing sales houses to try to win back the business by expanding into the area of mass audience programming which is currently unique to ITV1. We concluded that the barriers to such expansion made it unlikely.

6.4 Moreover, if CRR were removed and ITV were able to extract a larger share of advertising expenditure from media buyers and advertisers, this would reduce the share of advertising revenue available to other broadcasters. This may have consequences for the ability of these competing broadcasters to invest in any form of programming.

6.5 The effect of the removal of CRR on other broadcasters may be further exacerbated as a number of stakeholders commented that the introduction of the CRR mechanism increased the negotiating position of some TV advertising sales houses that compete with ITV. This is because the ratchet mechanism means that other sales houses can calculate approximately what share of TV advertising revenue media buyers are able to remove from ITV1 while still maintaining their CRR contracts. The sales houses can then open negotiations by demanding a portion of this amount. Stakeholders stated this has benefited Channel 4 and Five in particular. They also suggested that ITV was able to increase its revenue on its digital channels in a similar way. In its review of CRR, the OFT considered that there may be some evidence to suggest that CRR has increased the negotiating position of sales houses competing with ITV. CRR may also have contributed to increase the premium on ITV’s digital channels. However, the available information was not conclusive.

7. **THE EXTENT TO WHICH CURRENT ARRANGEMENTS REFLECTS THE PUBLIC INTEREST**

7.1 During the course of our review, a number of other issues were raised that pre-date, or go beyond, the merger situation. Questions arose in relation to the current trading mechanism for TV advertising ie the use of Station Average Price (SAP), Share of Broadcast deals (SOB), and “umbrella” deals covering a number of advertisers. In particular, it was suggested that SOB deals favour large broadcasters and reduces the amount of spend available to small broadcasters. This may have detrimental effects on the ability of small broadcasters to compete with larger broadcasters.

7.2 In addition, various stakeholders also suggested that the market between media buyers and advertisers is not functioning well, despite the widespread use of auditors. In particular, although auditors compare prices obtained by different media buyers and advertisers on each channel, they do not usually compare outcomes across channels. Advertisers may therefore be aware whether or not they are getting a good deal on a particular channel but may be unaware of whether or not they should be spending less on a particular channel and more on others, in order to get the same amount of coverage for reduced spend. It was claimed that this may be further inhibiting competition between broadcasters.

7.3 On the one hand, as the trading mechanism cannot be changed while CRR is in place, it may to some extent be entrenching any problems that do exist. On the other hand, if addressing any wider competition concerns required a change of the trading mechanism, a further review of the protection from the anti-competitive effects of the Carlton/Granada merger would have to be undertaken.

7.4 In its original review of the Carlton/Granada merger the CC considered there was a need for a review of the wider market for selling television airtime. In its final report on the review of the CRR mechanism the CC restated this position. It suggested that the way in which this market currently works has a significant influence on the need to retain a variant of the CRR remedy.18

18 See CC Final report, at paragraphs 38 and 39.
7.5 If the Select Committee proposes to recommend any relaxation to the CRR mechanism, the OFT considers that it would be appropriate for this to be considered as part of a wider review of the market for selling television airtime.

August 2010

Examination of Witnesses

Witnesses: DIANA GUY, Deputy Chairman, Competition Commission, DAVID SAUNDERS, Chief Executive, Competition Commission, BILL ROBERTS, Senior Business Adviser, Competition Commission, JULIET YOUNG, Director—Consumer Markets Group, Office of Fair Trading, and HANNAH PRIEST, General Counsel’s Office, Office of Fair Trading.

Q55 **The Chairman:** I welcome our witnesses today from the OFT and the Competition Commission. Could I ask you to introduce yourselves, very briefly, in a couple of sentences? We have quite a lot of questions and I suspect that this session will probably be at least an hour—it depends on how we do; it may go on slightly longer—but where there is general agreement and somebody has already answered the question satisfactorily, there’s no need for duplication. Obviously, between the OFT view and the Competition Commission view, for instance, there may be some difference, perish the thought, but if there is then it’s useful to have that contrast drawn when answering the questions. So, if you need to come in, don’t hesitate to do so. Hannah, perhaps I could ask you to introduce yourself and then go along the bench, so to speak.

Hannah Priest: Thanks very much. I am Hannah Priest and I am a lawyer at the Office of Fair Trading. I worked on various aspects of the OFT’s work on the CRR review.

Juliet Young: I am Juliet Young. I am a director at the OFT and I led the CRR review.

Diana Guy: I am Diana Guy. I am a deputy chairman of the Competition Commission, a position which I have held since 2004, and I chaired the group of members that was responsible for the CRR review.

David Saunders: I am David Saunders. I am the chief executive of the Competition Commission.

Bill Roberts: I am Bill Roberts, senior business adviser at the Competition Commission. I was on the inquiry into CRR, as well as on most media inquiries that the CC has followed.

Q56 **The Chairman:** Thank you. We will kick off fairly swiftly. We tend to start with the more general questions and then get into the nitty-gritty, so my first question is to OFT witnesses. What change of circumstance prompted the OFT to refer the CRR undertakings to the Competition Commission for review?

Juliet Young: We looked at it and we considered that the change in the way that the ITV schedule was delivered—the development of the +1 and HD channels—meant that the Competition Commission should review CRR, at least for that reason. We also looked to see whether there had been wider changes in the market, particularly regarding ITV’s market position. The evidence there was less conclusive. We felt that some kind of protection would be required to prevent the adverse effects that the CC initially identified from materialising, but we invited the CC to have a look and see whether there were alternative remedies that might be lighter or less distorting.

Q57 Lord Gordon of Strathblane: Coming to the Competition Commission, if I may, you say that the Fair Trading Act was based on a public interest test and that your concern with the public interest was a lessening of competition as a result of the merger. That is, presumably, only competition between sales houses, or was it competition for viewers between ITV and the BBC?

Diana Guy: No, that was the finding of our investigation in 2003 when we looked at the merger of Carlton and Granada to create ITV. That was our conclusion then, but we were purely looking at the competition effects of that merger. The CRR remedy was put in place to remedy the detriment that we had found although, under the Fair Trading Act, it was not a remedy actually put in place by the Competition Commission. We merely made recommendations to Ministers in those days.

Q58 Lord Gordon of Strathblane: I wonder if you feel, in retrospect, that that might have been rather a narrow interpretation, bearing in mind that Parliament created local monopolies for ITV—for Granada, Carlton and everybody else—in return for the delivery of a public good in public service broadcasting, regulated as it now is by Ofcom.

Diana Guy: By the time we got to 2003, the local monopolies were really under the control of either Granada or Carlton, so the original model for ITV had substantially changed by then. At that point, of course, one of them had the weekend in London and one had the weekdays, so there was clearly some direct competition there which we found also spilled out into the regions which each was then responsible for selling.
I wonder whether you took account of the fact that Parliament had thought that a lack of competition might be quite a good thing if it delivered public service broadcasting. I think we were conscious of that. At the time, what is now the Communications Act was going through Parliament. It was clear that the objective was to have one ITV, so we were aware in a general sense that that was what the Government wanted, although I have to say that no pressure at all was put on us by the Government to clear the merger. I should have said at the beginning that I was also a member of the group of members that decided the original merger case when I was an ordinary member of the Commission.

It was clear that there was a lot of momentum to have one ITV. We understood that and it seemed to us that it would be quite wrong to bar the merger completely, but equally the evidence we were getting at that time was that there was a potential for the adverse effects that we identified, so we needed some remedies to be put in place. The concept of CRR was originally put up by Carlton and Granada. It was not an idea of ours; it was an idea of theirs, albeit that it then got developed.

Following what Lord Gordon has said, did you take into account the public interest beyond competition in the television advertising market, and if not, why not? Was it excluded from your terms of reference because you thought that the public interest and the interests of advertisers and broadcasters were the same?

In those days, the test by which mergers were judged was a public interest test. That was set out in the Fair Trading Act. But by then, it was normally interpreted in competition terms. There was the so-called Tebbit doctrine, from when Norman Tebbit was Secretary of State for Trade and Industry, that the main focus of merger reviews should be on competition, so that is what we focused on rather than wider public interest issues, which in earlier times had, for example, been concerned with whether a Scottish bank should remain headquartered in Scotland, or what the impact on employment would be, and a number of other wider issues.

I must say, I don’t get it. If you were concerned with the public interest test, can you tell us how it showed itself in what you did? You then switched to there being something else going on and it was all about advertising, but your initial sentences said that you were concerned with the public interest test. I would like to know how you took that on board and how we can see it in this.

As we expressed it in the report, we found it would be against the public interest for the merger to proceed without any restrictions because of the ability it would give the merged company to demand a higher share of broadcast commitment from advertisers or to insist on lower discounts. That ability for them to leverage the strong position they would then have into disadvantaging advertisers would be against the public interest. Equally, we felt that it would be against the public interest because of the way in which television advertising is sold, by and large, which is through share of broadcast commitments. Advertisers are committing to putting a share of their total broadcast spend with ITV, which means that if ITV is getting more of the broadcast spend, other commercial broadcasters are getting less. That, too, seemed to us to be a potential concern.

I am still worried. I am still not satisfied. I am awfully sorry, I do not want to be rude. You talk of the public interest entirely in terms of advertising interests. What about the public interest of programmes? What about the public interest of broadcasters? What about the public interest of public service broadcasting? Was that taken into account?

There were other aspects that were also looked at and considered not to be a problem. There was some question of closing production studio facilities in other parts of the country and whether that would be against the public interest. We found that it would not.

But actually it was very much against the public interest. Closing studios in various regions in this country was greatly against the public interest, you could argue. You could also say that closing down whole areas of programme-making was greatly against the public service broadcasting interest. I wonder why you did not take that into account.

Because we were purely looking at the impact of the merger.

That was part of the impact of the merger.

I must admit I cannot remember exactly on that point, but I think we reached the conclusion that that was likely to happen in any event, because the large studio facilities that they had in certain parts of the country were no longer needed, with the way programmes were made nowadays.

Let’s switch from the studios to the remit of the programmes. They were allowed to merge for advertising reasons, but the broadcasting
accountabilities, which had been intact in ITV for many years, seemed to be waived.

**Diana Guy:** I don’t think that was the case, but it was not part of our remit.

**Q66 Lord Dixon-Smith:** We have used the phrase “the public interest” on both sides now. What is the public interest?

**Diana Guy:** We certainly were not carrying out the CRR review with a wider public interest remit in mind. We had taken the original decision in 2003 under the public interest test as enumerated in the Fair Trading Act. This was simply a review of whether the undertakings that were given at that time were still needed. Our remit in carrying out the CRR review, which is what I think you are primarily concerned with in this inquiry, was a very much narrower focus.

**Q67 The Chairman:** So it was a narrow definition of public interest?

**Diana Guy:** Yes.

**Q68 Lord Dixon-Smith:** Can I ask a supplementary to that, which is a bit naughty? Can I invite you to do a little bit of blue-skies thinking and suggest what, in the broadest sense, the public interest really is in this field?

**Diana Guy:** I am not sure it is really appropriate for me to answer you. I am sorry.

**Lord Dixon-Smith:** Let all of you have a go. I am quite happy.

**David Saunders:** It is not our remit to define the public interest. These days, since the Enterprise Act, the Competition Commission’s focus is to look purely at the competition issues in the things that are sent to us. The CRR investigation that we have recently concluded was slightly unusual, because it dates back to an original merger that was looked at under the Fair Trading Act, but in looking at the undertakings given by ITV at the time, we were primarily focused on competition, although in our report we also looked at what ITV claimed were the wider costs of the CRR remedy, which took us in directions that included looking at its impact on UK-commissioned content. That is all set out in our report.

**Q69 Lord Dixon-Smith:** So it is an issue that is, if you like, clouded in a number of specific interests, rather than being necessarily in “the wider public interest”? **David Saunders:** Our remit is to take on these investigations with a view to looking at what is in the interests of consumers. Our role is looking at competition. If we find that there is a competition problem, we try to find remedies that deal with it that mean that consumers and the wider economy benefit from it.

**The Chairman:** So you say that that is the public interest—consumers, basically?

**David Saunders:** Well, given our current statutory remit, our interest is in dealing with competition concerns from the specific perspective of consumer welfare and the welfare of the economy.

**Q70 Lord Gordon of Strathblane:** Picking up on the consumer point, I agree that it perhaps did not feature in 2003, but by 2009 it was clear that CRR had had a detrimental effect on ITV revenue. Do you think that adversely impacted on their ability to compete with the BBC, obviously to the detriment of programming provided to consumers?

**Diana Guy:** I am not sure I would agree with your statement that CRR had had an adverse effect on ITV’s revenues. It may have had some impact, but our conclusion was that a number of things had led to the decline in ITV’s revenues, not least the recession. CRR is not a price cap as such. It is described loosely as a price cap, but it is not actually one. It is rolling over contracts and giving the ability for advertisers to fall back on the contracts they had in 2003, but equally giving the ability to negotiate new contracts. As I said earlier, the key is share of broadcast commitment. If advertisers are spending less money advertising on television, the share is going to be smaller and ITV’s revenues are going to be smaller.

**Q71 Lord Gordon of Strathblane:** If I could just finish off on that, if you think the impact of CRR was very slight, then arguably its removal would have a very slight effect on advertisers.

**Diana Guy:** That was not the evidence we were clearly getting from the advertisers and the other broadcasters who gave evidence to us. Their concern is that if ITV is able to get a bigger share, then by definition they will be getting a smaller share, which will affect their ability to invest in new programmes.

**Q72 Lord Razzall:** I should like to turn to the OFT on this, because in their written submission to us that have very much confirmed the nub of Lord Bragg’s complaint, as confirmed by Diana Guy, that in their review they only looked at the question of advertising and did not look at all at the issues that we are touching on here, such as investment in further programming or in public sector broadcasting. The OFT say that the reason they did not do that was that they were constrained by the Competition Commission limitation on the review. Our problem here is, the nub of the ITV case is that the only way they can increase their funding in new programming is by a relaxation of these undertakings. The difficulty we have is that both the regulators have not looked at this at all, because they have not regarded it as their function. My question to the OFT is, I
know you may have ignored it, but did you receive any evidence regarding what we might define as the wider public interest on whether more money would go into original television programming? You may not be able to answer this, but would you regard that as a legitimate topic for inclusion in any definition of the public interest? That is the nub of the ITV case and it is why they say that they should be released from what they regard as onerous obligations.

The Chairman: Diana, you have been shaking your head, so I shall come back to you, but first of all either Juliet or Hannah, please.

Juliet Young: Just to explain, the scope of what the OFT does in the context of reviewing undertakings is to go back and see whether something has changed that means that the undertakings should be altered or amended. It is quite clearly established in law that we are not allowed to reopen the whole CC inquiry, and there are very good reasons for that. So in the scope of this particular review, our job was to ask whether things had changed that meant that we should refer it to the Competition Commission. It was not in our remit to open it any wider.

Lord Razzall: I was not criticising the OFT.

Juliet Young: Nor can we strengthen a remedy. We had a lot of submissions that said that CRR does not go far enough and should be extended to the digital channels. That is not something that we can do. We can’t go back and say that the CC’s remedy was too light and ought to be strengthened. In this particular review, all we could do was look at whether things had changed, yes or no. As for whether we should have looked more widely—

Q73 Lord Razzall: You had no evidence?

Juliet Young: We had evidence from ITV, who argued to us that CRR was impacting on their programming schedule and affecting their programming. We had a look at that. They made the arguments, but we had very scant evidence for that being the case. As we said in our report, we were not really sure that CRR was having much of an impact on programming. We did not have the evidence to support that.

Lord Razzall: They say that without this they can’t increase their investment in programming. They could also give the money back to the shareholders.

Q74 The Chairman: Diana, you were vigorously shaking your head when Lord Razzall was making his comment.

Diana Guy: Of course we were looking at the impact on advertisers, because that is what CRR is about. As Juliet said, this was a very narrow view looking at the whether remedies that were put in place then, which were to do with advertising and the impact on other broadcasters, were still needed. On the point about evidence on the impact it was having on ITV, we did have more evidence put to us than the OFT had had. They produced a consultant’s report, which we deal with at some length in our report. We found that many of the “costs”—they were not out-of-pocket costs; it was forgone revenue—that were referred to were nothing to do with CRR, or only to a very limited extent.

Q75 Baroness Fookes: My question is addressed to the Competition Commission specifically. Did you undertake any international comparisons with mass audience channels in other countries to throw a light on CRR?

Diana Guy: No, we did not, and nor was evidence put to us by ITV about the different situation in other countries. We started to look at whether the concept of share of broadcast was appropriate, not that we had any ability to do anything about it, although we did make recommendations. Because we had been told that this way of selling advertising was not allowed in some other countries, particularly France, we started to explore to see whether that would give us some insights. In fact it did not and we were told that the situation was so different in France that we were not going to learn any useful lessons. That is the answer that we got on any international comparisons, so we did not look at that in detail.

Q76 Baroness Fookes: So do we take it that the system we have operating here in the United Kingdom is unique?

Diana Guy: I can’t comment on that. I don’t know.

No one gave us any evidence to say whether that was the case or not. It would not be surprising if it was different in this country from other countries. Our broadcasting system has evolved differently.

Q77 Lord St John of Bletso: On the cost of airtime, against a background of the number of commercial impacts having increased significantly, yet the price per impact having been reduced by, I think, a third from 2000 to 2008, to what degree did you take into account the fall in the cost of advertising, including ITV, since the introduction of CRR undertakings?

Diana Guy: We did not look at it in detail, I don’t think. Can I ask Mr Roberts to comment on that?

Bill Roberts: Just to reiterate the point that has been made a couple of times already, our remit was not to review the decision we made in 2003, but to look at changes. One of the changes we looked at was a reduction in share of commercial impacts that ITV had achieved since CRR was put in place. So, yes, we did look at that and we noted, of course, that, whereas ITV1’s share had fallen as the number of digital stations proliferated, as we would expect, the share of the ITV family did not fall by nearly so much, because ITV was very successful in launching
its digital channels, which helped it to claw back some of those impacts that it was losing. ITV1’s share fell and the price of airtime fell quite strongly from about 2001 onwards, but the ITV family was very effective in retaining quite a lot of those impacts. To answer your question, yes we did look at it.

David Saunders: And ITV’s premium went up over the period.

Q78 The Chairman: Can I just clarify that, because you kept using the word share rather than price or cost. Their share dropped. Are you saying that, because of the way CRR works, therefore the cost fell?

Bill Roberts: Two things happened at the same time. The number of impacts around to be traded went up because the number of digital channels expanded. Because of that increase in supply, and the demand at that time was relatively static, the price of impacts went down. So, first off the price of impacts fell. If nothing else had changed, that would have happened. While that was going on, ITV was losing share to the new digital channels that were coming on stream, but the ITV family was losing share less rapidly and was clawing back some of the revenue that would have been lost under the ratchet mechanism in CRR. As they lost share of impacts, agencies were permitted to remove share of broadcast budget from them, but ITV were particularly skilful and successful in retaining some of that revenue that would otherwise have been lost by having the agencies spend it on their digital channels.

Q79 The Chairman: Before Lord Macdonald comes in, that really goes back to an earlier question. You have now explained the issue of cost, but was that taken into account fully? If not, why wasn’t it considered?

Diana Guy: I don’t think ITV put any evidence to us on the cost of impacts. That is my recollection. The consultant’s report that they produced for us showed, for example, the cost to them of not being able to launch an ITV1 + 1 or an ITV1 HD channel because if they did it would not count towards the ratchet under CRR. We agreed. That was a cost. The world had moved on. Catch-up services of that sort, delayed transmission and high definition had not happened in 2003. If they had, we would probably have included them. So we agreed that CRR could be changed to include that. That was the major cost. We accepted that it was a cost of CRR and we relaxed the remedy so that those impacts on ITV1 + 1, if they launch it, and ITV1 HD could be included. Clearly, there is an out-of-pocket cost of running the office of the adjudicator, which they are responsible for paying, but we did not accept that what they claim were distorted programming incentives were primarily to do with CRR. We felt that they were not; they were to do with a range of other factors. There was evidence—we looked at some internal board papers, for example—of a whole range of reasons why they made their programming choices.

The Chairman: We might come back to you about the internal board papers.

Q80 Lord Macdonald of Tradeston: Since the introduction of the CRR, ITV1’s share of the commercial impacts has fallen from 42% to 28% and the gap between ITV1 and its nearest competitor, Channel 4, has also narrowed, from about 26% to 16%. What is not clear is how far ITV1’s share would have to fall, or how much those gaps would have to narrow, before you considered that CRR was a disproportionate market intervention. We do not seem to have any clear guideline on that.

Juliet Young: It is generally acknowledged in competition policy that you can’t judge anything from market share alone. You can’t say that one percentage is good and another is bad. They are not an indicator, but you have to get behind what is going on with the market shares to work out the impact of competition and how it is working. We noted that ITV1’s market share had fallen. As Bill pointed out, some of that had gone to ITV’s digital channels. The sales houses for ITV digital can’t have been seen as a competitor to ITV1. We also looked beyond the market shares and found that ITV still had the mass audiences, which is what really gave it the negotiating strength vis-à-vis the media agencies. In answer to your question, competition policy has long since moved away from a time when we said that 25% market share is good, 50% market share is bad. You always do a much more detailed analysis. I don’t think there is an easy answer to that. I guess that the answer would be, when ITV’s mass audience advantage had been sufficiently eroded.

Diana Guy: That is the key. It is the mass audiences. It is not the total share of impacts. It is the fact that, as we said in the report, something like 98% of the top 1,000 programmes are on ITV1. It is the only channel on which, as an advertiser, you can reach a large audience all in one go. It was clear from the evidence we had from the agencies that this was something that they valued. Because of the umbrella deals that the large media agencies do for a portfolio of clients, it was clear that they were all going to need access to that very valuable airtime, which could then, because of the way the trading system works, spill over into getting a higher price for everything, even though the real value is in the very big audience programmes. The ability to leverage off that to affect all the rest of their airtime was our prime concern. The large audience programmes are key to our findings.
Q81 Lord Macdonald of Tradeston: That rapid build cover, which is mainly on fast-moving consumer goods and affects the Unilevers and the Proctor & Gamble’s, is only one small part of the marketplace. Here you had a public service broadcaster in visible distress, cutting into areas that had been very prized, particularly by local audiences, and yet, from their request in 2006 that you look at this again, it took almost four years before you concluded that. I know the Government are talking about making the OFT and the Competition Commission more efficient, but isn’t that a very long time while the service to viewers appeared to be suffering?
Diana Guy: I would agree with you. As you say, it is done at the moment in various stages. They made their first request in October 2006. The OFT then said it was not going to start looking at it until January 2008. I don’t know what the reason for that was.
Juliet Young: To be clear, we were waiting for our project team to become free. We couldn’t just drop everything we were already doing. We knew it was important, but we needed to wait until we had a team that could take it forward.

Q82 The Chairman: And you had to wait for over a year before that was the case?
Juliet Young: It goes through our prioritisation process. We agreed that it was a priority, but we had other projects on at that time and we needed to wrap them up first before we could launch this.
Diana Guy: The OFT then sent it to us in May 2009 and, to our great regret, we did not manage to produce our final report until May 2010. We would have liked to do it more quickly than that and we planned to do so. The reason for the delay was that ITV kept putting new proposals to us for a variation of CRR. Every time we came back to them, they came back with another modification of their proposals. That took a very long time. We also pride ourselves on being transparent in our procedures and taking evidence from all the people who are likely to be affected. We could not listen only to ITV. We had to take evidence from the other broadcasters and the media agencies. I am afraid that that alone takes time.
Juliet Young: I would echo that. We took a year on our review because, unusually, we consulted on this review, because we recognised that it was an area of importance and people would have views on it. We also had the same problem with ITV putting forward more and more evidence throughout the period. I see that they have now made a new submission to you with slightly different arguments. This process of ITV updating their arguments did not make it any quicker.

Q83 Lord Bragg: Can I develop what Lord Macdonald has said. Since the introduction of CRR, ITV’s combined SOCI has fallen from 46% to 38%. The gap between ITV’s sales and the nearest competitor, Channel 4, has fallen from 33% to just under 20%. So the share of commercial impacts enjoyed by ITV’s portfolio of channels fell significantly, as did the gap between it and its nearest competitor. Again, how much would these numbers have to decline or narrow before you considered CRR to be a disproportionate market intervention? Everything you say and the examples you give—the 100 most watched programmes—are in terms of serving the mass market. That is only one of the markets. You ask whether we in this country are different from other countries. Yes, we are. The prime difference is that, across the board there has been a public service broadcasting philosophy and implanted necessity. This has helped to erode it significantly. All you are saying is that they have masses of audiences, so that’s okay. They are in the top 100, so that’s okay, I don’t agree with that. How far do these numbers have to decline or narrow before you consider that CRR is a disproportionate market intervention?
Juliet Young: Just to be clear, when we talk about the mass market, we are talking about the fact that ITV has the very large audiences that are of particular value to advertisers.

Q84 The Chairman: Are you saying particular programmes?
Juliet Young: Particular programmes, yes. They have a very high number of impacts in a very short period of time, which is particularly valuable to advertisers, because they can get very fast coverage in a very short space of time. That is much harder to replicate by buying large numbers of slots with lower audiences. When we talk about mass audiences, that is the advantage that ITV has for advertisers. As we said at the beginning, our remit was just to look at what the CC originally decided, which was that mass audiences gave ITV leverage over advertisers and that post-merger it would be able to put the price of advertising up.

Q85 Lord Bragg: But did the fact that it was driving out what were not mass programmes for ITV not occur to you? It must have occurred to you. Didn’t you want to do anything about that? Did you think that as long as we have ITV producing the mass stuff, we are okay, but Discovery can go, World in Action can go, this that and the other can go, its documentaries in Yorkshire can go, and that’s okay? Did it not occur to you to say, “Hold on, let’s have a look at this again? It seems to me that every time you come back to your remit, it gets narrower and narrower.
Diana Guy: Well, it was.

Q86 Lord Bragg: It doesn’t get narrower and narrower.
David Saunders: There was also no evidence to support the assertion that the effect of CRR was to drive out that sort of programme making. It is an argument that ITV put to us, but actually CRR gives an incentive to make programmes that people want to watch.

Q87 Lord Bragg: Mass programmes.
David Saunders: No, not necessarily. It needs to attract the kind of people that the advertisers want to reach. That could include upmarket programmes that attract upmarket audiences that certain advertisers welcome. I think you will find a number of the submissions that have been made to your Committee back that up. There really isn’t any evidence that CRR has that impact on ITV by itself. There are other incentives for it, because it wants to attract advertising revenue.

Lord Bragg: I must say, from where the programme-makers sit, including Lord Macdonald, it did not seem like that and it did not seem to work like that internally at all.
The Chairman: Say it twice more with feeling, Melvin.
Diana Guy: The problem is that we were not looking at it from the programme-makers’ stance; we were looking at it from the advertisers’ stance because that is what the remedy was about. I am sorry that our remit was very narrow. That is one of the reasons why we recommended that there should be a wider review of this market. We think that it does not work particularly well at the moment. This was not the context in which we could carry that out.
The Chairman: And you were not legally competent to do a wider review.

Q88 Baroness Deech: You have pretty well answered the question that I was going to put to you on how you investigated the claim of the advertisers that there is no acceptable substitute to ITV1, the answer being that it produced the mass audiences.
The Chairman: Actually, there is a supplementary to that, but carry on.
Baroness Deech: Did you explore that? Did you carry out your own research? Repeatedly I have heard from all five of you that there was no evidence for this or for that. Does that mean that you sit back and take a passive approach, or do you commission your own research and go out to find, for example, the quality of the advertising and what proportion of the television advertising expenditure requires that maximum reach? How proactive were you in that area of ITV1 being dominant and the need for that?

Diana Guy: We did a lot of work looking at the coverage analysis, which ITV and the advertising agencies produced to show how easy it was to replicate the coverage on a variety of channels without using ITV. A great deal of work went into that. Unlike our normal inquiries, we did not consider that it was appropriate or that we had a remit to carry out new, original research into this, but we did take evidence from those very close to the market on how important it was to be able to have access to these kinds of programmes. ITV, frankly, is somewhat schizophrenic on this point, because in talking to us they say that it is not important to advertisers to have big audience programmes, it really does not matter and they don’t really mind about that, but equally when they are talking to advertisers, they say, “You really need to be on ITV1 because you get big audiences.” So they were slightly schizophrenic on that point.

Q89 Baroness Deech: So you took their evidence on that question and accepted it?
Diana Guy: Who, ITV?
Baroness Deech: No, the advertisers.
Diana Guy: We looked at the evidence from the advertising agencies.
Baroness Deech: You just looked at it?
Diana Guy: The problem has two bits to it. One is the large audience programmes that advertisers need. The other is the way in which advertising agencies tend to do umbrella deals for a portfolio of clients. They then decide how they are going to allocate that within their portfolio of clients. Inevitably, some of their clients were going to need ITV1, but because it is not individual deals for individual clients on ITV1, it is an umbrella deal covering all the requirements of all their clients, they have to be able to have access to that airtime on competitive terms or they are not going to be able to compete with the other media agencies. That also weighed quite a lot in our thinking. It was going to be very difficult for them to negotiate with ITV, in that they were not going to be able to say, “All right, we are not going to advertise on ITV1 any more”, because with a large portfolio of clients who need access to ITV1 airtime, that was not a tenable position.

Q90 Baroness Deech: There is something underlying all this. You have said more than once that your remit was narrow and you are talking about the access of the advertisers to this exposure. Surely underlying that, and the very existence of the Competition Commission and the OFT, must be some concept of how your existence serves the public interest. Isn't that the foundation of everything that you do?
Diana Guy: Yes, of course it is, but that came into play when we made the decision in 2003. All we were doing in 2009-10 was looking at whether circumstances had so changed that the conclusions we had reached in 2003 were no longer valid. We reached the conclusion that in certain respects CRR should be relaxed, but there was still a case for keeping it in being.

Q91 Baroness Deech: I appreciate that, but I just wonder whether, at the end of every day, you said to yourself that the public was getting more advertising that it needed, or the public were getting better programmes, or the public would be able to buy cheaper goods. What is it all about?
Diana Guy: We were looking at the public. If we were right in thinking that, completely unconstrained, ITV would charge a lot more, advertisers would be paying a lot more for advertising and therefore it would ultimately track through into the price of the goods that they were selling to consumers.

Baroness Deech: That is about price.

Q92 Lord Razzall: We have got to another fairly crunch issue here, because it appears, rightly or wrongly, that the Competition Commission has bought the argument of the media buyers that ITV1 is—I was going to say in a dominant position; I had better not say that because it has competition law consequences—certainly a unique medium. We have to some extent had conflicting evidence here. First of all, it is blindingly obvious that if the News of the World have a scoop on Sunday and want to advertise it on Saturday, the only medium they can advertise on to get national impact is ITV1. We don’t need the OFT or the Competition Commission to tell us that.
On the other hand, you mentioned Procter & Gamble, who are one of the rare big advertisers who don’t use media buyers. Procter & Gamble negotiate direct with ITV. ITV will no doubt tell us when they come to see us that next year Procter & Gamble are going to spend 20% of their budget on digital advertising rather than on commercial TV advertising. That is what ITV believe. In looking at this, did you have any qualitative or quantitative evidence on what proportion of television advertising expenditure requires the maximum reach through ITV1, or is it just a general assumption and you just accepted the evidence of the media buyers that it was significant? Have you got any numbers on what proportion of advertising depends on ITV1 because only ITV1 can give that maximum reach?

Juliet Young: That is something we explicitly asked for evidence on. We were asked earlier whether we went out and looked for evidence. When we consulted on our CRR review, we explicitly said if anyone has any indication on exactly what proportion really has to go on ITV, please give it to us.

Q93 Lord Razzall: What answer did you get?
Juliet Young: We did not get very much.

Q94 Lord Razzall: Do Procter & Gamble or Unilever indicate what proportion of their display advertising for a new brand they need ITV1 for?
Juliet Young: We did not get any clear evidence on what proportion of spend actually must go on ITV and what does not, although we did specifically request that. It is very hard to gauge.

The Chairman: David, you were about to say something, but I curtailed you. Did you want to add to something previously?
David Saunders: Only to make the point that it was not just about prices for customers; it was also about the impact on the other public service broadcasters.

Bill Roberts: One can argue all day long about the extent to which any particular advertiser is dependent on ITV1 for its marketing. The main point here was not to do with the substitutability of Saturday night TV on ITV1; the main point, which I think was very important to members of this group, was the way the agencies are structured. The way that deals are done, in terms of share of broadcast and discount schemes, means that no agency can afford to move a large amount of money out of ITV1 for fear of being penalised on their discount. Substitutability is less of an issue in the real world, where agencies are competing with each other and are anxious to maintain the discounts they have with ITV1. That is another factor that would prevent agencies from shifting large amounts of their spend out of ITV1.

Q95 Lord Gordon of Strathblane: The competition among the agencies has reduced considerably in recent years. I think they are now down to four covering the bulk of the market. Are you saying that if you were to investigate that and introduce some remedies on the way that ITV was bought, CRR might be worth another look and possible removal?

Bill Roberts: I think it definitely would and I think that is exactly what was behind our call again, as we called in 2003, for an investigation. If you mix together share-of-broadcast deals and agency umbrella discounts, you will tend to reinforce some of the factors there that we have concerns about, as the group said at the time.

Q96 The Chairman: We are anticipating a later question. That is an important issue, isn’t it? We are not talking about the wider public interest, but in competition terms the consolidation of the media houses did not influence you particularly.
Diana Guy: We did look at the impact it had on whether it gave countervailing buyer power to the media agencies and we concluded that it didn’t. We set out in our report why we reached that conclusion. Although there may be only four large groupings now, nevertheless they are competing very strongly with each other, so we felt that there is still considerable competition between them. ITV gave us evidence of particular negotiations with a particular agency to show us how they got beaten up by the agency. In fact, we concluded that ITV succeeded in getting what they wanted from the outset, pretty much. We were unpersuaded that the agencies really had the ability at the end of the day to walk away from ITV.

Q97 Lord Macdonald of Tradeston: I did just want to come in and say that, with the negative spiral that seems to have developed, since CRR came in the revenue of ITV has gone down, that has damaged investment in the programme budget, that in turn seems to have brought the ratings down. It looks as though you have created a negative cycle that drives them further down towards Channel 4. We have not been clear on when you will be satisfied that they have been reduced to a Channel 4 level. Against the international context, which you did not explore, it looks as though every other leading commercial broadcaster in the commercial countries with the freedom to trade has managed to maintain its programme budgets, except for ITV, which was once the best commercial broadcaster in the world. This seems to be a very British affliction that you have inflicted not just on ITV, but on its viewers.

Diana Guy: A number of points arise from that. First of all, the decline predated the merger of Carlton and Granada, so it predated the creation of CRR. The fact that there has been a huge proliferation of digital channels will inevitably take money away from ITV. As I think is clear in some of the evidence that has been given to you, ITV has declined proportionally less than some other broadcasters. We felt that CRR was not the prime cause of this. In fact ITV’s revenues are now increasing again. They have some very popular programmes, they are doing quite well and advertising has recovered a little bit from the recession. These deals are structured on the basis of share of broadcast commitment. If advertisers are advertising less, it is a share of a smaller pot, so there is less money at the end of the day.

Q98 Lord Macdonald of Tradeston: But in the complicated ecology of broadcasting, the fact that you have that ability for fast-build cover for mass audiences is just one unique selling proposition for ITV. Other channels have their unique selling propositions, whether it is subscription, or the legacy that Channel 4 has from its public sector birth. You have taken away the key factor that made ITV special.

Diana Guy: I don’t think we have. As I said, it is not a price control as such. If ITV makes popular programmes that people want to watch and people want to advertise on, it is still able to benefit from that. As their own consultants admitted in their report that was then sent to us by ITV, they made some poor programming choices in the past, and this could be part of the reason for the decline. Also, with the change of strategy that Michael Grade introduced in 2007, they seem to have been much more successful again. It has taken a while, but it seems to be coming through.

Q99 Lord Gordon of Strathblane: But is it not the case that ITV’s cost per thousand, to use an outdated concept, is back to what it was in the mid-1990s, but a lot of other costs have gone up considerably since then?

Diana Guy: But with more impacts available, is that not inevitable?

Q100 Lord Gordon of Strathblane: Is it exacerbated by CRR?

Diana Guy: In our view it was not significantly exacerbated by CRR. There are a number of different issues here.

Q101 Lord Dixon-Smith: I am getting a little bit lost in all of this. It seems quite clear that ITV’s total advertising revenue is forecast to be only two-thirds greater than Channel 4’s. It looks as though Channel 4 is now able to exert competitive pressure on the price of airtime on ITV. Is that a justifiable conclusion, or am I reading more into what you are saying and what is going on than is actually there?

Diana Guy: I come back to the large audience programmes, which enable them to leverage off that. Also, ITV’s audience share is more than twice as large as Channel 4’s. There is still a considerable discrepancy. We put quite a lot of information in our report on this, showing how, although total audience size for any broadcaster may have declined, in terms of relative size ITV is still attracting significantly bigger audiences than anybody else.

Q102 Lord Dixon-Smith: So you think that Channel 4 is not that influential on ITV at the present time?

Diana Guy: They are attracting different sorts of audiences.

Bill Roberts: ITV1 has a larger audience and certainly delivers much larger programmes at any one time. If Channel 4 is able to exert an influence or attract advertising, which it obviously is, it is not going to be on the basis that it can outdo The X Factor on a
Saturday night. It is going to be on more niche programming aimed at ABC1s or some other demographic that it can offer in preference—doing it better than ITV can, or bringing in younger people. The Chairman: *Big Brother* doesn’t cut it?

Bill Roberts: Not to the extent that it used to.

**Q103 The Lord Bishop of Liverpool:** Sorry, we are like a dog with a bone here. It is CRR again. If CRR had not been applied, would ITV have more, less or the same market power compared with the ITV network before the Carlton-Granada merger?

*Diana Guy:* It is very difficult to speculate on that. We certainly took the view in 2003 that as a result of the merger it would have enhanced market power, which needed some remedy, and the remedy was CRR. Whether, without CRR, it would not have been able to exploit that market power or whether it would have exploited it, I don’t know. We would be purely speculating on what might have happened.

The Chairman: Any other speculations on the bench?

**Q104 Lord Gordon of Strathblane:** Prior to CRR, Granada had a monopoly—well, not quite a monopoly because of Channel 4 and a bit of multi-channel—but essentially Parliament had given Granada a monopoly in the north-west in exchange for doing public service broadcasting, such as *Brideshead Revisited, The Jewel in the Crown*, etc. Merging with somebody else doesn’t increase your monopoly in the north-west. The only area that could possibly be affected was London, where there was a time difference between London Weekend and Thames—then Carlton—during the rest of the week. Apart from that, the monopoly was built in by Parliament.

*Juliet Young:* As Diana said at the beginning, that competition in London was what drove the Competition Commission’s original concerns. Before Carlton and Granada merged, within London if you couldn’t get a good price on spend with Carlton, you could say, “Well, if you don’t give me that I’ll go to Granada”, so you could play the two off against each other and they both had mass audiences that advertisers liked. You couldn’t get that elsewhere. Without that ability to play the two off against each other, the Competition Commission was concerned that they would be able to put up the price of advertising.

**Q105 Lord Gordon of Strathblane:** I wonder how real that competition was. To take the example that someone was giving of a *News of the World* scoop, they could not very well use Thames on the Wednesday, otherwise every other newspaper would have its scoop before the Sunday. They had to wait for London Weekend. That pre-existing CRR.

*Diana Guy:* Yes, but that was why the merger was referred to us in the first place. There was competition between the group of licences that were owned by Carlton and the group that were owned by Granada. There was a clear overlap in London. We concluded at the time that there was a spillover effect into the rest of the country. It was limited, but it was there. If somebody wanted to test the market for a product in a particular region, they could say to Granada, “Okay, if you don’t give me fair terms on my deal with you, I’ll go and do my test marketing in one of the Carlton regions.” In a sense, the world has moved on. That was the finding in 2003. It was not challenged in 2003. It was an independent, detailed review and that is the conclusion that we reached. We are now looking at where we are in 2009-10, with the remedy that was put in place then. I don’t think we can reopen what was decided in 2003—in fact, we had no ability to do so.

The Chairman: Thank you, Lord Macdonald, I am not sure that you ever got to your question.

**Q106 Lord Macdonald of Tradeston:** It was a question about the effects of the consolidation of the sales houses and the increased market power of the competitors. With the consolidation of the sales houses, given that there are three or four big sales houses and three or four big buyers, isn’t that an over-concentration and doesn’t that argue for a review that looks at this whole area and asks why it is very difficult for some broadcasters to get what would appear to be their natural share of advertising?

I think of small areas such as Border Television as was, or even Scottish Television today. Because of the consolidations, they don’t seem able to get their natural share of that kind of advertising. If the Government are talking seriously about city television, should you be thinking about how you can deconstruct this horn-locked pair of oligopolies from each other so that the advertising might spill down into the regions and the cities?

*Diana Guy:* I completely agree with you. That is why we have said that we think it would be appropriate for there to be a wider review of this market. We did not have the ability to do it in the context of what we were doing, but we highlighted a number of issues that we think require in-depth review. We don’t think it would be appropriate just to take CRR out of the picture. There are a lot of other factors there. You need to look at it in the round, and it needs a detailed review to do that.

Lord Razzall: Such as?

*Juliet Young:* You can do a market investigation reference for that kind of issue. That is something we highlighted in our submission to you.
Q107 Lord Razzall: Diana said there were a lot of issues. I wondered if she could give us an idea of her menu. 

Diana Guy: We highlighted three or four in the note at the end of our report. This is a personal view that I was not necessarily going to express, but my feeling is that it should be a system that brings the advantages of the programme you are advertising closer to the money that you are spending on your advertising. It is all mediated at the moment via share-of-broadcast deals, and you don’t know how big the pot of money is, or umbrella deals with agencies with lots of different advertisers underneath. Then there is station average price, which is a mysterious concept that I am sure your Lordships will get to grips with. It is a very complicated concept. It is an average that nobody ever pays, because everybody gets a discount off it. It is a hugely complex system. If it was possible to find a simpler way of doing it so that you brought the money closer to the benefit you are getting from advertising on that particular programme, it would enable ITV to benefit if it has successful programmes and it would enable niche broadcasters who attract particular audiences to benefit. If a way could be found to do that, I think it would be very beneficial.

Lord Razzall: I am sure that most of the public would believe that if the News of the World wants to advertise on a Saturday night, they simply phone up ITV and say, “We want to advertise on The X Factor” because we’ve got a scoop tomorrow. The public would be stunned to discover that they can’t do that.

Q108 The Chairman: I want to go straight on to question 20 and then come back to 18 and 19, if I may. We have got to the rather interesting point about what alternatives there might possibly be. My question is: in an ideal world, would you favour a system in which a broadcaster’s airtime price was established by advertiser demand for the airtime, which would reflect the size and type of the audience that it delivered? I am thinking of a kind of auction process, maybe, for the first 500 top-rating programmes, or an online auction for advertising during programmes with the largest audiences, and so on.

Diana Guy: Absolutely, I completely agree that that would be an aspiration that it would be very nice to be able to realise. I don’t think it is very easy to achieve that with the current system. I repeat, we have now asked three times, or suggested that there should be a review.

Juliet Young: In our submission, we also thought that there might be merit in a wider market review, but given the current concurrency regime, it would naturally fall to Ofcom to carry out that review.

Q109 The Chairman: Specifically, in some countries advertising airtime for large audience events—the Superbowl in the States, for example—is sold by auction. I believe that in France some airtime is sold by auction. Do you have an opinion on whether that would be an appropriate way of proceeding?

Bill Roberts: We did consult quite widely at the remedies stage, asking people precisely those sorts of question. We understood from the evidence put to us that an auction process takes place in France, for example. There was very little appetite for that.

The Chairman: They like their arcane way of proceeding, basically?

Q110 Lord Gordon of Strathblane: No appetite among whom?

Bill Roberts: Among advertisers, agencies, broadcasters or anybody who we invited to express a point of view. Not one person came back to us and said, “That sounds like a good idea.”

Lord Razzall: It obviously is, then.

The Chairman: Exactly, it sounds like a great recommendation for it.

Bill Roberts: To qualify that, it goes to something that was said earlier about the way airtime is sold. To an extent, some slots are auctioned. A small number at the moment are designated as specials in contracts with agencies, and they are taken outside the normal arcane rules on a station average price and discount. So that happens to an extent already. We were not able to find anybody with an appetite for extending that.

Q111 The Chairman: On any side of the equation?

Bill Roberts: No. We asked advertisers, we asked agencies, we asked other broadcasters, we asked everybody. Nobody seemed keen on that idea, possibly because it would be “a leap in the dark”, as somebody said to us. They were more familiar with the existing system, which may have suited quite a lot of players within the game as it is at the moment. We were aware that it happened in other countries, such as France, but there was no appetite within the UK.

The Chairman: Back to CRR.

Q112 Lord Bragg: If it were possible to remove CRR, what in your opinion would be the advantage to ITV? How much would its airtime price increase? Is it a few percent, 20%, what are we talking about?

Diana Guy: It is impossible to say. I don’t know. You’d have to ask them.

Bill Roberts: We did ask them, and they said it was very difficult to say. We put that question to ITV and they said it was very difficult to say. It might not even increase their revenue, certainly in the short term.
Q113 Lord Razzall: In that case, how do they justify the statement that they need this in order to put more money into programming?

Bill Roberts: ITV never justified the abolition of the CRR in terms of giving them more money. It was justified in terms of the distorting effects that it had, for example, on—

The Chairman: But they do now.

Diana Guy: They did not to us. It was all to do with the fact that it distorted the incentives.

The Chairman: Do you want to ask your second question?

Lord Bragg: No, I think we have had a good run round that track.

Q114 The Chairman: Do you think that this increase in ITV’s advertising revenue would mostly come from an increase in total television advertising, or from a switch from other commercial broadcasters to ITV? What evidence do you have for your view, whatever that may be?

David Saunders: You mean if CRR is taken away?

Diana Guy: I don’t think we would know.

David Saunders: We were certainly clear that it would pose big threats to the revenue of the other commercial broadcasters. That is clear in our report.

Q115 The Chairman: I think we just have two more questions. During your review, did you take evidence that ITV was using conditional selling, forcing advertisers to buy airtime they did not want on the portfolio channels in order to get airtime they did want on ITV1? If so, what was your assessment of those claims?

Diana Guy: We certainly had allegations made to us.

The Chairman: It is a sort of packaging.

Diana Guy: Yes. We were not able to reach a definite view on that because there are ways of achieving the same result without it falling foul of the conditional selling rules. Frankly, some advertisers want to be able to do a deal across a range of channels. It was quite difficult to get to the bottom of that. The Ofcom definition of conditional selling is quite narrow. There were things going on that, if you were taking a broad view, you would describe as conditional selling, but we didn’t reach a decided view on that.

Anyway, in some circumstances there seemed to be quite an advantage to being able to buy a package, and why should that be stopped? So we did not reach a decided view on that.

Q116 Lord Macdonald of Tradeston: Just on general impressions, when you looked at the market and heard the evidence over the various years you have been involved in it, did you get the impression that it was overly opaque and very difficult to understand? Were you worried that there were things hidden in that opacity that might be detrimental or unjustifiable?

Diana Guy: I think again it comes back to the fact that the system for selling advertising airtime is opaque. Did we get to the bottom of it? Was there more there? It was very difficult to decide on that. As we said earlier, we felt that if it was possible to devise a clearer and more transparent system, it would be more beneficial.

Q117 The Chairman: Finally, a very straightforward question: were you aware of Ofcom’s intention to rescind the airtime sales rules when you published the conclusions of your CRR review in May?

Diana Guy: Yes, we were aware of that. We had discussions with Ofcom. Initially we had some slight concern about the impact it might have if CRR were to remain, but in the end we reached the conclusion that even if the airtime sales rules were relaxed in terms of having to sell all your airtime, the incentives on ITV with CRR there would be to sell all their airtime whatever the airtime sales rules said. So in the end, we concluded that we did not think it would—

The Chairman: It did not make any difference to your conclusions either way?

Diana Guy: No.

Q118 The Chairman: If they were to be reinstated, would that change your view? Or are they not relevant to consideration?

Diana Guy: I don’t think they were really relevant to what we were doing. Is that fair?

Bill Roberts: Yes, I think that’s fair.

The Chairman: Unless we have any more supplementaries, which I don’t think we have, I want to thank our witnesses today very much, especially for your grace under considerable fire. Thank you.

Supplementary letter from the Competition Commission (RTA 18)

Thank you for giving us the opportunity to appear before the House of Lords Select Committee on Communications on 26 October 2010.

At the hearing, the Committee asked a number of questions regarding our interpretation of the “public interest” test, both in relation to the 2003 merger between Carlton and Granada and more generally. I thought you might find it helpful if we made our position on this clear.
The Competition Commission’s remit is to ensure that competition works effectively. It is widely accepted that effective competition is in the public interest. Greater rivalry between firms benefits consumers through lower prices, greater choice and greater innovation.

The Carlton and Granada merger was one of the last merger inquiries to be conducted under the Fair Trading Act 1973, and, as such, was subject to a public interest test. That having been said, the focus then, as today, was very much on the competitive effects of the merger. The inquiry considered the impact of the merger on a wide range of issues: the independent production of television programmes; the availability of studio facilities in the North of England; the future competition for ITV licences; the impact on the other ITV regional licensees; and the sale of advertising airtime. Consideration of each of these issues is set out in the 2003 report.

The CC found that the merger would not operate against the public interest in the areas of programme production, the availability of studio facilities, or the future competition for ITV licences. On the other hand, the CC found that adverse effects would arise from the impact of the merger on other ITV regional licensees and on the sale of advertising airtime. Undertakings were agreed with Carlton and Granada relating to both of these concerns. The Contracts Rights Renewal (CRR) remedy prevents ITV from using its enhanced market power from the merger to take higher share of advertising revenue from advertisers and, as a result, to reduce the share of advertising revenue for other commercial broadcasters.

Our recent review focussed on the ongoing need for the CRR remedy. We found that, despite all the changes in the market since 2003, the key competition concerns which gave rise to the CRR undertakings in the first place still exist.

Part of the benefits of the merger put forward by Carlton and Granada was that it would “give ITV the means and incentive to continue as a mass audience channel, able to provide home-produced programming of high quality, to make better programming decisions more efficiently, and to compete more effectively with the BBC, Channels 4 and 5, and the growing challenge from multi-channel operators”. Some of these benefits have evidently not turned out to be as significant as Carlton and Granada suggested in 2003.

During the course of our recent review, we looked very carefully at the arguments ITV put forward in relation to the impact CRR has had on its programming decisions. None of the evidence provided by ITV was sufficiently convincing to persuade us that CRR was the driving force behind ITV’s “poor programming decisions” since the merger.

ITV has argued that it is in the public interest that it is able to make good quality programmes and that the CRR remedy limits its ability to do so. However, this ignores the fact that CRR was not just designed to protect advertisers but also to protect other commercial broadcasters. If ITV were able to use its enhanced market power to take a disproportionate share of advertising revenue, this would (because of the “share of broadcast” basis of most deals) deny revenue to other commercial broadcasters. As a result, other commercial broadcasters would be less able to invest in programme-making, and the view taken by the CC in 2003 was that such an outcome would be against the public interest. In addition, we have seen no persuasive evidence that CRR does have the influence on its programming that ITV alleges. As a number of your witnesses have pointed out, it will generally be in the interests of a commercial broadcaster to produce programmes that viewers wish to see and that therefore generate advertising revenue.

15 November 2010

19 CC’s 2003 report, paragraph 2.15.
Memorandum by ITV plc (RTA 15)

ITV welcomes the decision by the House of Lords Select Committee on Communication to investigate the regulation of television advertising, with particular reference to the Contract Rights Renewal mechanism. ITV’s written submission is supported by significant new economic research http://www.parliament.uk/documents/lords-committees/communications/televisionadvertising/CRRev.pdf.

Summary

Advertising revenue is a mainstay of the UK’s creative economy supporting over £1.1 billion a year in investment in original UK content by the UK’s commercial free to air broadcasters (ITV, Channel 4 and five). Historically it has sustained a vibrant TV content market in drama, news, entertainment and factual programming, and provided the BBC with competition for quality.

However, in recent years, both the advertising revenue available to free to air broadcasting and the investment it sustains have fallen markedly. Outdated regulations that restrict competition and growth in the television advertising market are making it increasingly difficult for the UK’s commercial broadcasters to compete effectively and sustain their investment in original content.

This submission focuses on one particular aspect of advertising regulation—the price control mechanism on ITV airtime known as Contract Rights Renewal (CRR). CRR is the most significant distorting feature of the UK TV advertising market and the one that has caused most damage to the UK’s creative economy.

The case for removing CRR rests on four key arguments:

1. CRR is by any standards an exceptionally intrusive form of price control, unique in the world, that has a highly distorting impact on the UK media market.

2. The unintended consequence of CRR has been to cause profound damage to the UK’s creative economy, significantly reducing the level and range of programme investment in the UK:
   - CRR has reduced ITV’s revenues below what could be considered as a fair market outcome.
   - Because of the nature of competition in the broadcast sector, the effect has been to reduce content investment not just by ITV but by other free to air broadcasters, particularly the BBC.
   - It has in addition created a bias against innovation and in favour of low-risk mass market programmes.

3. CRR is becoming increasingly anachronistic and unnecessary in the fast-moving and highly competitive new multimedia environment of the internet, mobile devices and new media players like Google and Apple which is putting pressure on traditional platforms such as television.

4. The effect of removing CRR would be to deliver benefits for all stakeholders—viewers, advertisers and other broadcasters—and for the creative economy in the UK.

ITV now faces a highly competitive market for the attention of the public and for advertising revenue. ITV’s competitors have low cost operating models with minimal expenditure on content, significant free cash flow, international reach and a freedom from legacy business and regulatory constraints.

ITV does not want any special favours from government or regulators, simply a level playing field in which we can compete on our own merits in markets where the conditions of competition are being transformed by digitisation and the internet. We can only compete effectively by maximising our investment in content in order to continue to attract viewers and advertisers.

ITV recognises that the Competition Commission only recently completed a review of CRR, and concluded that it should be kept in place. However, we believe there is a strong case for a new review to be conducted:
— the pace of the change in the UK’s media market means that the information on which the CC’s investigation is based is already out of date (it was based primarily on 2007–08 data)—the world in 2010 already looks very different; and

— the CC’s scope and remit was extremely narrow, focussing just on the harm identified in the report on the merger in 2003—the impact on advertisers—and not taking account of the competitive market for viewers (which forces ITV to invest) and the impact on the UK’s creative economy.

A broader review is needed to encompass the totality of implications of CRR for the creative sector in the UK. Our recommendation to the Committee is that a new review into CRR is launched as soon as possible.

1. CRR IS A HIGHLY DISTORTING PRICE CONTROL

CRR was a behavioural remedy imposed by the Competition Commission on ITV at the time of the merger between Carlton and Granada in 2003. Its primary purpose was to remedy a perceived reduction in competition for TV advertising in London where Carlton and Granada competed via the Carlton weekday and LWT (Granada) weekend licences. CRR is unique to the UK and to ITV—nothing similar exists anywhere else in the world. It has a number of features that make it a particularly distorting and heavy-handed form of price control:

— CRR gives any ITV advertiser the right to reduce its share of TV advertising spend on ITV1 by the commercial share loss suffered by ITV1 in the previous year whilst still retaining all terms and conditions (including discount) from its 2003 contract.

— In effect, it has “automated” revenue decline by removing ITV’s ability to trade new terms and conditions (particularly discounts) in return for higher advertising spend.

— It means that some advertisers who have reduced spend with ITV by as much as 57% are still able to benefit from the same high discounts they had in 2003.

— Ofcom itself concluded in its evidence to the OFT and CRR investigations on CRR that “the CRR remedy may potentially be restricting the development of competition”.

2. UNINTENDED CONSEQUENCES: DAMAGE TO THE UK’S CREATIVE ECONOMY

The distorting effect of CRR has led to a range of unintended consequences which together are damaging investment in original UK creative content, not just by ITV but also other UK broadcasters. The overall dynamic has been clear.

CRR has artificially reduced ITV’s revenue below fair market and peer levels

— CRR has forced ITV’s revenues down mechanically, allowing advertisers to reduce their share of spend on ITV on a one for one basis with ITV’s viewing share loss. The effect of this has been to depress artificially ITV’s revenue below the market level and that of peers, with benchmarks that include comparable networks internationally and the trends in ITV’s revenue pre-CRR (along with those of Channel Four and five).

— Work carried out by Oliver and Ohlbaum Associates for ITV http://www.parliament.uk/documents/lords-committees/communications/televisionadvertising/CRRRev.pdf illustrates this. It also shows that the relative scale of large commercial TV networks across many markets is valuable to advertisers even where such networks lose share over time (which most have). The result is that the revenues of these comparable networks have not fallen directly in line with their falling share of commercial viewing.

— By contrast, the chart below shows the difference between the relationship between ITV1’s revenue (NAR) and its share of commercial impacts (SOCI) before and after CRR came into effect from 2004. Before CRR ITV1’s revenue did not fall directly in line with its declining share of commercial impacts whereas after CRR it did.
— The Oliver and Ohlbaum research also highlights the uniqueness of ITV’s experience internationally: ITV is the only leading network in the major international TV markets to experience this close connection between a falling share of commercial impacts and falling revenue. Since the introduction of CRR in 2003, ITV1 has become an anomaly.

— CRR was intended to prevent ITV from exploiting any additional strengthening of its market position that resulted from the merger to raise prices and revenues (and implicitly profits) to “supernormal” levels. This analysis demonstrates that in practice it reduced ITV prices below a “normal” rate, artificially and excessively depressing its revenues. This has had -and will continue to have -an adverse effect on ITV1’s level of spending on programmes.

— CRR ignores the two-sided nature of the market in which ITV operates and ignores the costs of attracting viewers. CRR is based on the premise that the costs faced by ITV1 to attract viewers are proportional to the share of commercial impacts that it achieves. As analysis commissioned by ITV from the economic consultants Oxera http://www.parliament.uk/documents/lords-committees/communications/televisionadvertising/CRRrev.pdf shows, this is not the case now, nor was it the case prior to the merger.

As a result, ITV has had to reduce its programme investment, contrary to its preferred strategy

— Since 2005, ITV has reduced its spend on original UK content by £146m. This was contrary to its preferred strategy and incentives, but was to a significant extent the result of CRR.

— At the same time as ITV’s revenues have been falling, competition for the time and attention of viewers has increased significantly. This competition now comes from the wide array of choices available to viewers round the clock -digital TV channels, internet content providers (such as Facebook and YouTube)—as well as more traditional sources of competition -publicly funded or subsidised competitors such as the BBC and Channel 4 and other players with a different business model such as Sky.

— In order to maintain its appeal to viewers and hence to advertisers ITV has to continue to invest in programmes. As competition for viewers increases however, attracting those viewers becomes more and more expensive. As Oxera’s report shows, ITV1’s costs of programming to achieve each percentage point of SOCI have been increasing since 1995.
Ordinarily, ITV would expect to sustain investment and be able to pass on higher costs to the extent that advertisers are prepared to pay for those costs in return for continued access to a network which still delivers mass reach relative to its competitors. This is what appears to have happened with comparable networks to ITV in most other major markets.

However, because of CRR ITV has not been able to do this. As the report from Oxera shows, the result of increasing programming cost per viewer and declining revenue has been to force ITV to cut costs (including its spend on programming) as well as cutting its commercial return to levels well below those of comparable TV companies in a number of different markets.

This drop in ITV programme spend has lessened competitive pressure on other broadcasters, leading to falls in programme investment across the sector.

Moreover, Oxera concludes that ITV’s reduction in original programme investment appears to have had a strong influence on BBC decision making with the result that the BBC’s own investment in programming for BBC1 has declined in parallel with ITV, despite rising licence fee income.

Although Channel 4 and Five maintained their overall programme spend for a period after the introduction of CRR their spending on original UK programming also fell in real terms.

According to Ofcom, investment in programming by the main PSBs has fallen by £500m since 2005.

This analysis suggests that the ongoing imposition of CRR is likely to result in continued de-investment in original UK TV content to the detriment of the creative industries in the UK.

To date the UK has seen high growth in exports of programming and formats driven by the relatively high (albeit declining) levels of investment in attractive and innovative UK content. It is not clear how this growth can be sustained with a contracting domestic market for original programming.

CRR is driving a cycle of decline in which UK audiences to ITV1 effectively “subsidise” large corporate advertisers most of whom demonstrate willingness to pay more to advertise on high reach networks which are comparable to ITV1 in other countries. Accordingly, advertiser profit may be higher than it should be whilst programme quality is lower. Moreover, money that might otherwise have been spent on UK TV content ends up being spent on advertising in countries other than the UK.

At the same time, CRR has dampened innovation by forcing ITV to chase mass audience

CRR has distorted ITV1’s own programme schedule since ITV is incentivised to chase large audiences with the most popular mainstream programming (such as soaps). By contrast genres such as current affairs, comedy, drama or arts often do not maximise ITV’s audience.
— It is also noticeable that, over the past five years, not only has the BBC’s investment in programming fallen (in parallel with ITV) but BBC1 is widely acknowledged (even by the BBC Trust) to have become less distinctive with more reliance on a narrower set of tried and tested programmes and talent.

**CRR also threatens plurality in regional and national news**

— Until recently, UK has benefited from a “public service dividend” in analogue spectrum that has funded strong and plural news coverage. Not only has the dividend virtually disappeared with DSO but CRR has also made it increasingly unaffordable for ITV1 to sustain its historic news commitment.

3. **WHY CRR IS NO LONGER NECESSARY: A CHANGING MEDIA MARKETPLACE**

— The UK’s media marketplace is changing at an extraordinary pace, making CRR increasingly anachronistic and unnecessary. ITV now competes in a multi-competitive media environment, facing extensive and intensifying competition for both advertising and for viewers. The UK telecom and media regulator Ofcom was clear in its advice to the Competition Commission (in June 2009) that: “Given the decline in ITV’s market position since the merger in 2003, Ofcom does not believe that retaining the undertakings in their current form is appropriate”.

**The rise of the internet**

— The UK now has over 46 million active internet users and broadband is now in over 73% of homes in the UK (fixed and mobile). The internet is no longer the preserve of the young—almost 60% of internet users are now aged over 35. Research suggests that the average UK online user spends over 13 hours online per week.

— Internet platforms and services are now achieving the mass reach that was traditionally only provided by television as the chart below illustrates:

### TOP 20 WEB BRANDS IN THE UK, RANKED BY UNIQUE VISITORS

<table>
<thead>
<tr>
<th>Brands</th>
<th>Rank (Jul 10)</th>
<th>Unique Audience (000)</th>
<th>Rank (Jun 10)</th>
<th>Unique Audience (000)</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Google</td>
<td>1</td>
<td>33,924</td>
<td>1</td>
<td>33,924</td>
<td>+0.4%</td>
</tr>
<tr>
<td>MSN/Windows Live/Bing</td>
<td>2</td>
<td>27,704</td>
<td>2</td>
<td>27,704</td>
<td>+2.1%</td>
</tr>
<tr>
<td>Facebook</td>
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<td>25,054</td>
<td>3</td>
<td>25,054</td>
<td>+3.4%</td>
</tr>
<tr>
<td>Yahoo!</td>
<td>4</td>
<td>21,255</td>
<td>4</td>
<td>21,255</td>
<td>+1.9%</td>
</tr>
<tr>
<td>BBC</td>
<td>5</td>
<td>20,199</td>
<td>5</td>
<td>20,199</td>
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</tr>
<tr>
<td>eBay</td>
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<td>6</td>
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<td>+0.9%</td>
</tr>
<tr>
<td>YouTube</td>
<td>7</td>
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<td>8</td>
<td>17,032</td>
<td>+2.6%</td>
</tr>
<tr>
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<td>7</td>
<td>16,751</td>
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<td>9</td>
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</tr>
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<td>10</td>
<td>13,920</td>
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</tr>
<tr>
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<tr>
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</tr>
<tr>
<td>Associated Newspapers</td>
<td>15</td>
<td>7,991</td>
<td>17</td>
<td>7,991</td>
<td>+6.1%</td>
</tr>
</tbody>
</table>

UK Active Online Universe 39,119K; Source: UKOM APS, 10 July (Internet Applications Included, Home & Work)

— Internet and online content are having a transformational impact on the ways in which people spend their free time whether searching for information, buying products, watching video or interacting with friends. There is now a far greater amount of content (much of it user generated) competing for people’s leisure time than there ever has been.

— The revolution brought about by the internet is still in its early stages. For instance, it is clear that connected televisions which bring the internet to the TV screen will bring rapid and significant change to living rooms throughout the UK in the very near future.
— Predictions for ITV suggest that the UK’s connected TV households will reach almost 11m by 2014—approaching half the total number of households and this is before the likely impact of the planned launch of Google TV. In future a YouTube video will appear on the same living room screen as Coronation Street. As the Financial Times put it earlier this month:

“The competitive challenge is steep: the world’s largest technology companies, including Google, Apple and Sony are all targeting the living room. This week Sony announced that its new Bravia sets will incorporate the BBC IPlayer, a key attraction of YouView” (FT 17 September 2010)

The digital revolution is broadening the advertising market

— Changing media consumption is changing the way advertisers reach and target clients and build brands. Advertisers are following consumers and advertising on digital television and online at scale—advertising spend has been migrating away from the main commercial TV networks for some years. ITV now faces very significant competition for advertising revenue from numerous other media.

— A seismic change is underway as advertising spend from television migrates online. As consumer habits change so major advertisers across all sectors are having to think and act differently when it comes to communicating effectively with consumers who are spending more time online. The extent of this transformation is described in more detail in the Digital Consultancy report in Appendix X at Annex 3.

— The Digital Consultancy report shows that online advertising increasingly offers the mass reach of television combined with more targeted and efficient marketing to consumers. Such effectiveness also comes at prices which compare very favourably to television given the relatively low fixed cost base of online advertising vehicles (which get much of their content at zero cost).

— Major online advertising players such as Google are now very large multinational businesses able to create convenient and compelling cross border offers to multinational advertisers in competition with primarily national TV companies. Google’s UK revenues are now larger than those of ITV plc.

— Mass market brands dealing in Fast Moving Consumer Goods (FMCG) have historically been the largest and most reliant of TV advertisers. Now they are using a variety of online marketing techniques (including search) as a key part of building their brands. In the process of doing this they are clearly redirecting spend away from traditional media at a high level. So, for instance, Proctor and Gamble (the world’s largest advertiser) announced in 2009 that it would increase its digital spend from 2% to 20% of total advertising budgets (including in the UK).

— Sir Martin Sorrell Chief Executive of WPP (the world’s largest advertising agency) has made clear his view that advertising will inevitably shift online in line with shifting consumer behaviour:

“it’s only a question of time. Because if consumers are spending 20, or 25 percent of their time online and clients are spending 12 or 13% of their budgets online, there’s a natural gravitational pull to that 25%”.¹

The arrival of internet TV will complete the merger of online and TV advertising markets into a single market for advertiser revenue. The recently announced Google TV will bring Google’s search functionality to the TV screen allowing users to search for web content of all sorts and Google’s search based advertising will appear on TV screens alongside traditional TV advertising.

Clearly the UK is not alone in this but the intensity of the decline in TV and rise of the internet in the UK are striking compared to other developed economies. The UK has experienced total advertising market growth similar to comparable markets over the past 13 years. However:

— In the UK, TV has fallen as a proportion of all advertising to a much greater extent than other main markets.

— At the same time, there has been a remarkable growth of internet advertising in the UK since 2004 well ahead of other markets in terms of the proportion of total advertising accounted for online.

¹ Sparksheet Branded marketing Q&A with Sir Martin Sorrell, 5 January 2010.
ITV also faces strong competition for traditional television viewers and advertising revenue.

- ITV also faces powerful competition for traditional TV viewers and advertising revenue. It competes strongly with the BBC, which has a television programme budget of over £1.3 billion a year, powerful new online channels and a stated commitment in the recent Strategy Review to spend even more on content for the core TV services in future.

- Moreover, Sky also appears (albeit from a very low base) to be beginning to target the core market of the commercial PSBs through aggressive content investments in original high cost UK drama and significant acquisitions (for instance the recent acquisition of the back catalogue and new releases from HBO). The relative scale of the revenues of Sky and the BBC compared to ITV are instructive:

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**PERCENTAGE POINT CHANGE IN TV AS A PROPORTION OF ALL ADVERTISING: 1997 TO 2009 (%)**

Australia: -4%  
USA: -1%  
Germany: -1%  
France: 2%  
Spain: 5%  
UK: -7%

Source: Zenith Optimedia October 2009, Oliver & Ohlbaum Analysis  
Note: all underlying data is in local currency in nominal terms

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**INTERNET ADVERTISING SPEND AS A PROPORTION OF ALL ADVERTISING: 1997 TO 2009 (%)**

UK

France

Australia

Germany

USA

Spain
select committee on communications

2009 REVENUES OF KEY UK MEDIA PLAYERS (£ billion)

- Overall, massively increased competition for the attention of viewers from online and digital TV content places acute pressure on ITV to invest to continue to attract viewers, undermining the need for CRR since ITV cannot simply extract profits for no investment.

- Ultimately it is success in competing for viewers that drives ITV’s current business model and therefore ITV has an in-built incentive to invest in programming to attract viewers. However, CRR is artificially constraining ITV’s ability to sustain that model. If the constraints of CRR were relaxed or removed, ITV has strong incentives to invest in greater volumes of high quality programming in order to attract the mix and scale of viewers that it needs to in order to continue to satisfy advertisers’ requirements (for as long as they are willing to pay).

4. THE BENEFITS OF REMOVAL OF CRR: A WIDE RANGE OF PROCOMPETITIVE AND PUBLIC BENEFITS

If CRR were lifted on ITV1, the benefits to the UK’s creative economy and to UK audiences would be significant:

- **Increased investment in original UK content**: ITV would be able to—and have every incentive to—reverse recent cuts in original content spend potentially driving increases in spend across the market. ITV’s business model is very different from most new entrant competitors, whose business models are not built on investment in original UK content.

- **Increased competition for other commercial broadcasters**: Just as the recent declines in ITV1’s investment in programming and original content lessened the incentive for others to invest, so it is reasonable to think that increased investment by ITV would have the opposite effect creating a multiplier effect in the UK creative economy.

- **Commercial broadcasting revived as effective competition for BBC and Sky**: the “third leg” of a healthy media economy

- **Potential for restoration of “public service dividend”, particularly in regional and national news**: ITV would be better able to afford to maintain national and regional news providing plurality of news provision to the BBC and Sky.

- **Sustained global competitiveness of UK creative economy**: growth, employment and exports.

**WHAT SHOULD BE DONE: NEXT STEPS**

The most effective route forward would be for the Secretary of State to oversee a broader-based review of the CRR undertakings. Responsibility for the review of the CRR undertakings was transferred by secondary legislation from the Secretary of State to the CC following the adoption of the Enterprise Act 2003. However, there are strong arguments for the Secretary of State to take back responsibility for overseeing a review of the undertakings assisted by Ofcom and the OFT. This is the case because:
— Without intervention there is no guarantee of a further review of CRR for many years and a further narrow review of the undertakings focussed entirely on the advertising market would again neglect the intense competition on the viewer side of the market.

— By contrast, a broader review overseen by the Secretary of State could begin more quickly, take less time and adopt a more coherent view of the two sided TV market in which ITV competes. Such a review would also be carried out against a policy backdrop of encouraging investment in the UK’s creative industries.

— the CRR undertakings were originally given to the Secretary of State under the old public interest merger regime. There are still a number of undertakings in other merger cases given to under the old regime that still rest with the Secretary of State that were not transferred to the CC and where the Secretary of State (rather than the CC) continues to be responsible for overseeing a review.

Under the current regime, reviews of merger undertakings are not led by sector specific regulators who have detailed sectoral knowledge and who can integrate reviews into the broader strategic and policy framework and have a broader, dynamic view of the market. There should be a central role for Ofcom in any further review of the CRR undertakings, in partnership with the OFT and reporting to the Secretary of State. This hand back of responsibility to the Secretary of State could clearly be achieved by primary legislation (though there may also be a route by which this is possible with only secondary legislation).

There may be a temptation to conclude that the only route to a solution is a full market review of the TV advertising market. However, having looked at this option recently, Ofcom concluded that such a "market study is not justified at this time". ITV concurs; such a review would take a long time to complete (at least three years); be an enormous resource drain on UK commercial broadcasters at a time when the top priority is to ensure a competitive offer to increasingly effective online competitors; and create significant uncertainty in the market, potentially undermining content investment incentives.

1 October 2010

Annex 1

INTERNATIONAL TELEVISION NETWORK PERFORMANCE TRENDS: WHY HAS ITV1 UNDERPERFORMED?

EXECUTIVE SUMMARY

1. Many major network broadcasters, both in the UK and in other major international markets, have been suffering an on-going loss of audience share for at least the last decade.

2. Despite this, network broadcasters have been able to maintain or grow net advertising revenues.

3. The ability to maintain revenues, despite loss of audience share, is repeated across all major markets.

4. For the period up to and including 2003, the UK performed like other markets.

5. Since 2003, ITV, Channel 4 and Five continued to lose SOCI but at a rate that was not remarkable compared to international peers.

6. However, Channel 4 and Five have increased net advertising revenue in line with international trends since 2003, despite their audience share falling.

7. ITV1 has not been able to maintain net advertising revenue in line with international trends, and has instead experienced significant falls in net advertising revenue in recent years, even before the recession.

8. It is not the UK that is different but ITV1 that is different—factors specific to ITV1 have driven its significant revenue underperformance by comparison with international peers.

9. Evidence suggests that ITV1 started to diverge from the market norm after 2003–04 when CRR was introduced.

10. The specific factors affecting ITV1 do not appear related to its audience performance—while declining, its loss of audience share, SOCI and the absolute decline in its supply of advertising inventory are not remarkable by comparison with international peers and so do not explain its marked revenue underperformance.

2 Ofcom Statement: Removing out-of-date rules on TV ad sales & ITV Networking Arrangements consultation, 28 July 2010.
11. This suggests that the “contract rights renewal” (CRR) mechanism, designed to prevent ITV1 exerting pricing power arising from the Granada/Carlton merger (and so prevent it from over charging advertisers and achieving higher price inflation than its rival networks), has disproportionately stripped ITV1 of the ability it had to maintain revenue prior to 2003 (and the merger), and disadvantaged it vis-à-vis its rival network owners in the UK and also internationally.

How have major television networks performed in large developed international markets?

Since the mid-1990s major traditional network broadcasters around the world have had to contend with significant changes to the competitive landscape within which they operate. Digital and multichannel television uptake has been rapid in all major developed markets and in many is now virtually ubiquitous. The rapid uptake of multichannel television services has enabled rapid growth in the number of commercial channels competing for audiences and advertising.

The resulting fragmentation of viewing has meant that traditional mass audience high reach networks have been steadily losing audience viewing share. While the starting points and rates of decline have differed from market to market and between networks within markets, the universal trend is broadly the same in all markets. As a result of network audience share declines, the absolute volumes of advertising inventory (“commercial impacts”) that network broadcasters sell to advertisers has fallen, as has each individual network’s share of all commercial impacts (SOCI) sold in any given market as a whole.

However, despite this, virtually all major network broadcasters have been able to maintain and in many cases grow advertising revenues (net of agency commission and discounts) in nominal terms. The relative rate of a network broadcasters’ audience share or SOCI decline does not affect this trend and even the networks which have suffered the most in audience terms have been able to at least maintain their net advertising revenues (NAR). From 1997 to 2003 the fourteen network broadcaster groups sampled for this study3 (includes ITV1, Channel 4 and Five in the UK) raised net advertising revenues in nominal terms by 36 per cent on average, while over the same period SOCI fell by an average of 6 per cent.

Figure 1

COMBINED MAJOR BROADCAST NETWORKS: INDEX OF NAR AND SOCI BY COUNTRY, 1997 TO 2003

From 2003 to 2009 the same trend was observed. The 14 network broadcaster groups sampled saw net advertising revenue rise 15 per cent on average to 2007, before the recession took effect, while SOCI declined steadily by an average of 20 per cent to 2007 and 23 per cent from 2003 to 2009.

Note: all data expressed in nominal terms

Source: Company Reports, OBS, SNL Kagan, CMT, ZenithOptimedia, ZAW, KEK, Oliver & Ohlbaum Analysis

3 Networks sampled for this study: ABC, CBS, NBC, FOX, Antena3, Telecino, RTVE, Pro7Sat1 Group, RTL Group, TF1, M6, ITV1, Channel 4, Five
Have UK networks performed in line with international trends?

From 1997 to 2003 the UK’s three major traditional commercial broadcast networks (ITV1, Channel 4 and Five) performed in line with international trends witnessed in other markets. Their combined audience share fell from 46 per cent of all UK television viewing to 40 per cent and their combined SOCI fell by 16 per cent. However, while audience share and SOCI were falling, the three networks increased their combined net advertising revenue by 10 per cent.

From 2003 to 2009 audience fragmentation continued at pace and the result was that the UK networks saw their combined SOCI fall by 31 per cent. While this SOCI decline was worse than experienced collectively by the networks in France and Germany, it was very similar to the declines in SOCI of networks in the USA and Spain which experienced proportionate SOCI declines of 31 per cent and 29 per cent over the same period.
However, whereas in other international markets the networks were able to maintain or increase revenues (at least until the recession started in 2008) in the UK the networks suffered a collective net advertising revenue decline of 26 per cent. However, when the individual UK networks are considered separately it can be observed that Channel 4 and Five have performed well, growing net advertising revenue in line with international trends while SOCI has continued to fall.

Figure 4

Figure 5
FIVE: INDEX OF NAR AND SOCI, 1997 TO 2003 AND 2003 TO 2009

The reason for the UK network market’s underperformance by comparison with other international markets is solely due to the underperformance of ITV1 which, due to its scale, has dragged down the collective performance of the UK network market as a whole.
Before the recession, Channel 4’s net advertising revenue grew by 8 per cent from 2003 to 2007 while Five’s grew 14 per cent. Over the same period from 2003 to 2007 ITV1 saw its net advertising revenue decline by 16 per cent. In fact, as can be observed in the charts above, ITV1’s net advertising revenue fell broadly in line with its decline in SOCI.

When considering the three UK networks separately, it becomes clear that ITV1’s relative underperformance compared to UK and also international network peers is due to ITV1 specific factors and not any UK television market structural effects eg the impact of increased digital channel competition or the growth of internet advertising which would have impacted upon Channel 4 and Five to at least some identifiable degree.

*What ITV1 specific factors might explain its underperformance since 2003?*

While the previous sections of this report have established that ITV1 has significantly underperformed both its UK and also international network broadcaster peers the trends themselves provide few clues as to what ITV1 specific factors have actually driven its revenue underperformance.

First, it could be suggested that ITV1’s loss of audience share was significantly worse than other international peers and its revenue underperformance might simply be a reflection of this. ITV1 has certainly suffered significant audience share falls with consequential declines in SOCI and the absolute volume of commercial impacts generated and sold. However, while the declines in share SOCI and impacts are significant, they are not exceptional by international standards, as can be seen below in Figure 7, and certainly do not explain the rapid decline in net advertising revenue experienced since 2003.
Second, there have been no major changes to the mechanisms that ITV1 uses to trade airtime since 2003 that might explain the radical and negative change in ITV1’s revenue performance in the period after 2003 when compared with the period before 2003.

Evidence suggests that ITV1 started to diverge from the market norm after 2003–04 when CRR was introduced. Indeed ITV1’s net advertising revenue declines broadly in line with SOCI decline, exactly as would be expected under CRR ratchet system and indeed as it was conceived to achieve. It would therefore appear likely that ITV1’s underperformance since 2003–04 has been driven primarily by the CRR mechanism. Indeed the speed and pattern of ITV1’s revenue decline, by complete contrast with almost all UK and international peers, means that any other cause is extremely unlikely.

CONCLUSION: THE CRR REMEDY APPEARS DISPROPORTIONATE

It is clear that the CRR mechanism, which came into effect in November 2003, has had a significant and negative impact on ITV1’s ability to even maintain its net advertising revenue as audience share and SOCI have declined.

The CRR mechanism, designed to prevent ITV1 from exerting pricing power arising from the Granada/Carlton merger (and so prevent it from over charging advertisers and achieving higher price inflation than its rival networks), has disproportionately stripped ITV1 of the ability it had to maintain revenue prior to 2003 (and the merger), and disadvantaged it vis-à-vis its rival network owners in the UK and also internationally.

Rather than simply proportionately limiting any pricing power that a merged entity may have exerted post 2003, the mechanism has in fact overly constrained ITV1 by comparison with the other UK networks and networks in other major markets. Without CRR, and even if the 2003 merger of Carlton and Granada had not proceeded, ITV1 should have been able to maintain revenues at around 2003 levels in nominal terms, at least until the recession. However, ITV1’s net advertising revenue actually fell by £262 million from 2003 to 2007, the year before the recession affected TV advertising, and so it might reasonably be suggested that the disproportionate negative impact of CRR on ITV1’s revenue in 2007 was £262 million.

A report by Oliver and Ohlbaum Associates Limited

1 October 2010
Examination of Witnesses

Witnesses: MR MAGNUS BROOKE, Director of Policy and Regulatory Affairs, ITV, MR ADAM CROZIER, Chief Executive, ITV, MS CAROLYN FAIRBAIRN, Director of Strategy and Development, ITV, MR ARCHIE NORMAN, Chairman, ITV and Ms FRU HAZLITT, Managing Director of Commercial and Online, ITV.

Q119 The Chairman: Welcome, and thank you for bringing such a strong contingent. We will first ask you to introduce yourselves.

Archie Norman: I am Archie Norman, the chairman of ITV. I am here to reflect the importance that ITV and the board of ITV attach to your work and the outcome of your work. Adam Crozier is our chief executive, who will be leading our evidence, and I shall ask him to introduce the team.

The Chairman: So Adam will be directing the traffic.

Adam Crozier: I believe so. This is Magnus Brooke, our director of regulation, on my far right. Then there is Carolyn Fairbairn, our director of strategy. I am Adam Crozier, for those who do not know me, the chief executive of ITV. Then there is Archie, the chairman, and Fru Hazlitt, the managing director of the commercial side of our business, directly involved in airtime sales.

Q120 The Chairman: Great, we will kick off. I expect you know what most of the questions are going to be, so no secrets there. You argue that CRR has forced you to prioritise mass-market programming to maximise your share of commercial impact, thus reducing your ability to invest in lower-rating or riskier content. What evidence can you give on that?

Adam Crozier: Our business is a relatively simple one. We compete by investing in great content and then using that great content to attract viewers and therefore revenue, which we reinvest in programming. Our advertising revenue has fallen by around 22% since CRR was introduced, so we are operating in a declining marketplace. That has led us to invest less and less in programmes over time, as we chase our share of commercial impact. As we have done that, so has the market invested less money. Ofcom announced recently that something like £500 million of investment in PSB programming had disappeared from the marketplace. Over time, that has led us to chase higher-rating programmes, with things like soaps and what have you. Therefore, the diversity of our schedule today is very different from the diversity of our schedule seven to 10 years ago, because we have to invest our money in the programmes that will drive the biggest audiences rather than the most unique audiences.

Q121 The Chairman: Because of the ratchet effect of the CRR. That is demonstrable by examining your schedules, is it?

Adam Crozier: It is. If you looked at a pictorial version of our schedule today versus a pictorial version of it 10 or 12 years ago, you would see a remarkable lack of diversity compared to then, simply because of the way in which the market now works.

Q122 Lord Bragg: I have great sympathy with you over the CRR, as you know, because I argued this when I was inside ITV. I declare an interest as I still have some shares in ITV. Other forces have been at work as well as the CRR over the past 10 or 12 years, as we all know—there are extra channels and Google has come on air—so it is not just the CRR. Nevertheless, it is a real nuisance and an impediment. However, if we got rid of CRR, do you think you would be able to give anybody promises that the money would go into classic British broadcasting rather than into the pockets of long-suffering shareholders, of which I am one? That is what is interesting for us. You have owned up to the poverty of some parts of the schedule compared with 10 or 12 years ago, although you do not have to own up, because we can all see it and I can understand how we got there. Would losing the CRR make that sort of difference, or would it give us relief all round? Would the money go into programmes?

Adam Crozier: It is a very good question. The first thing to say is that, unlike for many of the new entrants into the market, our model is primarily about investing in new, unique programming. Clearly, as I mentioned, we have not had enough diversity in our schedule over the past few years, which we believe is because of the effects of CRR. In some ways the best way to predict the future is to look at behaviour in the past. Despite a pretty savage recession, we have held up our investment in programming pretty well. We have had no dividend for our shareholders during that time and we have obviously had very little profitability. I guess the organisation, which I have only recently joined, could have been much more savage in cutting programme budgets, but it quite rightly chose not to, because we operate in a very competitive market. One problem with the way in which market definition is done is that it looks only at very specific bits of competition, when in terms of share of viewing we compete just as much against the BBC as we do against other commercial channels and against video on demand on the internet and all the new devices that are coming in.

In the past few months, we have been round all our shareholders to talk about our strategy going forwards. It is a strategy based on origination of owned content for ITV. Our shareholders are totally supportive of that approach. If we want to win in the long run, the model for us is very simple. We must create more of our own unique programmes,
showcase them on ITV and then sell the great new content around the world. All our direction is in investing more in programmes and more in content.

Q123 Lord Bragg: I shall be brief, as I know that lots of people have lots of questions to ask. That is a clear strategy and the right strategy, but I would still like to know whether you make any differentiation in the sort of programmes you are going to invest in. Do you have any categories or a strategy for different sorts of programmes, some of which you have left behind? I think that we would all like to know, because it is an important fact in tackling the CRR problem.

Adam Crozier: Were we not to have CRR in place and therefore not to have to chase volumes of impacts, that would allow us to have a much more diverse schedule. That would certainly be the plan. It would allow us to move advertising around the schedule. At the moment, the problem is that, if you take regional news, for example, because we have very little advertising around it, we have a return investment of minus 80%. It does not exactly encourage you to do more of that. Not changing audiences would open up things like the arts, more drama and more factual programmes, which would give us a real opportunity going forward. The truth is that the advertisers would like us to target more unique viewers rather than just reaching the same people again and again with the same programmes, but the system works against that at the moment.

Q124 The Chairman: In a sense you are talking about a quid pro quo in terms of programme investment with the release of CRR, but are there other aspects, such as commitment to training, which would be part of that “deal”?

Adam Crozier: ITV, perhaps understandably, if I may say so, given the recession and the difficulties that it faced over the past 18 months, pulled out of a lot of arrangements and cut back the spend on a lot of training aspects, not only within ITV but within the industry. However, over the past two or three months, we have restarted a lot of those conversations with projects such as Skillset to find out how we can get back involved in the industry. To be fair, it was the right decision at the time, given the financial state of the organisation. In fact, I am not sure that it was much of a choice, but we would in any event start to look at those things slightly differently going forward.

Q125 The Chairman: Have you got any concrete proposals in that respect? Taking away CRR would be a considerable step in the eyes of the regulators, the Secretary of State and so forth. It is a question of producing a concrete proposal, which would allow that to happen. That would include programme investment and training and so on. Is that in ITV’s mind, or is it still subject to your own internal debate and discussion?

Adam Crozier: I think that the genuine answer is that it is in very early stages. I met with Clive Jones only three or four weeks ago to begin the conversation. If anything changes with CRR, we will have that conversation anyway. I should say that to be clear. We believe that CRR should go anyway, for all the reasons that we outlined in our submission to you. In the period up to 2003—internationally, not just in the UK—there was a fairly direct relationship between the share of commercial impacts and revenue. Since 2003, in almost every country, even though the main broadcasters’ share of commercial impacts has dropped, they have been able to increase their net advertising revenue. ITV has gone in completely the opposite way. Indeed, Channel 4 and Channel Five have followed the international pattern and have been able to increase their advertising revenue. We really are set apart, from that point of view, and we have clearly suffered from that, which has led to this reduction in spend in programming. Our profit margin is around 10%, compared to the international average of around 20%. This has severely impacted on our business. What we would like is a level playing field to allow us to compete equally.

Q126 The Chairman: Yes, I understand, but you and Archie will appreciate that often these things are done by way of undertakings—effectively a contractual undertaking. Is that the sort of arrangement that you could contemplate.

Adam Crozier: It is certainly one that we would be prepared to consider, yes. Archie Norman: I should point out that both Adam and I, as well as Fru, are relatively new to ITV. There have been major changes to ITV in the course of this year, as Adam was describing. We have put those changes to our shareholders and have their backing to drive the business forward. Our ambition is absolutely congruent with the direction that you are discussing, so in principle what we want to achieve and what I think the people around this table would like to see happen with CRR are entirely in sync. We want ITV to become a global business, selling UK content around the world after showcasing it on ITV1, 2, 3 and 4. What we are seeking to do is to find the wherewithal to do that. To create the unique content that Adam was talking about, which appeals to segments of viewers, we need to be able to move away from the ratings rat race that we are caught in. The difficulty at the moment with CRR, among many difficulties, is not just to do with pricing; it is to do with the fact that we are driven to look for mass
audiences. In a sense, we are driven towards the lowest common denominator all the time.

Q127 Lord Razzall: Have you done any work on what you think the impact of removing CRR would have on the other advertising-funded public service broadcasters? Do you think that it would affect the investment of Channel 4 and Channel Five in new programming? Would it increase their profits or their losses? I take your point that Channel 4’s advertising has held up remarkably well in recent years, although it may not necessarily say that in public, but have you done any work on that issue?

Adam Crozier: We have looked at that. In many ways it touches on the point that Archie mentions about the lowest common denominator. As we have reduced our spend on programming, we think that the other broadcasters have fallen down, including the BBC—it is not just the commercial broadcasters. I think it would be fair to say that, because the market is very competitive and you are competing for a share of viewers, if we were to increase our spend on programming and more diverse programming, it is likely that the others would have to spend more also to compete for those viewers. We see that as a very healthy thing and as being good for creative Britain and for export and growth of programmes. I do not see that as a negative; I see it as a positive. As for advertising, it is ITV1 that comes under CRR and ITV1 has a share of commercial impacts of around 27%, down from 41% at the time when CRR was introduced. Of course, Channel 4 is now acting as sales agents to UKTV as well as to its own channels, so its share of commercial impacts is likely to be around 28%. Therefore, it is well able to compete in that marketplace. In fact, its premium price on things like ABC1 adults is not dissimilar to ours.

Lord Razzall: But it is not trying to compete in the same mass market.

Adam Crozier: No, indeed—in around six or seven of the 16 audience markets in which we operate, its premium is higher than ours. We are getting to the point where this is now an extremely competitive marketplace.

Lord Razzall: So if you gave an undertaking on increasing your programming, particularly in the more diverse areas—and I appreciate that you are not committing to that—you think that Channel 4 and Channel Five would be forced to do the same in order to compete.

Adam Crozier: I do not think that they would be forced to, but I think that they would probably want to.

Lord Razzall: But commercially, they would want to.

Adam Crozier: Yes, commercially. The market would find its level, which is right and proper if you want to compete for and win a share of viewing.

The Chairman: You said that that would have a knock-on effect on the BBC.

Adam Crozier: I did, that is right.

Q128 Lord Gordon of Strathblane: This is just a supplementary. You mentioned that your share of advertising revenue was not really keeping pace with your share of impacts. Other people giving evidence have claimed that your premium has actually increased since CRR. Presumably you disagree. Would you tell us why?

Adam Crozier: No, in fact our premium has increased. With ABC1 adults, our premium over the market has increased to around 45%, but at the same time so has the premium for Channel 4, for which it is now 42%. The bigger-reach channels’ premiums have increased, and then you have the newer entrants with very cheap airtime around that. So both statements are correct, but the relative positions have evened out.

Q129 Lord Macdonald of Tradeston: On ITV revenue, you had a bad year last year and a good year this year, and it looks as though a flat year is predicted for next year. With the completion of digital switchover in 2012, what is your forecast for your revenue going forward? I realise that it is a bit market sensitive, but how do you see that going forward in real terms?

Adam Crozier: Let me answer that as best as I can. At the half year, we said publicly that we were around 18% up year on year in terms of revenue. Certainly the market has remained strong in the third quarter, and we are due to report on that in a couple of weeks’ time. What we should not forget, however, is that it is a year-on-year increase on a fairly dreadful year last year. All we have really done is return to 2008 levels. In fact, over the past 10 years, the television advertising market has been in relative decline. The danger is that we look at the market as though there is a moment in time when the digital switchover finishes, because other things are also starting. Along with a number of partners, we have YouView launching next year, with Google TV and Apple TV bringing the internet and television together. That will exponentially increase the amount of channels that people can watch, with video on demand and more a la carte television services as well. Rather than seeing this as an end to one proliferating competition, we are in many ways in the beginnings of the next set of that.

Q130 Lord Macdonald of Tradeston: As a follow-up to Jimmy’s previous question, this is counterintuitive but, if you did not have CRR, you could bring in Melvin’s quality programmes, reduce your ratings perhaps—because that often happens—but then be able to charge enough to compensate to maintain
your revenue. So the fact that your ratings would fall would not mean that your revenue would fall.

Adam Crozier: Not necessarily

Lord Macdonald of Tradeston: Does that still hold as an argument?

Adam Crozier: It does still hold. If you look at all the international comparisons, you can see that advertisers are prepared to pay extra to be able to reach those large audiences in pretty much every country in the world. If you look at cost per thousands, you can see that our cost per thousand has gone down by around 18% on all adults since 2003, whereas the cost per thousand in many other countries has gone up. So we have moved away from the markets in the rest of the world, which puts us at an absolute disadvantage.

Lord Macdonald of Tradeston: If the advertiser wants that fast-build cover that only ITV can give, you can put a premium on that access, which would compensate for the loss of ratings on quality programming.

Adam Crozier: In many ways, that touches on the real disappointment for me as someone new coming into the business. We ended up in a very narrow discussion with the Competition Commission around those fast-build advertisers. The reality is that that accounts for about 1.65% of our revenue, so it is a tiny part of it. Talk about a sledgehammer to crack a nut. You understand that difficulty, which often comes from Sunday newspapers looking to generate a huge amount of PR on a Saturday night for the story the next day.

The Chairman: Do you expand on that in your evidence?

Adam Crozier: Yes, we do. It is a really important part, which I think everyone missed. We ended up down this very narrow route where there are some understandable issues for very particular advertisers that have only a 24-hour or 48-hour period in which to reach as large an audience as possible. But as you will remember from your old roles, if you do not remind me referring to them, most campaigns run over quite a long period of time and that is not how they try to reach an audience.

The Chairman: That leads into your question Lord Gordon of Strathblane.

Lord Gordon of Strathblane: Actually, it has answered it.

Adam Crozier: I am sorry about that.

Q131 Lord Gordon of Strathblane: No, I don't mind. I will ask a different one, if I may. Last week, when people from the Competition Commission were before us, they told us that CRR had been an idea volunteered by ITV. With the benefit of hindsight, do you wish that your predecessors had not volunteered that idea, or was it a good one at the time but the circumstances have changed?

Adam Crozier: The short answer would be yes, of course. I ran Royal Mail in my previous role, which was very heavily regulated, and talked to a number of regulating companies. It is often true, sadly, that the piece of regulation that companies hate the most is the one that they volunteered at some point in time to get something that they thought they wanted. Actually, this market has developed so quickly over the past seven years—and, if anything, the pace is increasing—that the law of unintended consequences is at work. I suspect that there was a deal of sense around it at the time, but right now it does not make much sense at all in the marketplace. That narrow argument about fast build does not even take account of the fact that we are competing with the internet, which we clearly are.

Lord Gordon of Strathblane: To be clear about the previous point, I imagine that your trump card as a sales force is that you are the only medium that can reach quite so many people quite so quickly. That is embarrassing when you are saying that your dominant position is being eroded.

Adam Crozier: I do not think it is. We have to distinguish between a sales pitch and normal business. I have never seen an ad for a VW Golf on television that says, “We're quite good but you should also have a look at Audi”.

Lord Gordon of Strathblane: Yes, that is right.

The Chairman: Yes, you should go to a comparison website.

Adam Crozier: You probably would not sell a lot of VW Golfs, if you said that. Of course, when we are selling, we are absolutely full on in selling mode and say that our airtime is the most terrific airtime in the history of the world, but the reality is that there is now so much choice in the market. I have been a client and run an agency, too, so I have seen all three sides of the business. This idea that we are in there competing for a bigger or smaller share of television money is the road to rack and ruin, because you are just competing in a declining market. The reality is that big-client customers start with a budget that they have to market to their customers and they look for the most efficient way in which to get their message across, including television, print, magazines, the internet, radio, cinema, outdoor and television. They start from there. That is really the market that we want to compete in. Television should be looking to grow the cake, not to cut the cake into increasingly smaller pieces.

Q132 Lord Gordon of Strathblane: To be absolutely clear, and stripping out sales exaggeration, the area where you are still dominant—that is, the fast and
broad reach—you say accounts for only 1.65% of your revenue.

Adam Crozier: Just to be clear, that was for those advertisers who are looking to buy fast build coverage, with 100 TVRs or more over a week. Those campaigns amount to only about 1.65% of our revenue. It is a very small part.

Archie Norman: Can I just add to that? When CRR was brought in, not only did we have a much higher share of viewing than we have today, as Adam said, but the media buying market was very different. Now four media buying agencies account for 72% of the market and those media buying agencies are extremely powerful.

Fru Hazlitt: In 2003, that was 36%. When we look at their position when CRR was introduced, we can see that their buying power was not considerable, but now it is.

Archie Norman: Let us just remember that they are buying for the most part the weight of our advertising on behalf of very large corporations. The big advertisers are people like Reckitt & Colman, British Telecom, Procter & Gamble and so on. Many of those have locked-in contracts that relate to the terms that they got under CRR in 2003 or before that. The result is that those very large advertisers have a competitive advantage against new and smaller companies coming to the market today. So it is not just that we have an extremely competitive market, in which ITV’s so-called dominance has not disappeared completely but applies to only a tiny part of the market, and it is not only that we have four buying agencies accounting for 72%, but we have a major market distortion, which is a distortion in pricing not just for ITV but for our customers.

Lord Razzall: Would this be the time for me to ask the big question, as that has just led into it?

The Chairman: Just ask that and I shall come to the Bishop.

Q133 Lord Razzall: We have had a lot of evidence that, were the Government or Competition Commission minded to lift CRR, they should do so in the context of a complete review as to how advertising is sold. Those of us who for the first time in this inquiry had to get into the mechanism by which advertising was sold were quite surprised as to how it has developed. Does ITV have a view as to whether it would welcome that overall inquiry, or do you think that, were the Government or Competition Commission minded to lift CRR, they should do so by any international comparison. Have you any estimate of what your revenue might have been had CRR not been in place?

Fru Hazlitt: Yes, for those advertisers who rightly say that they spent and still get the same discount. People concentrate on that. What is every bit as frustrating is this: for those advertisers who truly say that they would like to double their spend with us, what can we do? We do not have the discount left to encourage people into the market and to grow the market. It is not just the negative side that is the problem, but the lack of ability to do something positive as well.

Adam Crozier: I believe that Ofcom looked into this earlier this year and concluded that it was not right to do a market review. Although the market looks fairly opaque from the outside, the reality is that those involved in the market know very well how it works. I can vouch for the fact that, sadly, having started in media 25 years ago, I can see it working pretty much exactly the same now as it did then.

Lord Razzall: But you want CRR altered, which you have had for only seven years.

Adam Crozier: We have had it for only seven years. The market is there. Given that it has taken four years to look into only a piece of the market of that size, a market review could take years. Most developments in the television market are going at a pretty electric pace. For all the reasons that I have mentioned, we do not think that a market review would be right.

The Chairman: I think we will take that as a no, but you may have to persuade the Competition Commission.

Q134 The Lord Bishop of Liverpool: You said that the system of advertising was opaque. I think that the average viewer simply would not have any understanding of how advertising is transacted on ITV. Could you be explicit? You talked about four media agencies controlling 72% of the market, so do I take it that you are against that?

Adam Crozier: No, not against it. It is more by way of illustrating what is happening. The question is what has changed since CRR was introduced. Our share of viewing has gone down pretty dramatically and our share of commercial impacts has gone down pretty dramatically. The position of the people with whom we are negotiating has improved dramatically and our competition is now stronger than it ever was. Indeed, there are many more channels and many more forms of media, so the marketplace has changed completely. We have an agency that spends 70% less with us than it did and still gets the same discount; we have advertisers that spend half of what they spend and still get the same discount. People concentrate on that. What is every bit as frustrating is this: for those advertisers who rightly say that they would like to double their spend with us, what can we do? We do not have the discount left to encourage people into the market and to grow the market. It is not just the negative side that is the problem, but the lack of ability to do something positive as well.

Q135 The Lord Bishop of Liverpool: In your evidence, you make the case that CRR has artificially depressed your revenue below the market level and certainly by any international comparison. Have you any estimate of what your revenue might have been had CRR not been in place?
Adam Crozier: Magnus might be able to answer that. If you track the trend that our international competitors are on then applied that to us, I guess you could make a reasonable estimate.

Magnus Brooke: Yes, actual revenue has fallen by 22%, but the Oliver & Ohlbaum report—on the final page of annex 1—sets out an estimate of £262 million. That is a view. This is not an exact science, but that is a figure that it identified.

Q136 The Lord Bishop of Liverpool: If you had had that money, how far up the list of priorities, in relation to unique and diverse programming, would you put regional programming and regional news?

Adam Crozier: Certainly, we would have put programming right at the top of those priorities. ITV has regionality at its heart; therefore, it would be near the top of that list. As many of you will know, we have been struggling to carry on with regional news, which we understand is incredibly important. It is important to our brand and to the plurality of news in the country. We are one of only two broadcasters that do regional news. Obviously, we would like to find a way, through making a commercial return, to being able to continue to do that. We see that as being very important.

Q137 Baroness Deech: Can I clarify one issue? Perhaps Carolyn will know the answer. Somebody says that the continuation of CRR meant that programmes were pushed down to the lowest common denominator. What I do not understand is this: if the restrictions were taken away and you could make a reasonable estimate. That is a view. This is not an exact science, but that is a figure that it identified.

Baroness Deech: So you are saying that if you had more money, you could make programmes that ABC people like us would want to watch.

Adam Crozier: There would be far more diversified programming.

Q139 Baroness Deech: And we are bigger spenders.

Adam Crozier: Yes.

Q140 Baroness Deech: Let us imagine that you are free to have an online auction for advertising, where there is a free market and advertising slots on attractive programmes are transparently auctioned. Do you think that the resulting prices would be higher or lower than those currently prevailing, or about the same?

Adam Crozier: I am not sure that I am able to say. Certainly at the moment, less than 1% of our revenue is generated through ads sold on a spot basis, because most of it is done through agency deals or client deals, but very little is done on a spot-by-spot basis. That tends to be special things such as X-Factor finals or the World Cup.

Q141 Lord Skelmersdale: Is there a reason for that, or is it historic?

Adam Crozier: It is just the way that the airtime marketplace operates and it is primarily based on agency deals.

Archie Norman: Also, the media buying agencies that dominate the market and get the big discounts want to control it that way. The last thing they want, for understandable reasons, is advertisers going direct and buying spot ads.

Q142 Lord Skelmersdale: Can I follow up on that? Mr Crozier, in answer to one of Lord Bragg’s questions, you mentioned moving advertising around programmes. How does that work exactly? I got the impression that advertisers or advertising agencies would know what the programme was.

Adam Crozier: They sometimes do but not always. What they are really buying is access to commercial impacts and an audience. Of course, optimising our ability to deliver the audience that they are requesting for the lowest number of spots is the key to us getting our airtime efficiently used and optimised. Effectively, in those lower rating programmes, we will almost automatically put in less advertising, which of course reduces the return on the investment that they make. Again, it becomes sort of self-fulfilling, if you see what I mean.

Q143 Lord Bragg: I have always been puzzled by this. As I understand it, certain public service programmes, such as Lord Macdonald’s World in Action, were known to get audiences, on the whole,
whose spending power and profile value was calibrated at five times, 500%, that of people watching other programmes. So programmes that got 1.5 million viewers, in a certain way got 7.5 million. Why was that not played through? It has always puzzled me. It should be played through into the advertising market. I cannot work it out. If somebody has five times as much money watching World in Action, why is that not used in advertising? Fru Hazlitt: Two things go on. The media-buying companies will obviously target large audiences but, within that, they will want to target particular audiences. If certain programmes are particularly focused on target audiences that the advertisers are not going for, you will find that the money will not move in that direction. What goes on here is a belief that many advertisers want to target people who have lots of money—you referred to ABC1s. That is true to some extent. However, they fundamentally want to reach people aged 45 and under. That is how the advertising market works.

Q144 Lord Bragg: If I might say so, I think that we in ITV missed a really serious trick. We let ourselves be stuck with that label. We should have looked at segmenting markets inside one area. Look at the FT, for instance. The FT does what it does well. I do not think that the television scene has ever addressed itself commercially to the proposition that there is a collection of different audiences. ITV ought to address different audiences in many different ways and keep all those balls in the air. Unless that is done, I cannot see the abolition of CRR or anything else making much of a difference. Unless that is done, I cannot see the abolition of CRR or anything else making much of a difference.

Adam Crozier: I largely agree with much of what you have said in the sense that, as things such as Freeview and internet television come in, and as data become more important over the next four, five or six years, much more targeted advertising will take place on television. It will go full circle and people will start to be much more interested in which programmes advertisements appear in, as they used to be 10 or 15 years ago. Part of the reason that went away is that, as the media-buying side consolidated and media auditors came in, the buying agencies constantly needed to prove that they were outperforming their competitors. Therefore, being able to measure that became the most important thing—to be able to say, “I can buy this campaign 2% cheaper than my competitor over there”. The problem with the line that you are on is that it became very difficult to quantify from a buying agency’s point of view. How does it prove to its client that it has done a better deal?

Q145 The Chairman: We have to move on now. I want to reformulate the question about the change in terms of trading. Are you saying that an online auction would just not be a practicable way of proceeding as far a change to the way that advertising for your mass-market programmes with large audiences is concerned? Is that a practical way of proceeding?

Adam Crozier: The answer is I do not know. We operate in a much wider market. We sell airtime on the same basis as all of our competitors. Therefore, operating and doing as best we can in that market is the key thing for us. How an auction would work, I do not know. I am not sure that it is an idea we have every really visited.

Q146 The Chairman: So that particular way of operating is not something that you have given any thought to?

Archie Norman: It is not something that we have given thought to and it is not something that we have heard from the customers. I think one of the reasons for that is that if you do an online auction you are effectively asking the advertiser to take a programme risk. So we produce a new programme; they have bought the spot in an online auction and the programme does not do very well, then they lose their coverage.

Q147 The Chairman: Yes, I take your point.

Archie Norman: What they feel they are buying with us is the certainty of impact. That is really what we sell. We guarantee we will deliver you this audience.

Q148 The Chairman: That is how we understand the current system to be, but we looked at other areas, like the Super Bowl and so on, to see whether that was a way of proceeding. There is one other question

Adam Crozier: If I may interrupt. For special events, in some senses, that is what happens.

Q149 The Chairman: That is the model that we have looked at briefly. You seemed to suggest in an earlier answer that removal of CRR might help to raise television’s share of total advertising spend. Did you mean to say that?

Adam Crozier: I did.

Q150 The Chairman: How would that work? What is the economic underpinning for that?

Adam Crozier: If you look across the world, television’s share of the advertising cake has gone up globally by about 10%. In the UK it has actually gone down. So it is perfectly possible to grow television as a share of advertising. The only thing that is different from our market—or one of the
main things that is different—is CRR. We genuinely believe there is an opportunity there. Actually, it is very important that there is because we want to operate in a growth market. We do not want to manage decline; we do not think any of our competitors should want to manage decline; and continually worrying over a smaller or bigger share of a declining market is not a great route for any business.

Q151 Lord Macdonald of Tradeston: This is a complicated issue, but is there any kind of trade-off that would attract you if it was on offer? For instance, until a couple of months ago, you had to sell off all your airtime and now you are able to ration it for the best commercial effect. Would you be prepared to go back to having to sell all your airtime if CRR were lifted?

Adam Crozier: With CRR in place, the change in the rule about withholding airtime does not impact on us at all because, obviously, with CRR there, our job is to continually chase impacts. Therefore, there would be no point in us ever withholding any airtime as it stands now. Were it to go away, yes; I guess that, like any other media owner, we could flex—if we were a newspaper—the numbers of pages we have and the amount of ads we sell, as any other station could. That would be helpful. But, in the end, at the moment we are very focused on the commercial impact side.

Q152 Lord Macdonald of Tradeston: Just a quick supplementary on that: in terms of commercial impacts, do you actually pile up viewers that are not of much value to you because advertisers do not want to buy so many viewers, perhaps, in certain demographics?

Magnus Brooke: Yes, that is an issue. We do partly because you are chasing a mass audience so you are generating lots and lots of repeat audience all the time rather than targeting what advertisers are specifically looking for. So there is quite a lot of wastage.

Q153 Lord Macdonald of Tradeston: So it is not as simple as the idea that high ratings mean high revenue.

Magnus Brooke: It is not as simple as that, no.

Q154 The Chairman: Okay. Thank you.

Q155 Baroness Fookes: Could you have a look at the code which governs the amount of television time allowed per hour for advertisements. Do you have any strong views on that?

Adam Crozier: We have certainly been on the side of believing that the amount of minuteage should be brought down to PSB levels, rather than the other way round. We believe that also rewards the people who are also investing in content as well. So, for a number of different reasons, we would be in favour of it being levelled down.

Q156 Baroness Fookes: Am I right in thinking that the others have nine minutes, roughly, and you have seven.

Adam Crozier: That is correct,

Q157 Baroness Fookes: And you would harmonise it downwards to seven?

Adam Crozier: We would, yes.

Archie Norman: I think harmonising downwards is, firstly, in the public interest because obviously we have better television with less airtime taken up by advertisements. Secondly, it is supportive of the PSBs because it means that our airtime does not get deflated in price because it does not inflate the supply of airtime. Bear in mind that it is the PSBs that supply basically the weight of programme content and the investment in creative Britain.

Q158 Baroness Fookes: Do you feel that this would help with the quality of the programming?

Archie Norman: It would help the quality of the programming, not just for us but across the industry.

Q159 Lord Razzall: Although we do have evidence from the other commercial broadcasters and the satellite broadcasters. They say that harmonising down costs them more money than harmonising up.

Archie Norman: And in all fairness, it probably does cost them money.

Q160 The Chairman: But you would benefit from that?

Adam Crozier: Yes, we would.

Q161 Lord Bragg: You are recommending yet another review led by Ofcom and the Office of Fair Trading. What do you think the new review is going to give to this issue so soon after the Competition Commission published its final report? It seems rather final about it—I happen to disagree with it—but in going for yet another new review at this stage, what new ammo have you got, basically?

Adam Crozier: We have got to remember that they started looking at this in 2006 and that the market has changed fairly demonstrably since 2006, in terms of share of viewing, share of impacts, the effect on advertising rates, changing competition, increasing competition and the internet and television coming together. There is a whole host of reasons why it is perfectly obvious that the market has continued to move on, and at pace. We have obviously put a lot of work into creating the arguments we have around why we think CRR should be reviewed. I think we
need to move away from that very narrow argument, as we mentioned earlier, about fast-build campaigns and actually look at the situation as a whole.

Q162 I agree with you—I think that you are absolutely right—but the problem as it seems to me is that they obstinately have their heels dug in to a remit which is out of date. . . .

Adam Crozier: Indeed.

Q163 Lord Bragg: … and does not work. So the real problem, it seems to me, is how do you get the remit changed—because otherwise they are just going to dig in their heels and say, “That’s how it is; we were designed and set up to do this very, very narrow thing and we want to stick to this very, very narrow things”. That is what we have heard, and it was depressing. It is a question of how we can address this.

Q164 The Chairman: What confidence would you have that a new review would be any broader than the previous one?

Adam Crozier: I think that that is why we believe that part of the solution may be the Government looking at this, potentially through secondary legislation.

Q165 The Chairman: By giving the Secretary of State the power to institute a different type of review?

Adam Crozier: Yes, indeed. Lord Bragg is absolutely correct. The issue with most regulation, of course, is that it all derives from market definitions. In this case, the market definition is an incredibly narrow one and, therefore, in many ways—to be fair to the Competition Commission—they feel hamstrung by having to look at this in this particularly narrow way. So I think the more we can do to broaden out that argument and look at the television industry, and indeed the advertising industry as a whole, the more chance we would have.

Archie Norman: We would argue that the Competition Commission interpreted the arguments extremely narrowly within its remit. We ended up in a vortex where it said, “It’s not the advertising market; it’s the television advertising market”. Then it said, “It’s not the television advertising market, but the large-audience television advertising market within it, which accounts for a tiny proportion of the total. But that is the piece that we are going to base our entire recommendation on”. The other point about this is that we urge you, Chairman, the Competition Commission and the Secretary of State to look at this as an extraordinarily dynamic market. Our concern, because we operate in the world we operate in, is that whatever solution arises will not arise for years to come. Just as the market has changed dramatically since 2006 and since the Competition Commission was taking the evidence, in three or four years it is going to change dramatically again. We can see it before our eyes, as Adam said. Internet television will be a happening thing next year. The pace at which the downloading of films and television products on to iPads and other devices is accelerating is quite extraordinary. We are suddenly competing not just in the UK advertising market but with global competitors. From a national-interest point of view, unless we wake up to this and say that we need broadcasters to invest in UK content and become a global competitor to Google, Apple and others, we are going to end up in this country with diminishing investment in content, declining investment in creative Britain, declining opportunities for our talent and a lot of American broadcasting. I think that I am right in saying that, five years ago, 15% of drama shown in France was American; today it is 50%. Approximately two-thirds of all drama shown in Europe is now American-originated. We have a chance as a country to become a major exporter of content. It can be a great competitive advantage for us, but it makes no sense, when our global competitors have no regulation, to have hamstrung the British industry with outdated regulations that were designed for a previous era.

Q166 Lord Bragg: Do you think that scrapping CRR is the key to unlock this door? If you do, the only pressure that it is possible to exert is through government. The CRR lot will not change. They will say that they have a remit and won’t take off their blinkers. That is my experience.

Q167 The Chairman: I think that that is almost a rhetorical question.

Adam Crozier: I thought that I would just leave it there. It seemed a perfectly good question to me.

Q168 The Chairman: I would love to finish on Archie’s clarion call, but I just want to ask you whether you have a construct in your mind about how the Secretary of State could call this in. Secondary legislation could be put in place, and so on. How concrete is your advice on that?

Magnus Brooke: The Secretary of State could take back responsibility for the undertakings. The undertakings were originally given to the Secretary of State under the Fair Trading Act. In our view and counsel’s view, the Secretary of State could straightforwardly take back responsibility for the undertakings and become the decision-maker in place of the CC. The Secretary of State would then have to have some process for looking at the
undertakings. Our assumption is that it would be a combination of Ofcom and OFT under the existing Fair Trading Act. You could read the remit reasonably broadly—any change in circumstance such that CRR is no longer appropriate. So you could take a broader or different interpretation, not minimising the competition aspect of it but potentially including other relevant considerations and changes in circumstance. We have certainly had advice to that effect.

Q169 The Chairman: Where there’s a will, there’s a way, really?
Magnus Brooke: Potentially.

Q170 Lord Gordon of Strathblane: You do not need legislation?
Magnus Brooke: Yes, you would need secondary legislation for the Secretary of State to get that responsibility.

The Chairman: Having seen “The Social Network” at the weekend, I am reminded that Facebook was founded in 2003, so quite a lot has happened since then.

Lord Razzall: The difficulty that the Secretary of State would have is that he would be doing this in the context of statements by both the OFT and the Competition Commission—that “lot”, as Melvyn described them in a very even-handed way—that there needs to be wider inquiry. He would be ignoring that view. Mind you, by the time this happens, they may be one organisation. But that is their strong view and the difficulty that he would have, I suspect. It is not our difficulty because we say what we want.

The Chairman: Thank you very much indeed. It has been a very helpful session.

Supplementary letter from ITV plc (RTA 20)
During ITV’s appearance before the Committee on 2 November, a number of issues were raised by Committee members on which we thought further information might be helpful, beyond that already presented in our written evidence. In addition, the Committee has also asked us (in a letter from the Clerk dated 22 November—Annex 1) about the current status of the Rules for the Protection of Advertisers. The issues are considered below.

Rules for the Protection of Advertisers
The letter from the Committee Clerk of 22 November asked us to confirm the status of the Rules for the Protection of Advertisers. The proposed rules were submitted to the Competition Commission (CC) towards the end of its review process. In order to even be considered, the proposals had to fit within the narrow remit that the CC had set itself for the CRR review, as well as needing to reflect the CC’s narrow market definition and its view of the market dynamics. ITV sought at all times to engage constructively in the review process, but given our reservations about the approach taken by the CC in these areas we do not continue to support the proposed RPA remedy.

Campaigns requiring Fast Build Coverage/ITV1
The Committee asked about the importance of campaigns requiring fast build coverage and the need for them to use ITV1 and whether specific provisions were needed to protect advertisers who rely on such campaigns for some or all of their products.

Campaigns requiring fast build coverage actually account for a very small proportion of ITV1’s revenues. Short term fast build campaigns (ie campaigns that aim to reach a high proportion of their required target audience in a single week) accounted for just 1.65% of ITV1’s total revenues in 2008.

During the CC inquiry, ITV looked at this issue focussing on the ability of agencies to substitute other channels to build fast build coverage. As well as our technical analysis of the substitutability of ITV1, ITV also employed independent media consultants to look at whether ITV1 was substitutable in practice. The consultants took actual campaigns that had been transmitted and replaced ITV1 broadcast spots with broadcast spots that would have been available on other channels to see what effect this had on coverage and frequency. This was carried out for each of ITV’s six major traded audiences. The test was conducted across all major audiences and during an “unexceptional” time period.

All of the analysis undertaken demonstrated that ITV1 was indeed substitutable and campaign goals could be achieved without ITV1. Committee members raised the example of the advertising of newspaper titles. Not all advertising by newspapers is fast build—like other advertisers they do engage in advertising to build brand as well as normal promotional campaigns, neither of which requires fast build coverage within a single week.
or less. However, it clearly is the case that newspapers also require very rapid build (primarily at weekends) from time to time in advance of Sunday newspaper stories and features. There are two key points to make about this:

— First, as Lord Gordon identified in the Committee’s hearing with the OFT/CC, newspapers never had any choice of ITV company pre-merger since in London (arguably the only place where competition was actually reduced as a result of the merger) the newspapers already had to advertise on LWT which held the Friday peak/Saturday/Sunday Channel 3 licence.

— Secondly, as far as ITV1 is concerned, only around 1% of revenues were the result of the rapid-build coverage weekend advertising by newspapers.

What would be the impact of removing CRR on ITV1’s programming commitments and level of investment?

As we set out in our submission to the Committee other leading free-to-air broadcasters both in the UK and in comparable markets overseas appear to have been able to pass increased costs on to advertisers, who have been willing to pay them. Accordingly, these other broadcasters have sustained their net advertising revenues despite falling shares of commercial impacts in the period between the introduction of CRR in 2003 and the recent advertising recession in 2008. ITV, however, did not, and the independent economic consultants, Oliver and Ohlbaum, estimate that ITV’s revenue in 2007 (pre-recession) was £262 million less than in 2003 as a result of CRR.

Despite circumstances of rising costs and declining revenue, ITV still sought as far as it could to maintain its programme budget. Even during the recent recession, ITV sacrificed profit in order to defend its programme investment as far as possible. Given the intense competition we face for the time and attention of viewers from the BBC, Channel 4, Sky, numerous multichannel operators and online content providers, ITV has no choice but to invest in programming if we are to attract viewers and therefore advertisers. The more we invest the more successful we should be, provided that we make the right programme choices.

This conclusion is borne out by ITV’s delivery on screen. In 2009, 87% of ITV1’s schedule was made up of original UK productions over the whole day, rising to 96% in the peak time hours. This significantly exceeds our regulatory obligations (which require ITV1 to fulfil all-day and peak time original programming quotas of 65% and 85% respectively).

Overall levels of originated content on ITV1 today are probably higher than in earlier decades, when US drama in particular was often shown in peak time on leading channels such as ITV1 and BBC1. But though the quantum of original material is high, it is less diverse than it was a decade ago. Today, ITV has every incentive to invest more in a diverse range of content; our advertisers and viewers demand it. But we have to know that, if we do, we can make an acceptable rate of return. The fundamental problem under CRR is that, compared to mass-audience entertainment programming, areas such as current affairs or drama do not maximise the audience overall and therefore under the CRR mechanism are relatively unattractive and unprofitable programmes for ITV.

ITV’s competitive advantage is in making and exploiting attractive TV content. This underpins our overall strategy for ITV (confirmed in a recent strategy review) which we have presented to our investors and is strongly supported by them. We have set out a long-term strategy to build the company centred on investment in UK content, owning the rights to that content and exploiting it internationally. We are currently in the process of focussing the company on this core shared objective. So, for instance, we have set up share of viewing as one of the key metrics of success for the company as a whole and to maximise our share we will have to continue to invest heavily in the best programmes.

In short, if ITV does not maximise its investment in compelling content then we will jeopardise our future success, since in a crowded digital market place we depend on developing a steady stream of attractive UK content.

What would be the impact of lifting CRR on other broadcasters?

There is clear evidence that the UK television market overall has been out of step with other comparable developed television markets in the past six or seven years. In particular, the adult Cost Per Thousand (CPT—a standard comparator of airtime prices) in the UK declined by 15% between 2003 and 2008 whereas it grew in other major TV markets (until the recession hit). In addition, TV’s share of UK advertising has fallen since 2003 whereas it has risen in some other markets (and in others has not fallen to the same extent as in the UK). Clearly the rise of digital, multi-channel television has significantly increased the number of commercial impacts in the market in the UK. However, this cannot be the whole story since there has been an expansion in impacts in other markets too.
The challenge perhaps is to identify reasons why the UK might be different amongst international TV markets. There would seem to be three obvious factors:

— First, the internet has grown exponentially in the UK from 3% of total advertising revenue in 2003 to 24% of all advertising revenue in the first half of 2010—the highest share of any major market in the world.

— Secondly, the market leader in TV (ITV) has suffered year on year reductions in revenue commitments from advertisers (to a significant extent because of CRR) which standard economics suggests would lead overall market prices downwards compared to where they would otherwise be.

— Thirdly, the overall attractiveness of TV as a platform for advertisers is also likely to be affected disproportionately by the perceived health and investment level of the market leader, particularly in circumstances where there are alternative platforms for advertisers.

Isolating the existence and effect of these factors is difficult with any degree of accuracy given the number of variables in the market. However, they seem to have had a negative effect on the TV advertising market in the UK. In their appearance in front of the Committee, the team from Five seemed to accept that CRR might have caused some price deflation in the UK.

The choice for UK broadcasters is whether to accept the broader decline in the UK TV market as inevitable and continue to see it as a zero-sum game involving a shrinking TV revenue pot, or whether to fight back and try to grow the market, winning back revenue that is migrating online. CRR is a significant barrier to doing this given the focus it puts on Share of Broadcast as a key metric for ITV and therefore its key competitors. ITV was encouraged by what Channel 4 new Chief Executive, David Abraham, said in this regard in front of the House of Commons Culture media and Sport Select Committee in July:

“I am very much a glass half full person with regard to the power of television, particularly the creative power of television produced in this country based on powerful ideas…but I would say that the way in which we trade our medium, the way in which it is packaged and provided to advertisers, is inevitably going to evolve in the next three to five years given what is happening technologically. I believe it should be possible for television as a medium to become more responsive to the power of the Internet and for us to have a message to advertisers in which we are competing more effectively with many of the alleged benefits of Internet advertising.”

ITV agrees, but with CRR, protected contracts, and an automatic ratchet still in place it is very difficult for ITV to change the way it operates in the advertising market. This inhibits our capacity to innovate and drives ITV into a broadcast trading model that belongs more to the analogue than the digital age. We believe that all the main broadcasters have an opportunity to benefit from the removal of CRR.

CRR was primarily designed in 2003 to protect advertisers, not other broadcasters from competition from ITV1. Today the position of Channel 4 is greatly strengthened:

— Following the recent deal with UKTV, Channel 4 now has as much as 28% of television advertising sales, a strong position in any competition assessment.

— Both Channel 4 and Five were able to sustain their net advertising revenues following the introduction of CRR (at least until the recession in 2008/9) despite experiencing a declining share of commercial impacts. Whereas, as a result of CRR, ITV’s revenues have fallen in line with our SOCI decline.

— Channel 4 has grown its premium in key demographics much more rapidly than ITV1. For ABC1 adults, for instance, Channel 4’s premium was 23% of ITV1’s in 2003; by 2010 Channel 4’s premium for this group was broadly comparable to ITV1’s.

Finally, declining revenues, reduced profitability and falling investment in programming at ITV have led to reduced pressure to invest in original content across the market. Stronger competition and increased investment by ITV would be likely to drive content investment upwards to the benefit of viewers of all the Public Service Broadcasting channels.

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4 House of Commons, minutes of evidence, taken before Culture, Media and Sport Committee, Channel 4 Annual Report, Wednesday 28 July 2010.

5 The decline in investment in first run originations on ITV1, BBC1 and Channel 4 is documented in Ofcom’s Public Service Broadcasting Annual Report 2010 p 6.
What is the process for reopening the issue under the Secretary of State?

CRR forms part of the merger undertakings given to the Secretary of State (SoS) in 2003 following the Carlton Granada merger. The merger was reviewed under the Fair Trading Act 1973 (FTA) and the undertakings were accepted by the SoS under section 88(2) of the FTA, following a reference to the CC. Under Section 88 of the FTA the power to vary merger undertakings rested with the Secretary of State. Paragraph 16 of schedule 24 to the Enterprise Act 2002 however enables the SoS to transfer to the CC the power to vary or remove merger undertakings accepted under section 88 of the FTA. This transfer is effected by the SoS specifying the relevant undertakings in an order made by statutory instrument.

CRR was specified for these purposes (by the Enterprise Act 2002 (Enforcement Undertakings and Orders) Order 2004) and decisions on whether CRR should be varied transferred across to the CC. Although it is difficult to be definitive (because there is no single accurate record of undertakings still in force and not transferred to the CC), there appear to be a number of FTA undertakings that still remain with the SoS and which have not been transferred to the CC. These include the Fosters/Scottish and Newcastle undertakings from 1989, Stagecoach/Formia from 1993, or Service Corporation International/Plantsbrook Group from 1996. Moreover, in recent years the Secretary of State has carried out his own review of merger undertakings from at least one historic local newspaper merger as well as from the acquisition of Plessey by GEC (a merger which had defence implications).

Under Section 14 of the Interpretation Act 1978 the Secretary of State has the power to revoke or amend (by order) the relevant secondary legislation that transferred power over CRR to the CC. Speaking on behalf of the Government in a debate on the Digital Economy Bill on 15 March, Lord Davies confirmed that:

“The Secretary of State already has a power under the Interpretation Act to amend or repeal orders, such as the order specifying and transferring the CRR undertakings to the Competition Commission”.

We enclose a copy of the letter from Lord Davies to Baroness Bonham Carter (Annex 2) confirming the government’s position subsequent to the House of Lords debate on 15 March.

If the power to revoke the order transferring responsibility to the CC was exercised by the Secretary of State (via an order subject to negative resolution procedure) then the power to review CRR would return to the Secretary of State. This is the case since the scheme of the Enterprise Act 2002 is based on the review power being exercised by the Secretary of State or the CC so if the power of the CC is revoked then the power naturally returns to the Secretary of State.

In ITV’s view, there are two key reasons why it would be appropriate for the Secretary of State to take back responsibility for the undertakings:

— First, the pace of change in the media market is such that a further review on the timetable of the recently concluded CRR review process (around four years from the first request for a review) risks significant adverse effects to the UK media industries as a result of a remedy that is no longer required. Even since the CC concluded its inquiry the move to connected TV in the UK has assumed its own dynamic with the announcement of the launch of Google TV, Apple TV, Sky Anytime+ and YouView this year and next.

If he had responsibility for the undertakings the Secretary of State could decide to commence a review straight away and could be expected to make a decision much more quickly than the CC following advice from OFT and Ofcom. In this context it is important to note that the recent announcement by BIS of proposals to merge the functions of the OFT and CC appears to be driven in part by the perception that inquiries conducted by OFT and CC have taken too long.

— Secondly, it is clear that there is no consensus between the different regulators who have looked at CRR as to what should be done. So, for instance, in Ofcom’s report to the OFT and CC during the recent CRR review Ofcom concluded that “Given the decline in ITV’s market position since the merger in 2003, Ofcom does not believe that retaining the undertakings in their current form is appropriate”. Even the OFT in its advice to the CC concluded that a less burdensome remedy might effectively address any remaining concerns.

6 See the BIS decision in relation to the Nottingham Evening Post in relation to the request to release conditions imposed on owner Northcliffe. Consultation August 2009; decision Jan 2010.
What is ITV’s view about the levelling up or down of advertising minutage under the COSTA rules and how would viewers react to a change in minutage?

For the avoidance of doubt, ITV supports a levelling down of the amount of permissible advertising minutage across the market to the current level of the PSBs. This would involve a reduction in minutage for the non-PSB broadcasters from the current permitted average of nine minutes per hour to an average of seven minutes per hour with the additional limit of eight minutes per hour from 6.00 pm to 11.00 pm each evening. Independent modelling by Analysis Mason and Brand Science for Ofcom (published in March 2010) suggested that this levelling down would have an appreciable positive impact on the revenue of each of the PSB channels (but only 2% decline in revenue for non-PSB channels).

By contrast, the Analysis Mason work also showed that levelling up so that the PSB minutage would increase to non-PSB levels would have a very significant negative impact on the revenues of the PSBs. The work also showed that even meeting midway (involving some levelling up for the PSBs and some levelling down for the non-PSBs) had a negative impact on the revenues for ITV1 and Channel 4.

ITV is pretty clear that a reduction in overall advertising minutage (from levelling down) would also be welcomed by viewers. We know from our own experience that ITV1 faces its stiffest competition for viewers from ad-free BBC1—as is illustrated most graphically when the two channels simulcast major sports events. So, for instance, when both broadcasters showed the World Cup final earlier this year ITV1 attracted 11% of the audience compared to BBC1’s 48%. Any increase in advertising minutes in like-for-like programming would risk driving viewers across to the BBC. In this context, the amount of advertising already carried on ITV1 has, for instance, been the subject of negative press comments in the context of the recent screening of Downton Abbey—a genre of programming where ITV faces particularly stiff competition from the BBC.7

Is the differential in advertising minutage between PSBs and purely commercial multichannel operators simply part of the way in which PSBs pay for their privileged status?

This might have been the case many years ago when the policy imperative was to encourage new entry by multichannel operators in order to offer competition to incumbent PSBs (who benefitted from the very significant implicit subsidy of analogue spectrum). However, clearly those days are long gone. The UK has now almost entirely switched to digital television and it is very clear from the work that Ofcom has done in recent years that the value of the ITV PSB licences is much diminished. Ofcom’s last statement in this area was contained in its public response to the DCMS consultation on IFNC’s (published 22 September 2009). The Ofcom consultation response noted that:

“We estimate that the Channel 3 network is likely to be in deficit by 2011, and the deficit will reach £38–64 million in 2012” (p 7)

This deficit figure may be a little lower now given the recent announcement of the abolition of the remaining licence fees that ITV pays to government for its PSB licences but the savings involved (circa £8-9m next year) would not by any means eliminate the structural deficit in the licences. Despite the deficit in our licences we have, as I mentioned above, done all we can over the past few years to maintain our investment in original UK content.

I hope this additional information is helpful to you and your committee members in their deliberations. Please do not hesitate to contact me if you require any further detail or clarification during your inquiry.

2 December 2010

Annex 1

Letter from the Clerk of the House of Lords Select Committee on Communications to ITV plc

The Committee was pleased to hear evidence from Mr Norman and Mr Crozier on 2 November.

Since that evidence session the Committee has had the opportunity to consider the Rules for the Protection of Advertisers which ITV submitted to the Competition Commission earlier this year.

7 See for instance “How ads put a downer on Downton Abbey”—Stephen Armstrong, Guardian 28 September 2010 or the letter to the Sun from a viewer published on 29 September 2010 praising the programme but saying that “But I’m not looking forward to the six commercial breaks”.

Please would you confirm the status of the proposals and the current management’s opinion of them?
I would like to take this opportunity once again to thank you for your contributions to the inquiry.
22 November 2010

Annex 2

Letter from Rt Hon the Lord Davies of Oldham to Baroness Bonham-Carter of Yarnbury

DIGITAL ECONOMY BILL: CONTRACT RIGHTS RENEWAL

I gave you my assurance during Report Stage of the Digital Economy Bill on 8 March that the Government would look seriously at your concerns and those voiced by others regarding the Contract Rights Renewal (CRR) undertakings. Further to my letter of 10 March 2010, I am now writing to provide you with details of the steps the Government intends to take to address the issue.

As I noted in my previous letter, it was after substantial debate and consultation that Parliament voted to introduce the current competition regime through the Enterprise Act. A fundamental feature of the regime is that competition decisions are taken by independent competition authorities free of political lobbying. We need to take care not to undermine that principle.

The Government already has the power under the Interpretation Act to revoke the order transferring the CRR undertakings to the Competition Commission as the amendment tabled at Report sought to achieve. We will, as I assured the House in the debate at Report Stage, consider whether there are circumstances in which the Government might want to exercise such a power. However, in the meantime, we maintain that juridical review is the appropriate route for any challenge to the Competition Commission’s forthcoming decision.

I am copying this letter to those who spoke in the debate at Report, Lord Gordon of Strathblane, Lord Fowler, Lord Dubs, Lord Puttnam, Baroness Howe of Idlicote and Lord de Mauley; and to Lord Howard of Rising, Lord Razall, Lord Clement-Jones, the Earl of Errol and Baroness Young.

16 March 2010

Memorandum by the Satellite and Cable Broadcasters’ Group (RTA 8)

The Satellite and Cable Broadcasters’ Group (SCBG) is the trade association for broadcasters who are independent of the main terrestrial broadcasters in the UK. Its members are responsible for over 100 multi-platform services and channels within the UK and beyond.

SCBG channels provide citizens and consumers with programmes and services for a diverse range of audiences across a wide range of genres and audiences, including entertainment, factual, sport, education, history, music, nature, art and science. Our member companies commission and produce thousands of hours of original programming per annum and make a healthy and positive contribution to the Public Service contribution including news, sport, drama, arts, natural history, children and young people, and for ethnic minorities in their own languages. Their services are available in over 90% of UK homes.

According to a 2008 Deloitte study, SCBG broadcasters made a total economic contribution to the UK economy in 2007 of over £2.2 billion and employed 24,000 full time equivalents. They operate in an extremely competitive and volatile environment, without privileged access to scarce Government-controlled spectrum or the must-carry status afforded to terrestrial networks.

SCBG members are Bloomberg TV, BSkyB, Chinese Channel, CNBC, Discovery Networks, Fox International/National Geographic, Living TV Group, NBC Universal, QVC, SBS, Teachers TV, Turner Broadcasting, UKTV, Viacom (MTV, Comedy Central, Nickelodeon), the Walt Disney Company.

EXECUTIVE SUMMARY

1. SCBG believes that the question of “public interest” in relation to the TV advertising market is much wider than “public service broadcasting” and the effect that CRR has on ITV. We believe that the Committee should broaden its considerations to explore how the UK can develop a regulatory framework that enables an open and competitive broadcasting market, where all UK-licensed broadcasters are incentivised and able to invest in the widest range of programming to the benefit of viewers. It should also consider how to ensure that the UK’s competition regime remains completely independent and free from political intervention.
2. As stakeholders debate these issues, it is essential to recognise that some of the proposed changes that are being presented as “deregulatory” are in fact “re-regulatory”: instead of liberating all broadcasters to invest and innovate, they simply recalibrate the rules to favour some players over others. Not only do such regulatory changes unjustifiably advantage legacy providers, who already benefit from a raft of privileges (EPG status, must-carry status etc), but they will ultimately lead to a narrowing of competition and the range of programming available to viewers.

3. As the cyclical downturn comes to an end and the TV advertising market recovers, SCBG believes that television remains a powerful advertising medium capable of funding high quality content, provided that the existing remedies preventing adverse effects remain in place.

4. CRR is not responsible for the challenges facing PSBs and the wider creative industries. CRR is a necessary merger remedy that must remain in place to ensure fair competition:
   - As the expert and relevant authority, the Competition Commission concluded that although market conditions have changed dramatically over the last decade, “ITV1’s enhanced market position was still sufficiently strong that absent appropriate remedies it would have an adverse effect”.\(^8\)
   - Not only is ITV still the most dominant player in the market, but ITV1’s premium has actually increased since CRR’s introduction in 2003, so its relative position in the market has actually strengthened.
   - While ITV did suffer a significant drop in advertising revenues during the industry-wide downturn, its dominant market position enabled it to, in its own words, “outperform the market”.\(^9\) On the back of this resilient performance, ITV stands to be the major benefactor of the recovering TV advertising market, with analysts predicting an 11.5% increase for ITV this year.\(^10\) ITV’s financial future therefore looks to be increasingly healthy, meaning it is well placed to invest in quality content, which it is commercially incentivised to do regardless of its PSB status.
   - As the CC explained, where ITV has suffered financial losses and other challenges, a combination of management decisions, the global recession and a number of other factors are to blame, not CRR as ITV has claimed.
   - It is also misleading to equate CRR with wider challenges in public service broadcasting and the creative industries. In fact, the removal of CRR would gift additional revenues to a financially resurgent ITV at the expense of all its smaller competitors who would consequently be less able to invest in programming, with viewers the ultimate losers.
   - In addition to damaging competition, any interventions to over-rule the CC would also damage the merger regime itself. Amending the Enterprise Act to remove CRR would represent the abandonment of due, independent process free from political intervention.
   - Given the interconnection between CRR and other advertising regulations (ie COSTA and ASR), and the distortive effect that an unjustified amendment to a merger remedy would have on competition within the market and the balance of the regulatory ecology itself, it is essential that questions about CRR are posed in the appropriate merger and competition-based context.

5. SCBG is also very keen to draw the Committee’s attention to Ofcom’s proposed harmonisation of advertising minutage through its upcoming COSTA review:
   - Ofcom says it has a predetermination for harmonisation because it is concerned about “one or more of the commercial PSBs surrendering their [PSB] licences”.\(^11\) We do not believe it is appropriate to use a narrow regulatory review of minutage to address broader policy questions about PSB funding.
   - We disagree with Ofcom’s other justifications for harmonisation: that it would be “deregulatory” harmonisation is another example of re-regulation with rules simply adjusted to favour different parties—and that it would fix an “unlevel playing field”—rather than neutralising an imbalance, harmonisation would create a new one by enabling PSBs to derive additional benefit from their privileged status without a commensurate increase in their public service obligation.
   - Harmonisation of minutage would result in considerable, market-reshaping losses for commercial broadcasters, with around £80m being transferred to PSBs per annum.\(^12\) Such losses would force commercial players to scale back significantly on their content investment and may result in some niche channels having to close or relocate.

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\(^9\) [http://www.itvplc.com/media/newsrelease/?id=35840](http://www.itvplc.com/media/newsrelease/?id=35840)

\(^10\) [http://www.guardian.co.uk/media/2010/mar/30/analysts-television-market](http://www.guardian.co.uk/media/2010/mar/30/analysts-television-market)

\(^11\) [http://stakeholders.ofcom.org.uk/binaries/consultations/rada08/statement/costa.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/rada08/statement/costa.pdf)

\(^12\) Ofcom’s Proposals on Changes to RADA, a report for SCBG by Oliver and Ohlbaum Associates, May 2008.
6. In summary, SCBG’s two key messages to Committee are that:

— discussions about COSTA and CRR should not be taken in isolation or indeed ahead of the Communications Bill scoping exercise because of the high degree of interconnection between the advertising regulations themselves, and to broader issues such as the funding of PSB content and competition.

— neither COSTA or CRR represent true “deregulation”, as they merely advantage one part of the broadcasting sector over another, thereby reducing competition and the incentives for all players to invest in content to the ultimate benefit of viewers.

INTRODUCTION: PUBLIC INTEREST, APPROPRIATE REGULATION AND A NEW COMMUNICATIONS BILL

7. In the Committee’s Call for Evidence the issue of “the extent to which current arrangements reflect the public interest” is the last listed topic. However, SCBG believes that the question of “public interest” should be the starting point for any discussion about the appropriateness of the current regulatory framework for television advertising. While there is often a tendency in broadcasting policy discussions to equate “public interest” with “public service broadcasting” and more specifically (with reference to the CRR mechanism) the financial health of ITV, SCBG urges the Committee to consider this notion in a much broader context. Indeed, there is support for this in the Digital Economy Act 2010, which now requires Ofcom to consider the extent to which material included in media services (ie not limited to PSBs) contributes towards the fulfilment of the public service objectives.

8. The UK is entering a crucial time in media and broadcasting policy: we are rapidly approaching digital switchover; current PSB licences are due to expire in 2014; IPTV and web-based audiovisual services are on the verge of becoming mainstream; the market is rapidly consolidating and broadcasters are diversifying their revenue streams, just as a new government has come to power. We expect DCMS’ scoping exercise into a new Communications Bill to be wide ranging and future-proofed, recognising the broader “public interest” remit.

9. The Bill scoping exercise is likely to consider a number of issues that will be debated within this inquiry, as well as many wider but connected issues such as public service content, competition and the role of the regulator. We believe this process offers an invaluable opportunity to debate the evolution of the UK broadcasting sector in the widest possible context. We therefore strongly believe that the issues considered by this inquiry should be taken in this context and not in advance or in isolation, so that they do not preclude these important discussions.

10. We believe the following market and policy characteristics to be in the “public interest” as we enter a new era of UK broadcasting:

— An open and competitive broadcasting market, where all UK-licensed broadcasters, including those who do not have a public service remit, are incentivised to invest in the widest range of programming, catering to diverse consumer tastes in the interest of plurality and choice. This range includes high-quality content that could be said to fulfil a “public purpose”, as well as the full breadth of genres that meet both mass and niche audience needs;

— A competition-based merger regime that continues to be consistent and free from political influence; and

— A coherent, holistic vision within Government for the way in which the UK broadcasting market should evolve in a changing media and technology landscape, and a regulator that implements these policies through regulatory decisions that flow logically from that vision.

11. We do not believe the following scenarios to be in the “public interest”:

— A competition regime that is not independent from political groups and whose decisions can be overturned by politicians;

— Regulatory decisions that are taken in a piecemeal and short-term fashion, without reference to or consideration of the wider public policy or market impact; and

— A policy and regulatory framework that continues to favour and empower legacy PSB broadcasters and which hinders commercial broadcasters from investing in content.

12. The Committee’s Call for Evidence asks seeks views on the “appropriate level of regulation” for the TV advertising market. There has been much talk in recent months about “deregulation” of the broadcasting sector. While we would not argue against deregulation in principle, it is essential to recognise that many of the
changes that are being proposed as “deregulatory” are in fact “reregulatory”: rather than removing unnecessary regulation in order to liberate all players to invest and innovate, they simply recalibrate the rules to favour some players over others by triggering a transfer of costs and obligations, something that will ultimately lead to a narrowing of competition and the choice of programming available to viewers.

13. We would therefore urge the Committee to consider how the so-called “de-regulatory” proposals that will be discussed as part of this inquiry impact the whole of the broadcasting market over the long term, and not just how they assist specific players in the short term.

14. It is these convictions—regarding “public interest”, “de-regulation” as opposed to “re-regulation” and the danger of considering the various interconnected elements of advertising regulation in isolation—that have guided SCBG’s response in the remainder of this document. We look first at the contribution that commercial broadcasters make to the broadcasting sector and the importance of considering the impact of regulatory changes on these players; we then look briefly at the prospects for the advertising-funded model and the effect of the liberalisation of product placement rules; and finally we examine two proposed regulatory changes—to CRR and COSTA—and argue that rather than helping to tackle the challenges the industry is facing, they would reduce competition, choice and plurality.

About the commercial TV sector

15. The Committee’s Call for Evidence refers to the impact that the current regulatory framework for TV advertising has on public service broadcasting. However, it is vital to acknowledge that ITV, Channel 4 and 5 (and their portfolio channels) are not the only players in today’s UK TV landscape. Crucially, as we enter a debate about the next decade of UK TV, it would be a mistake not to take into account the current and potential contribution of the full range of UK-licensed broadcasters when discussing potential regulatory change. It is therefore worth briefly reiterating the role that those commercial broadcasters play in today’s television ecology in order to underline why they are a crucial part of this inquiry. Throughout this response we refer collectively to broadcasters who operate a PSB channel (ITV, Channel 4 and 5) and their portfolio channels (ITV2, More4, Fiver etc) as “PSBs”. We refer to those broadcasters who are licensed in the UK but do not operate a PSB or PSB portfolio channel as “commercial broadcasters”.

16. Commercial broadcasters:

— . . . had a 28.4% share of viewing in 2009,13 rising 0.2% from 2008 for the first year since 2003 when the PSB portfolios began to grow their share of the audience14—they therefore represent a substantial proportion of the whole broadcasting sector. . . .
— . . . spent £2.6bn on programming in 2009 in the eight key genres,15 a 6.7% increase on 2008. . . .16
— . . . made the biggest increase in content spend of all broadcasters17 in 2009, investing £755m, up 13% on the previous year. . . .18
— . . . took 14.6% of total UK TV industry revenue in 2009 (£1.619m from £11.109m) down 6.2% on the previous year19 and had a 25.1% share of NAR (Net Advertising Revenue) in 2009, down 1.8% on the previous year. . . .20
— . . . made a total economic contribution to the UK economy in 2007 of over £2.2 billion. . . .21
— . . . and employed 24,000 full time equivalents, comparable to the value add and employment contribution Channel 4 is estimated to have made to the UK in 2007.22

17. Commercial broadcasters are responsible for an increasing range of high-quality original UK content, including:

— History programming such as Channel Islands at War, Dunkirk—Forgotten Heroes, First day of the Blitz, Heroes of Biggin Hill, Colditz the Legend (UKTV’s Yesterday);
— Music programming from MTV, who will broadcast this year’s MTV European Music Awards live from the Spanish capital across MTV’s global network on 7 November;

13 In multichannel homes (which, according to BARB, make up 91.6% of all homes with televisions).
14 Ofcom’s Communications Market Review, August 2010.
15 Sports, entertainment, film, news, factual, children’s, leisure and music.
16 Ofcom’s Communications Market Review, August 2010.
17 Excluding film and sport channels.
18 Ofcom’s Communications Market Review, August 2010.
19 Ibid, in terms of the share of NAR—commercial broadcaster were down 2.7% from 2008 to 2009 in real terms, 20 Ibid
20 Ibid
22 PWC estimated that “the overall economic impact of Channel 4 could be worth up to £2bn in UK Gross Value Added in 2006, and could support 22,000 jobs, spread across the regions in the UK economy”. http://www.pwc.co.uk/pdf/pwc—Cb4Report—may07.pdf
19. However, the prospects for TV advertising appear to be very positive. A recent PwC study estimated that between 2009 and 2014 UK TV advertising will experience an impressive compound growth rate of 5.1% per annum. This will result in TV’s share of the advertising market growing from 36% to 37%. PwC find that, contrary to some concerns, TV advertising is not significantly affected by the growth on the internet because 70% of online advertising spend is search, with only pre- and post-roll advertising and display competing directly with TV advertising. This part of the internet market remains relatively small at just £100m per annum. Importantly the audiovisual richness of television advertising, as well as its ability to reach mass audiences, continues to be of distinctive appeal to advertisers. These qualities should enable television to compete with the internet and other media for advertising in the medium-term and we therefore remain optimistic about advertising’s role in the future of television funding.

20. The partial removal of product placement restrictions under the EU’s AVMS Directive was a welcome example of appropriate amendment to regulatory practice. This liberalisation means that EU-based broadcasters have gained the opportunity to secure additional revenue with which to commission and acquire high quality content. We were, however, disappointed that the previous UK government chose to go much further than the AVMS Directive to limit the range of products and genres in which placement can be employed, thereby restricting the revenue generation opportunities open to UK-based broadcasters. It is therefore essential that Ofcom does not introduce further restrictions as it adapts its Broadcast Code.

21. In terms of the financial impact, as the Committee will be aware that predictions about the potential value of the UK product placement market vary widely although it is crucial to bear in mind that the existing PSBs stand to gain most from these changes, given their dominant market positions. However, while product placement is unlikely to represent a panacea to the challenges facing the spot advertising model, the importance of revenue diversification is clear, as proved by the market for sponsorship which Ofcom says generated £189m in revenues in 2009 following the liberalisation of relevant regulation. SCBQ therefore supports the opportunity that product placement liberalisation represents, and asks the Committee to support a flexible regulatory regime which is grounded in the understanding that broadcasters are incentivised to maintain editorial integrity and viewer trust at all times.

24 http://stakeholders.ofcom.org.uk/binaries/research/cmr/753567/CMR—2010—FINAL.pdf

THE PROSPECTS FOR THE ADVERTISER-FUNDED BROADCASTING MODEL

18. Television advertising has gone through a difficult period with the recession exacerbating the situation. We consider there to be a number of factors likely to have contributed to that decline, ranging from the steady increase in supply, to increased buyer power (at least in so far as sales houses other than ITV are concerned) and potentially also to the growth in online advertising. The impact on television advertising of online advertising (which is in abundant supply, is measurable and relatively cheap), has probably been greatest in respect of Direct Response TV advertising (“DRTV”, involving specific calls to action, like dial a number to receive an offer), which accounts for a small part of the TV advertising market.

19. However, the prospects for TV advertising appear to be very positive. A recent PwC study estimated that between 2009 and 2014 UK TV advertising will experience an impressive compound growth rate of 5.1% per annum. This will result in TV’s share of the advertising market growing from 36% to 37%. PwC find that, contrary to some concerns, TV advertising is not significantly affected by the growth on the internet because 70% of online advertising spend is search, with only pre- and post-roll advertising and display competing directly with TV advertising. This part of the internet market remains relatively small at just £100m per annum. Importantly the audiovisual richness of television advertising, as well as its ability to reach mass audiences, continues to be of distinctive appeal to advertisers. These qualities should enable television to compete with the internet and other media for advertising in the medium-term and we therefore remain optimistic about advertising’s role in the future of television funding.

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24 http://stakeholders.ofcom.org.uk/binaries/research/cmr/753567/CMR—2010—FINAL.pdf
CRR AND ITV'S MARKET POWER

22. Following a comprehensive review, the Competition Commission (CC) published its final conclusion on the review of CRR on 12 May 2010, ruling that the definition of ITV1 should be extended to include ITV1+1 and ITV HD, but that the mechanism itself should remain because of ITV's continuing market power, as created by the merger between Carlton and Granada in 2003. Indeed, the CC reached its conclusion that CRR should remain because:

— “ITV1’s ability to reach mass audiences allows it to deliver many campaigns’ objectives more effectively than other commercial channels”;

— “agencies cannot threaten credibly to remove all their expenditure from ITV1”; and

— “[due to] ITV’s very strong negotiating position. . . in the absence of the CRR remedy, the ability to run some individual campaigns without using ITV1 would [not] act as an effective constraint on ITV”.26

23. Despite the CC’s clear decision that CRR should remain, calls for the further adjustment or removal of CRR continue to be made, something which is underlined by the prominent position that CRR has been given in this very inquiry.

24. SCBG has two key messages in relation to the continued speculation about the removal of CRR. Firstly, SCBG believes that any decision regarding a merger remedy, such as CRR, needs to be considered by the competent authority, in this case the CC. Given the CC’s recent ruling, SCBG strongly believes that CRR needs to remain in place and that the justifications that have been given for the removal of CRR are unfounded.

25. Secondly, it is crucial to acknowledge that there is a high degree of inter-connection between CRR and the other regulatory changes that will be discussed in this inquiry, as well between advertising regulation and wider issues relating to PSB funding and competition, and that they cannot therefore be considered in isolation from each other.

ITV REMAINS BY FAR THE STRONGEST PLAYER IN THE TV ADVERTISING MARKET

26. Many anti-CRR proponents have argued, as Lord Fowler did during the Digital Economy Bill debate, that since CRR was first introduced in 2003, when it was “a different age [and] when ITV was a major player”, “the advertising market has completely changed” because “the number of digital households has more than doubled to 90% and there has been an explosion of new digital channels”.27 This analysis of the growth of the television market and the subsequent audience fragmentation is correct, as the CC itself testifies.28

27. However, it is wrong to assume that these changed market conditions have weakened ITV’s market power. To the contrary, ITV1’s relative position in the market has actually strengthened rather than diminished compared to its competitors over time. The CC concluded that ITV1 retains a unique ability to deliver mass audiences. Indeed it accounts for 98.2% of the top 1000 most watched programmes on commercial television for all adults, compared with 93.3% in 2002 (before CRR).29 This mass-market appeal makes ITV1 unsubstitutable for advertisers. In a world where the proliferation in channels has lead to audience fragmentation, ITV1’s unique ability to deliver mass-audience airtime gives it even greater market power than when Granada and Carlton merged seven years ago.

28. ITV’s resulting position as the major player in the TV advertising market is seen in the fact that even though ITV1’s SOCI has fallen since 2003 it has, according to the CC, “remained by far the single largest commercial channel in terms both of SOCI and share of NAR”.30 This increased dominance is also reflected in both ITV’s latest financial figures, which reveal that even though ITV1’s SOCI fell 4% in 2010H1, its advertising revenues were up 18%, 3% ahead of the total market31 and in its premium, which has “increased from 1.18 in 2003 to 1.34 in 2009 despite the CRR being in place”:32 ITV1 is attracting fewer viewers, but making more money.

26 Ibid
28 “the number and availability of television channels. . . have increased as a result of digital broadcasting and the increased penetration of digital television in UK house-holds, leading to increased fragmentation of audiences across channels”: http://www.competition-commission.org.uk/inquiries/ref2009/itv/pdf/final—report.pdf
29 Ibid
30 Share of Commercial Impact.
32 http://www.itv.com/documents/doc/ITV%202010%20%20Interim%20%20Results.doc
29. ITV’s dominance is compounded when considering that the main beneficiaries of ITV’s decline in SOCI have been ITV’s other channels—the ITV Group’s SOCI now stands at 39.8%.34 SONAR (share of NAR) is a more relevant measure of ITV’s market power, and with the inclusion of GMTV (which it now wholly owns), this far exceeds 40%, an important threshold, which is recognised in law as raising a presumption of dominance.

30. ITV has achieved this strong position with CRR in place, which the CC therefore concludes continues to be necessary to prevent ITV from exerting its unrivalled leverage with advertisers and agencies and distorting the market. If it were removed it would reduce “the amount advertisers would spend on other commercial broadcasters”35 and reduce those broadcasters’ ability to invest in the content.

31. The CC also concluded that “despite various changes in the television industry [. . .] and in the advertising expenditure by media [. . .] since 2003: [. . .] the relevant product market remains no wider than television advertising”. In other words, the rise of internet advertising in recent years does not impact the appropriateness or otherwise of the CRR mechanism.

**Rather than being financially weak, ITV is in a strong position from which to invest in future content**

32. Over the past few years ITV has sought regulatory relief from CRR by claiming that it has heavily contributed to the fall in advertising revenue that it has suffered during the recession and that it is therefore responsible for the decline in ITV’s investment in high quality content. However, both arguments—that ITV continues to be financially vulnerable and that CRR has caused that vulnerability and the subsequent impact on programming—are incorrect.

33. Firstly, it is clear that ITV’s dominant market position (as described above) has helped it to withstand the financial challenges of the cyclical advertising down-turn. While ITV did indeed suffer big losses in advertising revenue between 2008–09, it was not alone in doing so—revenues across the UK TV sector fell 9.6% overall in that period.36 Indeed, against this market-wide down-turn, ITV has repeatedly told investors in a succession of financial reports that it has outperformed the market (ie it has increased its relative position in the market, which is more pertinent to an assessment of market power than looking at audience share alone):

- “ITV plc NAR was down 4% at £1,425m (2007: £1,489m), ahead of the total market down 5%”—Year end results for 2008.37
- “UK television advertising suffered its worst year-on-year decline on record over the first half, with net television advertising revenues falling by £277m or 17% for the overall market. ITV outperformed the market, with ITV NAR down £108m or 15%”.—Interim results 2009.38
- “ITV television advertising revenues were down 9% at £1,291m (2008: £1,425m), ahead of the total market which was down 11%”.—Preliminary results 2009.39
- “ITV television advertising revenues were up 18% in H1 at £728 million (2009: £615 million), ahead of the total market which was up 15%. The sales team outperformed the market every quarter”—Interim Results 2010.40

34. Against the backdrop of this resilient performance, ITV has repeatedly been relieved by Ofcom of its costly programming requirements (in religion, children, arts, regional non-news), while continuing to benefit from a range of PSB benefits—EPG listing, must carry entitlement, relief from spectrum.

35. Where ITV has suffered financial losses it has not been due to CRR. As the CC concluded, “at most, only a small proportion of many of the other costs which ITV had attributed to CRR in fact derived from it”. This extends to ITV’s programming choices, which the CC concludes “were adopted for a wide range of reasons”, including because “ITV may have made some ‘poor programming decisions’ during this period”. These potential mistakes cannot be blamed on CRR. Indeed, the CC was critical of ITV which it believed “overstated the cost and distortions imposed by CRR. When it succeeds in making popular programmes which attract large audiences, CRR does not prevent ITV from reaping the rewards”.

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34 http://www.itv.com/documents/doc/ITV%202010%20Interim%20Results.doc
37 http://www.itvplc.com/media/newsrelease/?dateRangeToDay=Aug&dateRangeFromDay=5&filterType1=sectorId&filterArg2=35840&y=2010&x=5
38 http://www.itv.com/media/newsrelease/?dateRangeToDay=Aug&dateRangeFromDay=25&dateRangeFromYear=2005&dateRangeToMonth=Aug&filterType2=sectorId&filterArg2=13821&filterArg1=cr&dy=13&dateRangeToYear=2009&dx=9
39 http://www.itvplc.com/media/newsrelease/?dateRangeToDay=Aug&dateRangeFromDay=25&dateRangeFromYear=2005&dateRangeToMonth=Aug&filterType2=sectorId&filterArg2=13821&filterArg1=cr&dy=13&dateRangeToYear=2009&dx=9
36. Indeed Adam Crozier has admitted in this year’s financial statement, “for the past decade ITV has not faced up to the challenges presented by the rise of internet-based platforms, the continuing growth of pay TV and subscription services and the globalisation of content”. It can therefore be argued that it is the combination of these management decisions, the global recession and a number of other factors that have caused the challenges that ITV has recently faced, not CRR.

37. ITV’s existing financial resilience is likely to be strengthened by a number of factors that will advantage ITV over the coming months and years:

- ITV has a new Senior Management Team and a clear strategy for growth based on the exploration of new revenue streams and a “lean, creatively dynamic and fit for purpose organisation”.

- ITV’s financial position will be strengthened by the addition of ITV HD and ITV +1 to the CRR mechanism following the CC’s final conclusion, which independent analysts have predicted will result in a £17m -£93.5m p/a revenue uplift for ITV. Given that TV expenditure tends to be relatively static, this uplift is likely to be at the expense of other sales houses.

- ITV, and the other commercial PSB broadcasters, are likely to benefit disproportionately from the liberalisation of product placement rules (as above).

- Crucially, the TV advertising market is now recovering, with analysts predicting an 8% increase year-on-year this October, with ITV Plc the major benefactor and ITV1 predicted to see an 11.5% increase this year.

38. All in all, ITV’s financial future looks to be increasingly healthy, providing it with a good base from which to invest in high quality content, which it is commercially incentivised to do regardless of its PSB status as this will enhance its audiences, and in turn advertising revenues.

CRR is not responsible for wider PSB and creative industry challenges

39. It is equally misleading to equate CRR with the wider challenges in the provision of public service broadcasting and the creative industries. However, in responding to the CC’s decision not to remove CRR, ITV has done precisely this, saying that the “decision...to leave the CRR remedy in place is damaging to the broadcasting and the creative industries. However, in responding to the CC’s decision not to remove CRR, it is disingenuous to claim that the CC’s decision is based on a mistaken belief that the “competitive environment is still very similar to that identified in...2003” (as the CC fully acknowledged that dramatic changes have taken place, but concluded that these have not altered the underlying fact that ITV airtime is unsubstitutable). Indeed, the CC was cognisant of the changes taking place when it reached its initial decision in 2003, including the reduction in investment in UK-originated content; the challenges in providing local news and other PSB content; the commercial sector’s difficulties in competing with the BBC and the rise of Google and other online players in the content arena.

40. Further, by simply listing developments that have coincided with CRR, ITV does not make a compelling case as it in no way proves cause and effect. There are a host of other reasons why these developments have taken place—the global recession, competition from other broadcasters and commercial PSB management decisions, for example.

41. It is also wrong to assume that a reduction in investment in content spend is necessarily negative. As Ofcom’s most recent Communications Market Report argued, “reductions in content spending are driven by a variety of dynamics, not all of which suggest that the reductions have an on-screen impact”. These reasons include the fact that there are increased efficiencies in the production value chain; reductions in spend on on-screen talent (presenters); changes to programmes, scheduling and commissioning strategies and the rise in the provision of “gap funding” by independent producers, all of which have taken place without negatively impacting viewers perceived value of PSB, which Ofcom says remains “high”.

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42. Third parties estimated effect of inclusion of ITV1 +1 and HD impacts as being between £17m and £93.5m revenue upside to ITV.

43. http://www.guardian.co.uk/media/2010/aug/18/recovery-tv-advertising

44. http://www.guardian.co.uk/media/newsrelease/?dateRangeToDay

45. http://www.itvplc.com/media/newsrelease/?dateRangeFromDay

43. It is also misleading of ITV to argue that their view of CRR is shared by others in the commercial PSB and creative industry space. While SCBG does not claim to speak on behalf of these broadcasters, it is not automatically the case that Channel 4 (who under new leadership has a commitment to self-sufficiency from public support) and Five (who has previously argued to this Committee that CRR should be maintained), wish to echo ITV’s call for CRR’s abolition. To the contrary, the removal of CRR, and the gifting of additional revenues to a financially resurgent ITV, would take place at the expense of all its competitors—both public service and commercial broadcasters—who would consequently be less able to offer plurality and choice of programming, with viewers the ultimate losers.

As well as damaging competition, removing CRR would damage the merger regime itself

44. In addition to our view that any move to abolish CRR would distort the market to the detriment of viewers, any attempt to do so by employing a loophole in the Interpretation Act or through more fundamental amendments to the competition-based merger regime would also have far-reaching procedural implications. There was unanimous political support for the establishment, via the Enterprise Act 2002, of competition authorities that were independent of political interference. This appears to be a view that the Conservatives still hold, Jeremy Hunt having said on 31 March 2010 (in relation to the Pay TV review), “we have always said that competition issues should be decided at arm’s length of government...the [then] culture secretary must now explain why he thinks it is appropriate to make a political issue out of a decision by the independent regulator”. 49

45. Any interventions to over-rule the CC on CRR would therefore suggest a change of policy from the Government, and have huge ramifications not only for the health of a vibrant, diverse and competitive TV market, but for the merger regime as a whole. It would represent a complete abandonment of due, proper and independent process.

CRR’s linkages with other advertising regulation

46. As we have outlined above, we do not see any justification for the removal of CRR on competition grounds, or on the grounds that it is hampering ITV or the wider PSB and creative industries. However, it is also important to underline the wider ramifications of removing CRR on the functioning of the TV advertising market, given the significant interplay and interconnection between CRR and other key advertising regulations.

47. An example of this interconnection and complexity can be seen in Ofcom’s decision to lift the Airtime Sales Rules, which prevented ITV and the other PSBs from withholding airtime and from conditional selling. In deciding to remove the rules, Ofcom argued that because CRR incentivises PSBs’ sales houses to sell out all of their minutes, the ASR withholding rule which required them to do just that was redundant and should therefore be removed. CRR also explicitly prevents conditional selling (making the sale of airtime on the main channel/s absolutely conditional on the purchase of airtime on the digital portfolio of channels) and so Ofcom was also able to remove this ASR rule. The interconnection between ASR and CRR is therefore clear, as recognised by Ofcom, who have said that if CRR is removed they will have to consider reintroducing ASR regulation. If both ASR and CRR were removed there would be nothing preventing ITV exploiting its market leading position, thereby quashing healthy competition and reducing the range of programming available to viewers.

48. CRR is also inherently connected to the rules governing advertising minutage (COSTA) as discussed below. To date, Ofcom’s analysis on COSTA has been based on the understanding that CRR will be retained. But if CRR were to be removed and Ofcom also decided to alter the minutage available to ITV, there would be significant implications for the industry, with a transfer of economic benefit away from SCBG members towards ITV.

49. Such interconnection means that assessing the impact of a change to CRR (and indeed to COSTA) is necessarily complex, and must take place in a context that allows the breadth of these issues to be fully considered. Making decisions in isolation will inevitably lead to unintended consequences, and should therefore be avoided at all costs. To this end, we support Ofcom’s decision to use third party experts to econometrically model the impact of changes to the current landscape and warn against policy making on the hoof.

47 http://www.guardian.co.uk/media/2010/jun/23/channel-4-annual-report-lord-burns
48 Dawn Airey said to the House of Lords Communications Committee on 29 January 2009, “ITV represents 46% of the market which is market dominance. Five would like CRR to be maintained while we have a broadcaster with that share value”. http://www.marketingmagazine.co.uk/news/877282/Airey-Grade-clash-future-CRR/
49 http://www.guardian.co.uk/media/2010/mar/31/sky-bradshaw-tories-ofcom
50. To conclude, contrary to the Culture Secretary’s assertion that CRR is “a piece of micro-regulation that we can do without”, CRR is in fact a highly integral regulatory mechanism which cannot simply be plucked away without having a significant distorting impact on the market and the operation of other advertising regulations. Further if the UK wishes to maintain a plural and diverse television market that provides viewers with the full range of programming to enjoy it would also be inappropriate to give ITV regulatory relief given its continued and growing market power.

COSTA—ADVERTISING MINUTAGE

51. In addition to CRR, SCBG is also very keen to draw the Committee’s attention to the concerns we have regarding Ofcom’s potential review of its COSTA rules on advertising minutes and its apparent predisposition towards harmonisation of those rules. SCBG has two key points to make to the Committee:

— Firstly, given the fundamental connection that advertising minutage has with wider questions relating to public service content funding and competition mechanisms such as CRR, we believe that Ofcom should delay its COSTA review so that the strategic questions it raises can be posed in the broader, more appropriate context of a Communications Bill scoping exercise or a PSB review.

— Secondly, that any harmonisation of advertising minutes would represent an example of “reregulation” not “deregulation”, as its only possible outcome is to reinforce the market power of the incumbents at the expense of newer content providers, just at a time when those providers are increasing their investment in content.

What is COSTA and what impact would potential changes have on broadcasters?.

52. COSTA—or Code on the Scheduling of Television Advertising—is Ofcom’s set of rules governing the amount and scheduling of advertising on television. Between 2008 and 2009 Ofcom undertook a review of these rules (under the name of RADA)50 which considered but did not reach a conclusion on whether to change the rules on the average number of permitted advertising minutes for PSBs and non-PSBs.51 At present PSBs are permitted an average of 7 minutes per hour (reflecting the opinion that viewers should be exposed to less advertising on PSBs); non-PSBs are permitted 9 minutes per hour (the maximum allowed under the EU’s AVMS Directive).

53. Ofcom has said that it believes there to be “a strong case for harmonising the regulation of advertising minutes” and is considering either allowing PSBs additional minutes or restricting non-PSBs, or a variation of those options. However, because any change from the status quo would result in very heavy financial losses for commercial broadcasters, Ofcom deferred further consultation until spring 2010. On 21 May Ofcom announced that this consultation had been further delayed until “later”.52 SCBG understands that Ofcom intends to go ahead with the review at some point in the near future.

54. The precise range of options to be featured in Ofcom’s upcoming consultation is not clear. However, based on the options in the RADA review53 and the options cited in its recently published independent report on “An econometric analysis of the TV advertising market”,54 it is clear that harmonisation would result in considerable, market-reshaping losses for commercial broadcasters. Ofcom’s RADA review predicted that harmonising PSBs’ minutes up to non-PSB levels would result in the commercial broadcasters losing £44m per annum and that harmonising non-PSBs’ minutes down to PSBs’ level would lead to commercial broadcasters losing £17m per annum, the majority of these revenues going to the PSBs. SCBG’s own research during the RADA review, by the consultants Oliver and Ohlbaum, estimated these figures to be even higher, at − £64m and − £80m per annum respectively.55

55. These are very substantial losses indeed, which would have the following impact on the sector:

— Commercial broadcasters—who have invested an increasing amount in programming in recent years,56 thereby making a growing contribution to the quality and range of programming available in the UK—would be forced to scale back significantly on their investment, resulting in a considerable narrowing of the range of quality of programming available on UK viewers.

50 http://stakeholders.ofcom.org.uk/consultations/rada08/statement/
51 Non-PSBs in this instance refer to the PSBs’ portfolio channels as well as commercial broadcasters.
52 http://stakeholders.ofcom.org.uk/market-data-research/tv-research/arr/
53 http://stakeholders.ofcom.org.uk/binaries/consultations/rada08/summary/rada08.pdf
54 http://stakeholders.ofcom.org.uk/market-data-research/tv-research/arr/
55 Ofcom’s Proposals on Changes to RADA, a report for SCBG by Oliver and Ohlbaum Associates, May 2008.
56 Non-PSBs (excluding the PSB portfolio channels and film and sport channels) increased their spend on content in 2009 by 13%: http://stakeholders.ofcom.org.uk/binaries/research/cmr/753567/CMR—2010—FINAL.pdf
— Some niche channels—who perform an important role in meeting specific audience needs and who
tend to rely very heavily on advertising revenues—could close.
— Other channels may decide that the UK no longer offers an attractive regulatory environment and
opt to relocate, potentially resulting in the loss of UK jobs and damage the UK’s status as a hub for
the creative industries.

Continuing with COSTA now would prejudge Communications Bill debates and other PSB reviews

56. Ofcom’s motive for conducting the review is of great concern to SCBG, as is their clear preference for
harmonisation well-ahead of having gathered evidence through consultation. Ofcom has said that it regards
harmonisation as a means of meeting its commitment to deregulate and to support PSB content by securing
ITV’s adherence to the public service obligations: “our presumption is that, in due course, we shall need to
move towards a more level regulatory playing field, including in relation to advertising regulation. The
alternative, of maintaining the differences in advertising regulation, risks the possibility of one or more of the
commercial PSBs surrendering their licences (thus affecting delivery of the ‘modest but important public
service commitments’).”

57. SCBG has urged Ofcom not to use a narrow competition-based regulatory review of minutage to address
broader policy questions about PSB funding, not least because such a review cannot properly assess the costs
of PSB provision relative to the benefits conferred to ensure that the commercial PSBs are not over-
compensated for their PSB obligations. There are two significantly more holistic and therefore appropriate
opportunities for Ofcom to do this—the Section 264 PSB Review, which is scheduled to start in autumn 2012,
or the Section 229 PSB licence framework review, scheduled to start in 2011.

58. The rationale for using a more holistic review to consider these issues has been strengthened by the fact
that the scoping process for a new Communications Bill will begin this autumn. If Ofcom were to persevere
with the review, and cause massive losses to the commercial sector, it would pre-judge the outcome of the new
Bill with potentially far reaching consequences for consumer choice and a healthy broadcasting competition.

59. In response, Ofcom has insisted that its primary motivation for conducting the review is to “examine
whether there is a continuing justification for the maintenance of differential regulation”. However, even if
it is not Ofcom’s intention to “transfer funding from one group of broadcasters to another” in order to
secure the provision of PSB, the outcome of harmonising minutes for other reasons will have the same effect:
up to £80m per annum moving from commercial broadcasters to PSBs and their portfolios channels is a
market-changing amount of money, which will substantially dent the former’s ability to invest in high quality
content and preclude the decisions about public service content and the shape of the market that will be taken
in the Communications Bill.

Harmonisation of advertising minutes would represent “re-regulation” not deregulation

60. Aside from the concerns that SCBG has regarding the process of the potential COSTA review, we also
have serious questions about the “appropriateness” of harmonisation and argue that there continues to be
“continuing justification for the maintenance of differential regulation as between PSBs and non-PSBs”, for
two reasons.

61. Firstly, although Ofcom has signalled that harmonisation would represent “deregulation”, we argue that
it would in fact be a case of “re-regulation”, where regulations are simply adjusted to favour different parties.
Indeed, one of the three options consulted on in the second RADA review would see an increase in regulation
for non-PSBs, allowing them substantially fewer minutes than they are permitted under AVMS. Not only
would this achieve the opposite of deregulation but it would massively disadvantage non-UK broadcasters
who are licensed by Ofcom against the locally-regulated competitors, and allow all UK broadcasters
substantially fewer minutes that their EU counterparts.

62. Secondly, the justification for reviewing the rules is unfounded because the unlevel regulatory playing field
between PSBs and non-PSBs, which Ofcom is attempting to fix, does not in our view exist. It is true that
different minutage rules apply to each set of broadcasters, but this is because those sets of broadcasters are
themselves different: some have public service obligations and corresponding benefits (legacy benefits, EPG
prominence and must carry privileges) and some do not. While there has been a diminishment of the value
derived from PSB status, adjustments to commercial PSBs’ obligations have been made by Ofcom accordingly.

57 http://stakeholders.ofcom.org.uk/binary/consultations/rada08/statement/costa.pdf
58 Ofcom letter to SCBG dated 18 May 2010.
59 Ibid.
If Ofcom were to harmonise minutage, rather than neutralising an imbalance, they would be creating a new one by enabling PSBs to derive additional benefit from their privileged status while requiring the same level of public service obligation.

63. Notwithstanding our objections to the rationale for harmonisation in the first place, it is because changes to minutage will have such a significant impact on the PSB cost/benefit balance that a holistic review, such as the Communications Bill, must be used to consider the issue rather than a narrow regulatory review such as COSTA.

Conclusion

64. The discussions that will take place during this inquiry will be helpful to all stakeholders as we prepare to scope a new Communications Bill, an exercise that will undoubtedly provide an opportunity to consider a number of relevant wider issues related to competition and the funding of high-quality audiovisual content.

65. The first of our two key messages to the Committee is that decisions about specific regulations should not be taken ahead of this exercise or in isolation because of the high degree of interconnection between the advertising regulations themselves, and because of the impact that those regulations have on broader issues related to the funding of PSB content and competition. This complex web of issues can only be properly tackled in a wide-ranging and holistic review and by the relevant and competent authority.

66. Our second message to the Committee is that it is a mistake to automatically regard the removal or amendment of certain existing regulations with acts of liberalisation that can deliver win-win outcomes for the viability of the ad-funded television model and UK broadcasting more generally.

67. SCBG supports regulatory changes that genuinely liberate ALL players in the broadcasting ecology to explore new revenue streams and encourage innovation and investment, for example the liberalisation of product placement rules. Such changes are good for all those operating in the UK TV market, and ultimately UK viewers, who will benefit from an increase in choice and diversity.

68. What SCBG does not support, and urges the Committee to reject, are regulatory changes which are presented as “deregulation” but which merely advantage one part of the sector over another, rather than genuinely free-up all broadcasters to create value. As we have described above, both CRR and COSTA are rules that are performing a necessary and appropriate tasks. Making changes to those rules in the belief that it will assist the future funding of high level content will instead result merely in significant redistribution of revenues within the market. Such actions would not only be interventionist on the part of politicians and regulators—creating winners and losers in the market—but it would reduce competition and the incentives for all players to invest in content to the benefit of viewers.

24 September 2010

Examination of Witnesses

Witnesses: Mr Martin Heaton Cooper, VP Commercial Development, Discovery Communications Europe, Mr David Lynn, Managing Director, MTV networks UK and Ireland, Mr Andrew Mallandaine, UK Sales Director, Turner Broadcasting, Ms Victoria Read, Executive Director, SCBG, and Mr David Wheeldon, Director of Policy and Public Affairs, BSkyB.

Q171 The Chairman: Welcome everybody. I will ask you to introduce yourselves in a minute, and we will start the questions shortly. Obviously, you all represent different interests under the same banner, generally, but if someone has already answered a question satisfactorily do not feel the need to add to that. If you feel that there is a nuance or issue that has been lost somewhere, do pick that up, because that would be very helpful. The questions that we ask will probably be directed at you generally, so it will be the first one who leaps to answer it. Perhaps you could just introduce yourselves.

David Wheeldon: I am David Wheeldon, director of policy and public affairs at BSkyB.

Victoria Read: I am Victoria Read, the executive director of the Satellite & Cable Broadcasters’ Group, the trade body represented here today. We have 17 members, representing about 100 channels.

David Lynn: I am David Lynn. I am the managing director of MTV Networks UK in Australia, which incorporates MTV, Nickelodeon and Comedy Central. I am also chairman of the SCBG.

Martin Heaton Cooper: I am Martin Heaton Cooper, the VP for commercial development for Discovery Networks, and we have 13 channels here in the UK.

Andrew Mallandaine: I am Andrew Mallandaine, the sales director for Turner Broadcasting UK entertainment channels, which represent Cartoon Network, Boomerang and TCM movie channel, among others.

Q172 The Chairman: Thank you. I should have started by apologising for the late start. It was pure indiscipline on the part of the Committee. I shall ask the first question and then we will go round. What
proportion of SCGB members’ total revenue comes from advertising? What is the contribution of other sources of income such as subscriptions and sponsorship? How has the balance shifted over the past five years?

David Lynn: First of all, thank you for the opportunity to give evidence today. To answer the question, advertising is a critical part of our revenues. We do not have numbers for the sector as a whole because of the confidentiality of the information, but suffice it to say that it is a very significant and growing proportion.

Q173 The Chairman: You do not have a precise figure for it.
Victoria Read: The figure tends to differ very widely between different channels.

Q174 The Chairman: I understand that there is no aggregated figure.
Victoria Read: No, there is none, but I think we can probably give a bit more detail.
David Lynn: I can speak for MTV in saying that advertising is a bigger revenue stream for us than subscription, for instance.

Q175 The Chairman: Whereas the reverse would be the case for some other broadcasters. Is there any table that shows the breakdown of that by channel?
David Lynn: No, because it is quite confidential information, so channels generally do not release that type of information. It is fair to say that there is quite a wide range among different channels. Some channels will be primarily advertising while others will have a greater proportion of subscription.

Q176 The Chairman: And the way the balance has shifted over the years?
David Lynn: I would say the balance has been reasonably constant over the years. I would say that advertising, apart from the recession in the past year or two, has been a growing revenue for MTV Networks and an increasing proportion of our income.

Q177 Lord MacDonald of Tradeston: Has the growth of multi-channel television taken revenue away from the public service broadcasters, or has it actually increased the size of the pot and generated new advertising revenue?
David Lynn: I believe that the advertising associated with the cable and satellite sector has generally been driven by growth in the market place. I think that over the last two or three years we have seen a deep advertising recession and we, like the public service broadcasters, have seen declines in advertising revenue during that time. Likewise, this year we are seeing a strong recovery across all channels. We are actually recovering all of the losses that we suffered in 2009 as a sector.

Q178 Lord MacDonald of Tradeston: What is the forecast for next year? Is that flat?
David Lynn: Different forecasters have different opinions on that. The general consensus seems to be that the growth will continue.

Q179 The Chairman: Are you saying that all boats have risen, basically? I mean, this is not just the PSBs at your expense; it is generally a trend that covers all channels really.
Martin Heaton Cooper: This year there has been a really big bounce back from last year—everybody felt the pain last year—but the PSBs in general have grown beyond all TV this year, in particular ITV.

Q180 Lord Gordon of Strathblane: Can we move to COSTA and the regulation about minutage. You appear to justify the discrepancy of seven minutes for public service broadcasters and nine minutes for yourselves on the grounds of the opinion that viewers should be exposed to less advertising on PSB. Who has expressed that opinion?
Victoria Read: I think the original reason for the difference was a view that PSBs have greater responsibility to viewers in exchange for the obligations and benefits they get from the licences. One of those obligations was to have less advertising. So that is the original reason for the difference.

Q181 Lord Gordon of Strathblane: But on the other hand, things have moved on since then. Is there any justification for maintaining that differential?
Victoria Read: People talk a lot about the unlevel playing field and perhaps correcting it. We do not actually recognise that there is an unlevel playing field. In fact, Ofcom has recently concluded its review of how much the Channel 3 and Five licences are worth, and in that it lists as one of the costs of having a licence the additional minutes. So that has already been taken into account. We are not quite sure that if you were to harmonise up and down you would in fact be creating another unequal situation because those minutes have been counted over here already.

Q182 Lord Gordon of Strathblane: If the decision was to harmonise it, would you prefer it to be harmonised up—everyone having nine minutes—or down and everyone having seven minutes?
Victoria Read: Our position as a group is that we don’t support harmonisation either way for the reasons I have just given. Obviously different companies are affected differently, but we agree as a
group that we do not think there is a justification for a review at all or for harmonisation up or down.

Q183 Lord Gordon of Strathblane: Can I just ask a basic question about restricting advertising time? I mean, in many ways, is it not in your own interests? Quite apart from the differential with ITV et cetera, is it not in your own interests to have some restriction on advertising time? Otherwise, frankly, if you had 13 minutes an hour the price would come down.

Victoria Read: We are all working under AVMS from Brussels, which is the piece of legislation which governs all of this, and the maximum there is 12. We cannot go above 12 anyway, so there is no question of going up and up. We are working within the limits that we have already.

Q184 Lord Gordon of Strathblane: But you recognise the basic economic point that if you have a degree of scarcity the price will go up? You might be better off. You might get more money in with seven minutes.

Martin Heaton Cooper: But if you do the model, the loss of minutes is not countered by an increase in price and we as a group lose substantially. I take your point. I can hear exactly what you are saying, but if you take away minutes you take away revenue.

Q185 The Lord Bishop of Liverpool: Can I be a little more explicit about this? Would you agree that the present system of regulation actually discriminates against public service broadcasters.

David Lynn: No, because we think that as part of being a public service broadcaster there are a whole range of benefits and obligations, and you have to look at the whole package. There are still a number of benefits, such as the EPG prominence, must-carry spectrum that is granted to the public service broadcasters which we do not avail of as commercial broadcasters.

Victoria Read: As I say, Ofcom have already done the sum including this as a cost.

Q186 Lord Razzall: You have put in evidence—and clearly your evidence would indicate that you do not want any change—that if you harmonise down it would mean a loss of £80 million—presumably that is annually—and that you could harmonise up with a loss of £64 million. I have two questions. We are having difficulty getting our minds around this because, on the face of it, this would seem to indicate that there is a subsidy at the moment from the PSB channels to the non-PSB channels—otherwise why would there be a loss of revenue to you if it was harmonised? I do not know whether you want to comment on that. However, I am assuming from those numbers that were there to be harmonisation you would be in favour of harmonising up rather than down simply because the losses are less.

David Lynn: As Victoria said, we are against—

Lord Razzall: You are against any change. But assuming there was a change?

David Lynn: We are against any change. Different members of our group have different views on that. In general, we are against the change. With regard to the £80 million, we see that any change will result in a transfer value from the multi-channel sector to the PSBs. We do not see that the overall advertising pie will increase, and we think that that will have a corresponding knock-on impact on our ability to invest in content in the UK. That is something that we as a group have been increasing substantially and have big ambitions to increase further going forward.

Q187 Lord Razzall: So are you suggesting that all of your members are in favour of no change? Or are you saying that some of them are in favour and some of them are not? Or are you saying that, assuming there is change, some are in favour of harmonising up and some of harmonising down?

Victoria Read: I think it is fair to say that we are all in favour of no change.

Q188 Lord Razzall: But you are not agreed on which way it should go were there to be a change?

Victoria Read: Yes. As David said, it is important to reiterate what would happen. Either way, money is going to be moving out of the sector. That is a very important issue for us because this is money which we want to be able to invest in content. So I think that what would happen if harmonisation took place would be that we would be looking at a reduction in ability to invest in content in the UK. For smaller channels that are very reliant on advertising, it could mean closure. Sometimes channels provide for niche audiences, and other channels are based in the UK and broadcast across Europe. It is a good thing for the UK to have that hub here, but they may see this as one thing they cannot cope with in the UK and will want to relocate elsewhere. So there is a considerable knock-on effect of harmonisation.

Q189 The Chairman: I heard what David had to say, and you as well, Victoria, but after digital switchover there are going to be far fewer benefits for PSBs, are they not? How long after that period do you think that the COSTA regulations should stay?

David Lynn: We still see significant benefits to the public service broadcasters from elements such as the EPG position. So ITV at channel 103 gives it significant prominence and it attracts higher audiences due to that prominent position. So even in a digital world, we still think that—
Q190 The Chairman: So the EPG is the essence of it, basically, is it?
David Wheeldon: Not entirely. The point about the differential is that it is a PSB obligation, and that is accounted for in the licence. So the right time to look at whether or not that obligation is still valid is at the point at which you review the licences, which is 2014.

Q191 Lord Razzall: But some of the PSBs are struggling to sell seven minutes advertising—advertising every seven minutes—are they not? There is virtually no advertising on Channel 4 News, for example.
David Wheeldon: Well, that’s a choice they make. We do not sell all the advertising—
Lord Razzall: No. I do not think people want to advertise on it.

Q192 Lord Gordon of Strathblane: That is another differential that I have just picked up. You are not required to sell all your advertising. You know how ITV, for example, must sell all its minutage.
Victoria Read: That rule has just been changed.

Q193 Lord Gordon of Strathblane: You are not required to sell all your minutage. In other words, you get a maximum of nine minutes, but if you want to sell only six, you can. Is that the position?
David Wheeldon: You have an average, so you do not necessarily sell all the minutes in a particular hour. You try to smooth it out over a period.

Q194 The Chairman: Just to recap, you are saying that 2014 is when you should next review whether or not it is appropriate for PSBs to have the COSTA regulations?
David Wheeldon: Absolutely, because it is part of the PSB licences, and if you start picking apart every bit of the PSB licences before that point, you actually call into question the validity of licences before that point. But it is then right to review all of these things, and at that point it will be a question of whether or not it is worth bidding for a PSB licence.

Q195 The Chairman: And you will have had a couple of years’ experience of digital, as well.
David Wheeldon: Indeed.
Lord Bragg: We are talking about investment in original content in this next section. In its written evidence, the SCBG says that commercial broadcasters “spent £2.6bn on programming in 2009 in the eight key genres”—sport, entertainment and you can fill in the rest. I know that you are reluctant to give figures, but the main argument seems to be that if this investment is at risk, it is worthwhile us knowing something about what you think is at risk. Could you respond to that, and then I shall turn to Sky, from a slightly different angle? Can we have some idea of where that is going regarding regional programming?
Andrew Mallandaine: Just from Turner Broadcasting’s point of view, recently, in the past couple of years, we set up a UK-based production facility, creating UK content for our children’s channels—predominantly animation. That is something we have been able to do only because of the level of revenue we have taken over the past four or five years. It is a movement that we have wanted to produce, simply trying to invest in the UK and Europe, because of criticism of the amount of American content on the channel. Without CRR, there is a definite risk that our revenues would drop to a point where we were unable to continue with that investment. That is a definite risk on our part.

Q196 Lord Bragg: You see CRR as protecting you?
Andrew Mallandaine: Definitely in this particular case, yes.
Lord Bragg: Does “in this particular case” mean that this a specific marginal case or that this is a case with a huge umbrella impact?
Andrew Mallandaine: I can speak only on behalf my own company, but I would imagine the same to be true of the rest of the members here.
David Lynn: I would add that CRR will have the same effect as any change in COSTA. It will not increase the size of the advertising pie. It will move the share from our sector to ITV, and that loss of advertising revenue will have a knock-on impact on our ability to continue our growing investment in UK content.
The Chairman: Concretely, though, I think Lord Bragg wanted to know what the figures are.

Q197 Lord Bragg: Can you give us an idea of what is being spent where in these areas?
Victoria Read: I can quote some research that we did a couple of years ago. We are looking to update it, but just to give you an idea of the commitment to the UK—it is a piece of work that Deloitte did for us—83% of commissioning costs were spent in the UK, and 43% of acquired costs. In total, over half members’ content spend was incurred in the UK, so that gives an indication of the commitment of the broadcasters in our group to spending in the UK.

Q198 The Chairman: Sorry, could you just repeat those figures slightly more slowly?
Victoria Read: I will send you them as well. I should start by saying that half of total content spend was in the UK; 83% of commissioning costs and 43% of acquired costs were spent in the UK.

Q199 The Chairman: But again, that is not figures—it is not money.
Victoria Read: No, I don’t have the figures for money.

Q200 Lord Bragg: So you are absolutely convinced that the CRR enables your businesses to go forward. David Lynn: Absolutely, because any change of loosening of CRR will result in ITV taking a bigger share of the advertising pie.

Q201 Lord Bragg: What about ITV’s complaint that it ties their hands behind their backs?

David Lynn: The Competition Commission put that remedy in place as a result of the merger that took place and the dominance that ITV has in the marketplace.

Q202 Lord Bragg: How does this play with regard to Sky?

David Wheeldon: Perhaps I may start by saying that the way that we look at this is that the multi-channel sector is one that should be celebrated and embraced. We have brought massive innovation and, critically, choice that did not exist 20 years ago to this market. That is in the consumer’s best interests and the public interest, because it encourages investment and allows people to make their own minds up. In looking at all this, our view is that one would want to continue with and encourage an environment where that investment and choice can be nurtured because it is in the public interest. I note some of the questions that were asked to the competition authorities about public interest. I believe that competition is, by and large, in the public interest. In this case CRR is about ensuring competition in the market.

Q203 Lord Bragg: Thinking about original content, can you give us some indication of what the spend is?

David Wheeldon: I can give you some numbers. We invest annually about £2 billion in content, of which half is spent in the UK. That includes the spending on sport and news, which we celebrate and believe makes a big contribution, as well as drama, comedy, the arts and other genres that we spend money on.

Q204 Lord Razzall: Would you not agree that to include sport is a little strange in this debate? Of the £1 billion you spend on sport, most of it goes on rights.

David Wheeldon: I would not agree.

Lord Razzall: I do not think anybody would suggest that using your money to pay well paid foreign footballers is necessarily improving British content. David Wheeldon: I would not agree. It is a valuable contribution to consumers’ choice. It provides them with something that they were not able to get before, and it is a contribution to the creative sporting cultural industries. It is completely valid.

Lord Razzall: I completely agree with that but the argument that is being bounced around in this committee is about whether, and to what extent, making alterations to the undertakings that we are considering will improve the original British programming. That is true for both ITV and your sector. All I am saying is that spending money on sport is not directly relevant to that issue. I completely agree with all the other points that you have made.

Q205 The Chairman: Given that, it would be very helpful for the committee if we had a breakdown of the different forms of investment in content.

David Wheeldon: I have heard the argument many times that Sky spends lots of money on content but it is not content that we approved of.

Lord Razzall: I do approve of it. We carry on spending the money.

Q206 The Chairman: Many of us are subscribers, I am sure.

David Wheeldon: In terms of what we are spending on other genres, we spend tens of millions on drama, news and comedy. We are investing heavily in drama on Sky One, which is becoming the home of our UK content commissioning, as well as what is soon to be Sky Living, which will be alongside Sky One on the EPG.

Q207 The Chairman: Can you give us figures for the UK-originated content?

David Wheeldon: We do not separate out our spending on UK content by genre for commercial reasons.

Q208 Lord Gordon of Strathblane: Could I suggest that it might well be in your interests to take a different view on how much you make public? Bearing in mind that you are resting your case for the continuation of the differential minutage on your ability to invest in programming, were you able to demonstrate the diversity of that programming, your case would be that much stronger with the public, wouldn’t it?

David Wheeldon: I am very happy to supply a long list of all the programming that we are investing in, which would provide ample evidence of the diversity of that programming.

Q209 The Chairman: But you are not prepared to tell us how much you are spending on UK-origination.

David Wheeldon: That is an inputs argument about the amount of money that people are spending on putting into the system. It is not an argument about what comes out at the other end, which, frankly from our point of view, is what consumers care about.
Q210 The Chairman: It is one of the arguments that we are addressing and we would like to know what the figures are. Would anybody like to contribute on that?
Victoria Read: David has made my point. Obviously, you are interested in input figures and we do not have a figure to give you. However, we should also look at outputs, as David said, and the whole sum of UK broadcasting. There are two broadcasters that are dedicated to delivering public service broadcasting. Two have PSB obligations and a commercial incentive to produce high-quality content. On top of that, we also have a whole range of choice and diverse programming from another sector. Put together, that is something that the British public value and want. That is a more interesting way of measuring this.
The Chairman: I do not think there is any question about that at all. That is not the issue before us. We are looking at incremental investment in content and UK investment in content. That is one of the areas that we are trying to investigate. At the moment, we do not have much in the way of data from you to assist us in that respect. As you say, we may have the outputs but are we going to have to look through your schedules to ascertain that production?

Q211 Lord Razzall: David, would you disagree with the Ofcom figure that you are spending in excess of £1 billion on sport?
David Wheelton: I do not disagree with that. We make clear what we are spending on sport as part of the overall package of spending in the UK. Yes, we do spend a lot of money on securing sports rights---over 100 sports on Sky Sports alone. We think that that is a big contribution to the sector. We fundamentally disagree, Lord Razzall, about what is a contribution to the sector and what is investment in UK content. If this is an industrial policy point, then, to be frank, I think that every pound spent by our sector on content that is spent in the UK counts just as much as ITV’s content spending. That is if it is an industrial policy point. If it is a PSB point, we can have a debate about what is PSB and what you want money to be spent on but, from an industrial policy point of view, we spend billions in the UK on creative content.

Q212 The Lord Bishop of Liverpool: I declare an interest, having received a fee for taking part in a Sky Arts programme. Perhaps you could address this question because this would really help us. If the CRR were abolished, what impact do you think that would have on your sector’s contribution to creative programming in the UK? Can you tell us anything in that area?
Martin Heaton Cooper: Can I just talk about Discovery? Next year, we aim to spend five times the amount on locally commissioned content, as we did last year. We are working with the BFI. We have just done an absolutely wonderful film which unearthed Herbert Ponting’s original footage of Captain Scott’s trip to the South Pole. It was incredible and it would not have happened without us. We are working with the police, and we have a fantastic relationship with the Ministry of Defence. All this is locally produced content. We have really committed to that as part of what we do next year.

Q213 The Chairman: Can you give us figures?
Martin Heaton Cooper: I cannot because I work for a big multinational and it is commercially sensitive. I wish that I could, but it is a sizeable increase in what we are doing and we are really committed to it as a US company in the UK.
David Lynn: I would add that from an MTV Networks perspective both for our own TV channels and for Nickelodeon we are using the UK as a production base for all our international networks. Part of the reason for that is that primarily we are able to partially fund that investment through the advertising that we receive in the UK. So any effect through CRR or COSTA changes would damage the UK’s ability to take that lead within MTV Networks, and I think that it is probably a similar story for other international networks. I think that the UK is a very attractive destination for making content, not just for the UK audience but for the international markets.

Q214 Lord Bragg: Does Sky have a similar position with regard to CRR?
David Wheelton: Our position, most broadly put, is that we want to see a competitive market. CRR is a measure that was put in place to ensure that the market remained competitive, allowed new entrants to enter the market and ensured that the dominance of one broadcaster was not allowed to undermine the competitive level playing field in respect of advertisers and, in our view, broadcasters. Advertising in that area is a zero-sum game, so essentially, where ITV gains, everybody else loses.
The Chairman: I am anxious to bring in Baroness Deech, who has to go in 10 minutes.

Q215 Baroness Deech: I have to go very shortly. There is an assumption behind what you say that UK content would not of itself be very attractive to advertisers. Is that right?
David Lynn: Not at all.

Q216 Baroness Deech: Are you assuming that it is synonymous with quality and would also be attractive to advertisers? If it were, would you not be spending much more on it right now?
Andrew Mallandaine: Looking at ITV’s argument in the previous session, it appeared to be saying that, in order to gain mass-market appeal and therefore, by default, an ability to trade that programming content internationally, you have to go for high-audience-yield programming. That is completely contrary to what it is saying about its interest in producing high-quality, smaller-interest programming, and therefore its inability to sell that programming internationally. I think that what we all prove is that you can produce high-quality, high-interest programmes, and we air those on our channel on a daily basis.

Q217 Baroness Deech: If there were harmonisation of the airtime minutage, what do you think might be lost? What channels might go, and what would be vulnerable if the minutage were harmonised? Martin Heaton Cooper: If as a group we lose money, the biggest single item in any of our P&Ls is programming, so you would have to look hard at that.

Q218 Baroness Deech: So it would be content. Would it be UK content? Is that more expensive than other content? Martin Heaton Cooper: You put a lot of investment into local content, especially fast turn-around shows.

Q219 Lord Razzall: One of you was suggesting that channels would close, but you do not have any idea how many. David Lynn: No.

Q220 The Chairman: Can I come back to this chestnut again? Our advisers have reminded us that the SCBG told this committee in oral evidence last year that its members contributed £193 million to the UK. Lord Razzall: £193 million?

Q221 The Chairman: Tell us? Victoria Read: We are looking to update the piece of research that you referred to very soon.

Q222 The Chairman: And very soon is? Victoria Read: We are just about to commission it.

Q223 The Chairman: So by the end of the year? Victoria Read: Probably not. That is probably a bit soon.

Lord Razzall: Sky is saying that it alone is doing more than £193 million.

Q224 Lord Gordon of Strathblane: But this is non-sport. David Wheeldon: I do not think that it said that, actually.

Q225 The Chairman: I thought you said over £100 million on sport. David Wheeldon: No, I did not give any figures. The figure that we use is £1 billion spent in the UK.

Q226 Lord Razzall: On sport? David Wheeldon: No, not on sport, on content. I would not put a number on the total amount of UK investment, because that is not what we give out, but it is true that we are spending tens of millions on drama, news and comedy. They are not insubstantial amounts of money but I am not able to give you a number because we do not break it out in our accounts.

The Chairman: I think you have made that very clear.

Q227 Baroness Fookes: Why not? David Wheeldon: As has already been pointed out, programming costs are very variable within any business, and traditionally we have reported the overall programming spend. It is commercially sensitive and market sensitive.

Q228 The Chairman: The BBC gives all those figures. David Wheeldon: Yes, but the BBC is not subject to commercial or market sensitivities. The Chairman: ITV gives those figures. Baroness Fookes: I am not convinced.

Q229 Baroness Fookes: Can we go back to the harmonisation issue? You are clearly very much opposed to it but, if you were given no choice but to say that there should be harmonisation, would it go up or down? Victoria Read: It is a bit like saying would you like your left arm or your right arm cut off. Baroness Fookes: Yes, precisely.

Q230 The Chairman: I think that we need to move on from this as we are not going to get much further. We are talking not about industrial policy, David, but creative content and creative policy. That is the characterisation that we as a committee would want to put on it. Ruth, have you asked all your questions? Baroness Deech: Yes, I think that they have all been covered.
Victoria Read: No, we cannot give an answer on it. Sorry.

Q230 Lord Razzall: Their members disagree. Victoria Read: We have exactly the same starting point, which is no change.

Lord Razzall: You agree on no change, but you do not agree which way it would go if there were change.

Q231 Lord Gordon of Strathblane: Obviously, you know your own business best, but it would appear to me that many of your channels are for niche markets. I am ignoring things such as Sky Sports and so on, which are aiming at a mass market and successfully getting it. That advertising might be competed for by ITV1, but I do not see how ITV1 can compete with Sky Arts, for example. Therefore, you are producing niche programming attracting sizable, targeted audiences. I do not see how that is going to be affected by a mass channel such as ITV1.

Martin Heaton Cooper: Simply, if you take away a large chunk of our revenue--

Q232 Lord Gordon of Strathblane: Why would it disappear? You can produce audiences that ITV1 cannot because you can target them.

Martin Heaton Cooper: Only if we have the funding to do it.

Q233 Lord Gordon of Strathblane: I agree, but you are doing it at the moment.

Andrew Mallandaine: I think I am in a good position to answer this because obviously a huge proportion of our revenue comes from one single audience, which is children. However, our secondary audience is housewives with children, our third audience is all adults and so on. Without that secondary revenue stream, we would not be able to continue, but that secondary revenue stream is dependent on our ability to deal share points with media-buying points. That ability would disappear if ITV's CRR mechanism was taken away and they were able to negotiate a much larger share of total broadcast expenditure. Peripheral channels like ours would not be able to compete in that area at all and we would be the ones that would lose our non-core audiences. So, fine, we would hold on to the key audiences—kids in our particular case are the specific audiences—but we would lose big chunks of revenue from non-specific audiences and that would be very, very devastating for us.

David Lynn: The vast majority of campaigns that would appear on our channels would run across all cable and satellite channels, and on the main broadcast route. So if ITV was to have more minutage, and advertisers were to buy a bigger proportion of their campaigns there, that would be money taken away from cable and satellite broadcasters.

The Chairman: That is interesting. You are all linked together, in a sense, in terms of campaigns. That is how advertisers buy across the channels for particular impacts.

Q234 Lord Bragg: As you are so specialist, what worries have you got about ITV, which is less and less specialist in your areas? In that sense, what is the serious problem there? Is it apprehension rather—

David Lynn: An advertiser who is going after a 16-34 audience may advertise on “X Factor” at the same time as MTV. So we are competing for the same advertisers.

Andrew Mallandaine: The key objective of any advertising campaign is to reach as big a percentage of your target audience as is physically possible, and obviously you cannot do that with one or two even very wide-reaching channels. You still have to add on a number of other channels to extend you reach to the maximum level possible. That is why we pick up these extra points of cover and therefore revenue.

Q235 Lord Skelmersdale: I find this discussion absolutely fascinating, Chairman, because throughout your evidence this afternoon you have been giving me the impression that there is only one advertising market you are interested in: and that is your competition with the PSBs. Of course, the advertising market is very much bigger than that. There is the print medium, computer advertising and a whole lot. Why have you been so knotted-in, so to speak? Andrew Mallandaine: That is the key focus and there is no doubt about that. We look at the existing TV market and those people with television budgets to try to attract. Even within our own organisation, we have spent time looking at particularly press for the gaming market—video games—which tends to do a lot of advertising in the press. We have done research to show that TV is a more effective form of media. There is an attempt to steal share from other advertising media as well, not just television.

David Lynn: But the TV market is fairly discrete.

Q236 Lord Skelmersdale: We have received evidence that the revenue of ITV has decreased disproportionately since CRR was introduced. Would you agree with that, especially in relation to other countries, or do you think that it is just something in the air that we should disregard? Andrew Mallandaine: I would be interested in what figures you have, because I have figures that do not necessarily equate to that argument.
Q237 **The Chairman:** They are cross-country comparisons, basically, allegedly demonstrating that ITV has suffered disproportionately as a result of CRR compared to commercial PSB channels in other European countries.

**Lord Razzall:** They also say that it has decreased disproportionately in comparison with Channel 4 and Channel Five.

Q238 **Lord Skelmersdale:** I am asking whether you have any views to support or disagree with that statement.

**Andrew Mallandaine:** I do not have an intimate or working knowledge of international markets, so therefore I would be guessing. The only thing I would say is that what is very different in the UK compared to other markets is that we have a huge non-commercial public service broadcaster which eats an enormous amount of audience away from ourselves and from our competitors around this table, let alone ITV, so I am not sure that we are comparing apples with apples in that case.

Q239 **The Chairman:** You might just wish to talk to your own consultants, Oliver and Ohlbaum, because these are figures from them. Victoria, I think you use Oliver and Ohlbaum, do you not?

**Victoria Read:** I am sorry. Whose figures?

Q240 **The Chairman:** The figures that we have seen. The charts we have seen showing this disproportionate effect are produced by Oliver and Ohlbaum.

**Victoria Read:** For ITV? We have employed them for a different purpose on the COSTA issue previously.

Q241 **The Chairman:** But they are not a Mickey Mouse outfit?

**Victoria Read:** I am not saying they are.

**David Wheeldon:** No, they are consultants

**David Lynn:** I think it is worth pointing out that the Competition Commission said that the cause of the decline in ITV’s revenues was largely down to the recession, which was worse in the UK than in other international markets; and also to the reduction in the number of sales of houses and the increase in the number of channels. So there are a number of factors which have affected ITV’s revenues which are particular to the UK.

**Andrew Mallandaine:** The figures from the Competition Commission finding in May were that ITV’s share of impact in 2003 was at 45.4 per cent, and that reduced to 40 per cent in 2009, including GMT in fairness. Its revenues reduced in that time from 51.1 per cent to 48.4 per cent, so approximately a 5 per cent drop in audience with a 2.5 per cent drop in revenue as a share. So actually it is growing disproportionately—or it is losing less than its audience share; it is disproportionate.

**Martin Heaton Cooper:** Which is why the prices go up.

**Lord Razzall:** I take your point on the foreign comparison because you are not really comparing oranges and oranges because of the existence of the BBC.

Q242 **Lord Bragg:** A lot of things did come in to impact on ITV and everything else. Do you think that Sky had a big impact on ITV?

**David Wheeldon:** When you say, “had a big impact”, Lord Bragg, how do you mean?

Q243 **Lord Bragg:** Well it is bound to impact really, is it not? I mean, it is a big beast, competing away, so there is every reason it should.

**David Wheeldon:** I think the multi-channel sector has made the industry more competitive. I would not disagree with that. But I think that that is a positive.

Q244 **Lord Bragg:** And added a great deal to the sector as well. I hope you do not think we all do anything but that accept that. It enriches it enormously. It is getting to the bottom of what is going on that is really quite difficult when you get one set of people saying one thing very convincingly; then they go out and you come in—or you have been in anyway, whatever it is—and you say another thing very convincingly too. I suppose it is called making decisions.

**David Wheeldon:** Can I categorise? I do not want to put words into your mouth, but there is a different philosophical approach here. We believe that what our sector has brought has been massively in the public interest; it has brought a lot of great diversity. We have spent a lot of money. I know that it is not money and numbers that you necessarily want to agree with us on, but we will stick by our £1 billion.

Q245 **Lord Razzall:** We are not saying that, David, but you are really making a very technical point. We are not criticising you over sport coverage now.

**David Wheeldon:** But the point is that the idea that the system should be preserved in aspic, that existing PSBs need to be given constant leg-ups to maintain their position, is one that we fundamentally challenge. We do not believe that that is in the public interest. We believe that the public interest is served by dynamism, by competition.

**The Chairman:** Or, conversely, constant leg-downs, so to speak.
Q246 Lord Gordon of Strathblane: Or obligations. David Wheeldon: They are obligations that come with massive benefits. There are clear trade-offs. We all know what they are because they are set out in the licence.

Q247 Lord Gordon of Strathblane: You are familiar with the fact that Ofcom said that the benefits were now being outweighed by the costs. That is part of the problem but it is not what we are on at the moment. You are pushing at an open door in quite a lot of what you are saying. You are assuming that we do not recognise the contribution that the multi-channel, cable and satellite area has made. Everyone around this table does.

Andrew Mallandaine: The point I would like to make is that ITV has hung its hat on the argument of public service programming and public interest content. I dispute the fact that if we go back seven years its schedule was awash with public service interest programming. I do not think it was. I am sure that we will all go away and look at that individually. But in that seven years, and the preceding 10 years before that as well, the multi-channel environment has added enormous amounts of public interest programming into the overall schedules of the UK and invested heavily in programming content as well. That alone completely blows its argument out of the water.

Q248 Lord Razzall: Although, to be fair, its argument is more that if somebody takes away CRR it will make more programmes. It does not actually say that it will invest in sport. That is it. It will make more programmes, which is why we get into the argument about making UK programmes with UK content.

Andrew Mallandaine: But if you go back eight years, without CRR in place, was it making those programmes then and what guarantees do we have that it will make those programmes in one year’s time if CRR goes away?

Lord Bragg: That is a very fair question.

The Chairman: It is the sort of question that we have been asking.

Lord Bragg: If you do not take seven but take 10 years, there was a difference. I think you are dismissing that far too lightly. I am not just talking about arts programmes. There was classic drama; they had a strong and well funded documentary unit, which was one of the best in the world—and that is not being silly; it was up there in Yorkshire. It afforded things like Cracker and took risks on things like Prime Suspect, which it would not do now. That is an argument that it can bring forward. This is what happens in a democracy; we are trying to consider all these different points of view and sometimes they seem equally valid. We will just have to work our way through. But I do not think that it is black and white. I do not think that the dramatic move is necessarily the best move. But I reiterate that people in this room subscribe to channels and watch channels and they are very pleased that they are there; they go to pubs to watch channels sometimes, or they used to.

The Chairman: I think they understand how sympathetic we are.

Q249 Lord Gordon of Strathblane: Moving on to a totally different subject—the nature of the advertising market itself. Frankly, the way in which advertising is bought and sold is fairly opaque. As far as I can see, every agency claims that it has bought at a discount or below the average price, which is mathematically impossible. Do you think there is a case for looking at the way airtime is bought and sold? Specifically, would you favour the idea of an auction for peak programmes? Would that determine in a free market the true price of an advertising spot in Big Brother, for example, or a sporting event such as the Ryder Cup, which Sky is showing? Would that be a sensible way forward?

David Lynn: If you are referring to a market review to change how the advertising market works, we are against it. A market review would take a long time and be very complex and we think that the outcome is very uncertain. We think that during that period it will lead to quite a bit of lack of visibility, which will curtail our ability to make investment decisions.

Q250 Lord Gordon of Strathblane: But are you happy with the way that airtime is bought and sold at the moment?

David Lynn: Broadly happy. There are ways you could change things.

Q251 The Chairman: You do not need a review to change models for special events and things of that sort.

David Lynn: A market review would take a number of years and its outcome would be quite unpredictable.

Q252 The Chairman: I understand that point, but you would not necessarily need a market review to move to an auction system in certain circumstances.

David Lynn: If the market moves in that direction of its own accord, we work with the market, so we will be happy to work in that new environment.

Andrew Mallandaine: Adam Crozier earlier alluded to the fact that they do have an auction process in place for certain special programmes such as the World Cup and even The X Factor is sold on that basis. The problem is that not all the content of those breaks is sold, so they end up giving the content to advertisers.
on their deal rates anyway. It has just not really worked in the past; they have tried it, but it has not really worked. That is my experience, and I have sold ITV as well in the past.

The Chairman: So this is not necessarily a way forward to try to get through some of the arcane aspects of the trading system.

Lord Razzall: That is the only thing that this group of witnesses have said that agreed with what ITV said.

The Chairman: On that note, while peace and harmony reign, thank you very much indeed. I assure you that we listened extremely carefully to what you had to say despite the fact that we do not have any figures from you. That is the end. Thank you.

Supplementary letter from the Satellite and Cable Broadcasters’ Group (RTA 22)

INTERIM CONTENT INVESTMENT FIGURES FROM THE SCBG

The Satellite and Cable Broadcasters’ Group was very pleased to be able to give oral evidence to the Committee on 2 November as part of its inquiry into the regulation of TV advertising. During the evidence session, the Committee was rightly interested in the level of investment that our sector makes in content and in particular UK content. We explained that we were on the verge of commissioning some research that would give us those figures and that we would let the Committee have access to those figures should we be able to complete the research in time.

Following that session we commissioned Deloitte to undertake independent research and analysis of our sector’s investment in content. We have been working hard with Deloitte over the past 8 weeks to complete the difficult task of collating data from the wide range of commercial players who are members of SCBG and the full conclusions of that research will be published in March. We are able, however, to share some interim figures from that forthcoming report with the Committee. I understand from the Committee’s clerk Audrey Nelson that we are sharing these figures with sufficient time for them to be included in the Committee’s report and we are happy for them to be included provided their interim status is made clear.

The four interim findings of particular relevance to your inquiry are:

— SCBG members spent in the order of £2.3 billion on all content in 2009—that is UK and non-UK spend on originated content (fully funded and co-funded), productions and acquisitions/rights from all genres, an increase of 8.7% from £2.1 billion in 2008.

— 70% of SCBG members’ total content spend, or in the order of £1.6 billion, was invested in the UK through fully funded originations, co-funded originations, productions and acquisitions/rights across all genres.

— SCBG members spent in the order of £430 million on original UK commissions in 2009, an increase of 7.5% from approximately £400 million in 2008. Of the £430 million in 2009, over 45% (or in the order of £200 million) is derived from fully funded originations, a further 10% is co-funded originations and the remainder is production expenditure. Note that this figure excludes all acquisitions and rights spend from all genres including sport and movie rights.

— SCBG members invested diversely across all key genres, including news, factual programming, arts and music, sports, film, drama, soaps, comedy, entertainment and children.

These are preliminary findings which are subject to further validation by Deloitte and completion of internal reviews. The full Deloitte report will also go into more detail about the context and relevance of these numbers, but a useful benchmark is to compare the £430 million that SCBG members spent on UK original content in 2009 with the £370 million that Channel 4 reported that it spent on UK original content in the same year in its submission to the Committee. While we will be doing more work to understand these interim figures, we do believe that they support the points we made in both our written and oral evidence to you: that our sector is committed to investing in original UK content; that our sector is a significant industry player in UK originated content; and that, consequently, any regulatory changes that result in revenues moving away from our sector will impact its ability to invest in original UK content, to the detriment of the range, diversity and quality of content that viewers have access to in the UK.

I hope that these figures are useful and timely as you finalise your report, and that you and the Committee will be interested in receiving details about the full report when it is available.

27 January 2011
Memorandum by Channel 4 (RTA 13)

1. Channel 4 welcomes the opportunity to provide written evidence to the House of Lords Select Committee on Communications’ inquiry on the regulation of television advertising. Television advertising regulation—such as the scheduling of advertising and product placement—has an impact on broadcasters’ ability to invest in UK content, and Channel 4 welcomes the opportunity to discuss where changes might enable greater investment. Equally, essential forms of competition regulation—such as the Contract Rights Renewal mechanism—can also have an impact on content investment and the public service broadcasting ecology as a whole, and this submission also discusses the effect of CRR on UK content investment.

2. Channel 4 is a publicly-owned, commercially-funded public service broadcaster. Its core public service channel, Channel 4, is a free-to-air service funded predominantly by advertising. In recent years, Channel 4 has broadened its portfolio to offer a range of digital services, including the free-to-air digital television channels Channel 4 + 1, E4, E4 + 1, Film4, More4 and 4Music as well as HD services on a number of platforms. Channel 4 also offers a range of content and other material on its website channel4.com, including the video on-demand service 4oD.

3. As a public service broadcaster, Channel 4 is committed to the fulfilment of its statutory remit and to generating the maximum possible amount of revenue to invest in UK-produced content. As commercial revenues are the primary way of delivering Channel 4’s public purpose end, Channel 4 believes it is vital that the advertising regulatory framework provides appropriate incentives for broadcasters to invest in UK content. Channel 4 is therefore actively engaging in the various advertising regulatory processes which may affect the amount of revenue available for the broadcasting sector as a whole to invest in UK content.

4. In this context, Channel 4 would like to address the following issues in this submission:

— the importance of television advertising in supporting UK content;
— the impact of regulation on television advertising;
— the potential consequences of regulatory change in the advertising market;
— the impact of CRR; and
— the importance of advertising innovation in supporting content investment.

5. The Committee’s inquiry is a timely opportunity to advance the debate on how the UK can continue to fund high quality, domestically-produced content. As the Committee identifies, the prospects of the advertising-funded model will have serious implications for the future of public service broadcasting. Advertising is a key pillar of the UK’s mixed broadcasting system—where public funding (via the TV licence fee), subscription revenues (for cable and satellite operators), and advertising revenues (for free to air broadcasters) fund a system which provides audiences with a wide range of UK-produced content.

6. On the advertising side, the three commercially-funded public service broadcasters—ITV, Channel 4 and Five—use the revenues generated from advertising to invest in UK content and meet their public service remits. The Channel 4 model in particular—public ownership combined with commercial funding—has always ensured the maximum flow of funds from advertising to content investment. Thanks to its public status, Channel 4 is able to re-invest its profits in the creative economy, instead of paying out dividends to shareholders. This has allowed Channel 4 to sustain high levels of investment in UK content, despite the economic downturn Channel 4 still spent over £370 million in 2009 on UK-originated content across its portfolio, in genres like drama (eg. This is England ’86, the follow-up to Shane Meadows’ award-winning feature film); film (eg. Never let me go, the adaptation of Kazuo Ishiguro’s novel, which will open this year’s
London Film Festival); and comedy (eg. The Inbetweeners, which recently won the Rose d’Or for best sitcom). Across all genres, Channel 4’s investment seeks to support innovation and risk-taking—providing audiences with programmes that wouldn’t be supplied by other broadcasters.

PROSPECTS FOR TELEVISION ADVERTISING REVENUES

7. Given the fundamental importance of television advertising in supporting UK content creation, the Committee is right to assess the prospects for television advertising revenues in future. As the Committee identifies, in recent years television advertising revenues have been in decline—falling from £3.6 billion in 2007 to £3.1 billion in 2009 according to Ofcom—and have only recovered partially in 2010. That said, while it is difficult to predict future revenues with certainty, Channel 4 believes that the prospects for television are sound and that it will continue to compete successfully for advertising in future. This section discusses the reasons behind the fall in advertising revenue, as well as the likely prospects for revenues in the medium term.

8. The decline in advertising revenues has been driven by two broad factors—the economic recession; and structural changes in the market caused by the move from an analogue to a digital television multichannel landscape. Digital television is now in 92% of homes, meaning the commercially-funded public service broadcasters have moved from an analogue world of three competing commercial channels to a digital world where, on some platforms, they compete with over 800 channels. The volume of commercial impacts (one person seeing one advertisement), grew by 35% between 2002 and 2009, from 603 billion to 817 billion as viewing of commercial multichannels increased and viewing of BBC channels decreased—and this growth in supply has been a leading cause of the drop in price of television advertising, and the consequential reduction in advertising revenues.

9. In addition, as the Committee points out, advertisers are shifting expenditure online. While this is a relevant factor, Channel 4 believes that it is important not to overestimate the substitutability between advertising on television and on the internet. In the UK in particular, shifts in revenue to online have been driven to date by our relatively high levels of e-commerce activity, rather than demand for audiovisual content. In addition, while the internet has increased its share of advertising expenditure in recent years and this may grow in future, over 80% of internet advertising spend is directed to search and classified advertising. For now, internet display advertising remains a small proportion of the total display advertising sector relative to television, and is not currently growing at the significant expense of television.

10. These structural changes were exacerbated by the recent economic recession, which accelerated the rate of decline in advertising revenue. Taken together, these developments contributed to the fall in television advertising revenue. This decline has put pressure on content investment by the commercially-funded public service broadcasters, who have had to generate efficiencies and cut programme budgets in response. Channel 4, for example, implemented an aggressive series of efficiency measures and savings in 2008, but these actions alone could not compensate for falling revenues and Channel 4 had to cut its programme budget—with a consequential impact on content investment.

11. However, the cyclical situation is improving and television advertising revenues recovered somewhat in 2010—revenues are forecast by some analysts to be up by between 10% and 12% on 2009. Going forward, while we don’t know with certainty how advertisers will react, as the economy continues to grow advertisers are likely to increase their budgets, which should go some way to offsetting the decline in television advertising revenue of recent years. While the structural changes mean that the market may not return to its previous peak levels, Channel 4 believes that television advertising revenues will still be key to funding public service content in future.

12. Despite the structural changes, Channel 4 believes it is important not to underestimate the continuing and significant success of television, and commercially-funded television in particular. Viewers have more and more options competing for their time—such as radio, social networking or the internet—yet television viewing has actually increased in recent years. Ofcom’s Communications Market Report 2009 found that the average viewer watched three hours and forty-eight minutes of television each day, up 3% over five years. Viewing of commercial television has also grown, and is now at an all time high of two hours and twenty-one minutes per viewer per day. And despite the commonly held view that younger audiences are turning away from television, viewing of commercial television by 16–34 year olds is at its highest level for the past five years, at two hours and five minutes per day per viewer.

13. Given this ongoing popularity, Channel 4 believes that television will continue to compete successfully with other media for advertising in future. Television is a ubiquitous, mass medium, and will continue to be attractive to advertisers thanks to its ability to build mass awareness quickly and deliver a shared experience. Even with developments online, television advertising still makes up a significant proportion of the display advertising market—generating 35% of total display advertising spend in 2009, compared to 8% for online.
14. Broadcasters are also seeking to take advantage of the growth in online by developing their own offerings—for example, Channel 4’s video on-demand service 4oD—in order to sustain revenues to invest in UK content. In addition, projects such as YouView (previously Project Canvas), which will bring a new free-to-air, internet connected television service to UK homes next year, will not only provide viewers with greater choice, but will also be key to sustaining investment in UK content.

The Impact of Regulation on Television Advertising

Is the current level of regulation of television advertising appropriate?

15. The UK broadcasting system is subject to high levels of regulation. There are rules designed to prevent harm and offence in programming, quotas requiring the provision of certain types of content (like news and current affairs), and regulations affecting the advertising market. The level of advertising regulation can affect the revenues generated by broadcasters, which in turn has an impact on their ability to invest in UK-produced content.

16. In recent years there have been widespread calls for a reduction in the level of regulation faced by businesses and consumers across all industries—including broadcasting. The Coalition Government Agreement, for example, set out a range of measures designed to reduce regulation, including plans for a “one-in, one-out” rule, whereby no new regulation is brought in without other regulation being cut by a greater amount; and plans to impose “sunset clauses” on regulations and regulators to ensure that the need for each regulation is regularly reviewed.

17. Calls for deregulation have also extended to the creative industries and the broadcasting sector. For example, the DCMS Structural Reform Plan set out ambitions to reform the media regulatory regime for the digital age to reduce regulation, encourage investment and create the conditions for sustainable growth; and to change the media regulatory regime by reining Ofcom and deregulating the broadcasting sector. Outside of Government, some broadcasters have also argued for deregulation, such as ITV’s long campaign to have the Contract Rights Renewal (CRR) competition remedy removed, or the BBC’s call to remodel the terms of trade governing the relationship between broadcasters and independent producers.

18. Channel 4, like any business that earns its keep in a competitive marketplace, is keen to minimise the regulatory burden facing the industry. As outlined above, Channel 4 relies on commercial revenues in order to deliver its remit, and is constantly seeking to minimise costs in order to maximise its investment in content—Channel 4 does not therefore support regulation for regulation’s sake. Channel 4 also recognises that regulation often imposes costs on organisations in the industry, and believes these costs should be minimised wherever possible.

19. However, in Channel 4’s view, when considering potential regulatory changes it is impossible to take a blanket approach. While some regulations are outdated and merely generate red tape, other regulations are essential for the proper functioning of society and the economy. Regulation is needed where markets don’t work to the benefit of consumers or don’t create the best outcome for the economy, and this is seen across many sectors of the economy. While removal of these essential types of regulation can benefit some organisations it can also impose costs on others, especially in highly competitive sectors, so any debate about removing these types of regulation should be approached with care.

20. Further, regulation can also be useful where the Government wants to achieve a social policy objective. For example, the Government uses the broadcasting regulatory regime in the UK to promote investment in UK-produced content; and has used regulation to restrict advertising of products such as alcohol or food and drink high in fat, salt or sugar. In these cases, regulation has been used with the objective of influencing behaviour.

21. Channel 4 therefore believes that it is impossible to look at all “regulation” in the same way. While it’s true that poor regulation can cause frustration and unintended consequences, some regulations are essential for a well functioning economy and society, and the Government should think carefully before altering them. In this context, the remainder of this submission looks at the potential impact a number of advertising regulatory changes could have on the market.

Potential Impact of Regulatory Changes in the Advertising Market

Airtime Sales Rules

22. In July 2010, Ofcom concluded its review of the Airtime Sales Rules (ASR). Ofcom looked at the “withholding rule”, which requires the commercially-funded public service broadcasters to sell 100% of the advertising minutes they are allocated, and the “conditional selling rule”, which prevents advertising sales houses from anti-competitively bundling channels (ie. selling airtime on one channel on the condition that the
advertiser will also buy airtime on another channel). Ofcom decided to remove both of these rules from 1 September 2010.

23. Channel 4 supported the removal of both of these general regulations as they were outdated and unnecessary and had little, if any, positive effect on broadcasters’ incentives to invest in UK-produced content.

24. In particular, Channel 4 welcomed Ofcom’s decision to remove the withholding rule. In Channel 4’s view, broadcasters have the incentive to manage the supply and demand for airtime on their channels in an appropriate way. The rule requiring broadcasters to carry a minimum amount of ads was therefore unnecessary, especially as it did not support broadcasters’ investment in UK content.

25. Channel 4 also welcomed the removal of the conditional selling rule. This could have a positive effect on revenues, as some conditional selling can benefit advertisers and the market by allowing advertisers to strike deals with one sales house for airtime on a number of channels. In addition, advertisers are still protected from anti-competitive conditional selling by the ex post competition regulation regime—so the removal of the conditional selling rule had the benefit of streamlining two layers of regulation into one.

**Product placement**

26. In March 2010, the Government legislated to allow television product placement in the UK, in a limited number of genres and subject to a number of restrictions designed to safeguard viewers. Ofcom is currently consulting on changes to the Broadcasting Code to permit product placement, and aims to publish a revised Code allowing product placement by the end of 2010.

27. The removal of the rules prohibiting product placement does represent a new revenue opportunity for commercially-funded public service broadcasters. Channel 4 is therefore working closely with its independent production partners to establish how product placement might work in practice. However, Channel 4 believes it is important that the potential benefit from product placement is not overplayed—additional revenues are likely to be at the low end of the estimates cited, which range from £25 million after five years, through to much larger estimates of £140 million per annum. There is also a risk that revenue from product placement is substitutional—with advertisers shifting money away from other audiovisual advertising, such as sponsorship, towards product placement.

28. In addition, the introduction of product placement will involve further regulatory and compliance costs for broadcasters. Channel 4 has seen it as a priority to help ensure that product placement is implemented responsibly and in a way which maintains broadcasters’ editorial independence. Channel 4 therefore welcomes Ofcom’s proposals for a clear regulatory framework in the Broadcasting Code, with industry guidance, to ensure that the central principles of preventing undue prominence, protecting editorial integrity and prohibiting direct encouragements to purchase are maintained.

29. However, some of Ofcom’s proposals would have the effect of limiting the amount of revenue broadcasters could generate from product placement. In particular, Ofcom’s proposals are likely to provide a disincentive to invest in certain key types of public service content, including “specialist factual programmes”—in genres like education or the arts—and single dramas. The regulations proposed by Ofcom for these genres would have the perverse effect of discouraging programme investment, which is inconsistent with the public policy rationale underpinning the introduction of product placement in the UK.

30. Channel 4 has made a full submission to Ofcom on these issues and would be happy to provide a summary of the arguments to the Committee. Ofcom is due to publish a revised Broadcasting Code, setting out the regulatory framework for product placement, by the end of 2010, and the Committee’s inquiry therefore comes at key time in that process.

**Advertising minutage**

31. In autumn 2010, Ofcom plans to review the regulations governing the amount of advertising television channels can broadcast per hour. These rules are currently set out in the Code on the Scheduling of Television Advertising (COSTA).

32. At the moment, there are different rules for the PSB channels (ITV1, Channel 4 and Five) and the non-PSB channels (ie digital multichannels like Sky One, but also ITV2 and E4 etc). The PSB channels are allowed an average of seven minutes per hour (rising to an average of eight minutes per hour across peak-time); while the non-PSB channels are allowed an average of nine minutes per hour (12 minutes in peak-time). All channels must operate within an overall limit of 12 minutes of advertising in any one hour.

33. In Channel 4’s view, of all the current reviews of advertising regulation, Ofcom’s decisions in relation to advertising minutage could have the greatest impact on the UK broadcasting ecology and broadcasters’ ability to invest in UK-produced public service content. Regulatory changes relating to advertising minutage are
likely to have an impact on both the amount of revenue available to the commercial broadcasting industry as a whole, and equally importantly the distribution of that revenue between different broadcasters.

34. Regulatory changes in this area must therefore be considered carefully. In particular, minutage regulation is currently used to achieve a specific social policy objective—investment in UK content—and changes to the rules could damage that ecology. For example, an increase in minutage, such as harmonising up the PSB channels to non-PSB channel levels of advertising, could have a deflationary effect on the television advertising market as a whole—which would further limit investment in content. A recent report commissioned by Ofcom supported this view, finding that any change resulting in an overall increase in commercial impacts is likely to lead to a further fall in prices and reduction in advertising revenue.

35. Regardless of whether the market as a whole goes up or down, regulatory changes could also have an impact on the distribution of revenue between the PSB channels themselves, with bigger channels benefiting at the expense of smaller channels. In turn, this could affect the balance of the UK broadcasting ecology, as different channels have different public service remits and varying levels of commitment to UK-produced content—i.e., an extra pound spent on ITV1 is not the same as an extra pound spent on Channel 4.

36. In addition, increases in advertising minutage are likely to have an impact on viewer enjoyment, which in the longer term will affect the revenues available to commercial broadcasters. For example, an increase in the amount of minutage is likely to decrease viewer enjoyment, which could turn viewers away from commercial television to publicly-funded television or other media altogether. Recent research commissioned by Channel 4 found that two thirds of viewers oppose an increase in advertising on commercial PSB channels, while over half of all viewers would switch over or fast forward through adverts if advertising minutage was increased. If fewer viewers watch commercial television this will over time further limit the revenues commercial broadcasters can generate to invest in UK content.

**IMPACT OF CRR**

Reasons for the introduction of CRR

37. The Contract Rights Renewal (CRR) mechanism is a competition remedy introduced in 2003 as a condition of the merger between Carlton and Granada to form ITV plc. The merger was referred to the Competition Commission due to concerns about the combined ITV abusing its market power in the advertising sales market. The Competition Commission found that the merger could be expected to operate against the public interest and recommended that, before allowing the merger to proceed, the Secretary of State should ask for undertakings from ITV which put in place certain safeguards to remedy the adverse effects of the merger. These undertakings included the CRR mechanism.

38. The CRR remedy was proposed by ITV, and was intended to ensure that advertisers and media buyers are no worse off after the merger than before. It includes a ratchet mechanism which means that advertisers can reduce the share of their television advertising budget committed to ITV1, in the event that ITV1’s audience share falls. In essence, this prevents ITV1 from abusing its dominant position in the market and forcing advertisers to pay higher prices for fewer viewers seeing their advertisements. It does not restrict ITV from benefitting from improved performance—if ITV1’s share increases it is free to charge higher prices—so there is no question of the market being artificially frozen at 2003 levels.

39. There are therefore clear economic and competition reasons underpinning the CRR remedy. It is a necessary form of behavioural regulation needed to address a situation where the market, left to itself, would not provide the best outcome for viewers or advertisers. Despite this, concerns have been raised that CRR limits ITV’s ability to invest in UK content. ITV has argued that CRR serves “only to tilt the playing field away from the biggest investors in UK content”, and that a further review of CRR is necessary. However, in Channel 4’s view CRR cannot be viewed in the same way as other types of regulation which could be removed with only positive outcomes—it is an important example of competition regulation which is needed to protect consumers.

Competition Commission review of CRR—published May 2010

40. In May 2010, the Competition Commission published a review of the CRR remedy, following a review period lasting nearly two and a half years (including a preliminary review by Ofcom and the Office of Fair Trading). The review was undertaken in light of possible changes in the television advertising sales market since 2003.

41. The Competition Commission found that ITV1 still has continuing strength in the advertising market. The Competition Commission considered alternative remedies to CRR but rejected these in favour of modifying CRR slightly—to allow viewing of ITV + 1 and ITV1 HD to also be included in the definition of
ITV1—but the key conclusion was that the CRR mechanism continues to be necessary to protect consumers and advertisers from the enhanced market position created by the ITV merger.

42. ITV still has an extremely strong position in the market (45% share of net advertising revenue in 2009). The Competition Commission found that “ITV1’s relative position of strength compared with other commercial broadcasters is little changed since 2003”. It added that while ITV’s share of commercial impacts has fallen since 2003, ITV “remains by far the largest commercial broadcaster with a share of net advertising revenue around double that of the next largest commercial channel (Channel 4)”. In addition, media agencies and advertisers continue to believe that ITV1 offers them something that no other commercial channel can give.

43. ITV still has tremendous negotiating power because there is no mass market alternative for advertisers. The Competition Commission found that ITV1 retains the unique ability to deliver audiences of up to 18 million at a time, and in 2009, ITV1 accounted for 982 of the top 1,000 most-watched programmes on commercial television. ITV has traditionally used this power to drive a hard bargain and charge advertisers a premium for the privilege of advertising on its flagship channel. Indeed, the Competition Commission found that ITV1’s price premium over other commercial channels has increased since the CRR undertakings were introduced. In the view of almost everyone except ITV (the Competition Commission reported “virtual unanimity among advertisers, media agencies, commercial broadcasters and trade bodies we have heard from”), CRR is working as it was intended in that it is still preventing ITV significantly increasing its prices at the same time as its audience share is declining.

Does CRR limit ITV’s ability to compete in the production of quality programming?

44. In relation to the effect of CRR on ITV’s ability to invest in UK content, the Competition Commission found that ITV overstated the detrimental effects of CRR. The Competition Commission clearly found that CRR “does not prevent ITV from producing good-quality programmes that people want to watch”. This is borne out by ITV’s performance in 2009—ITV1 was still able to spend nearly £700 million on original UK commissions. In terms of viewing, in 2009 all but one of the top 50 rating programmes on commercial television were broadcast by ITV1, while every commercial programme with an audience of greater than 6 million was on ITV1 (as were 95% of programmes with an audience between 4 million and 6 million).

45. The evidence shows that ITV is still able to invest hundreds of millions of pounds in UK content while CRR is in place. Of course, CRR does prevent ITV from abusing its position and generating super-normal profits, and in that sense it does restrict the revenues ITV can invest in content. However, this is a positive outcome—aakin to a monopolist being prevented from artificially raising prices to generate excess profits. CRR is therefore in the interests of consumers and advertisers.

46. While CRR does prevent ITV from abusing its position in the market, there is no definitive evidence showing that CRR, in itself, has had a deflationary impact on the UK advertising market as a whole. While the UK market has declined at a greater rate than advertising markets in other EU member states, this has been caused primarily by structural factors in the UK market, rather than as a clear consequence of CRR. As discussed above, the decline in the UK has been largely driven by the rapid shift to digital viewing. The UK has been one of the most successful countries in moving towards digital switchover, which means that the supply of commercial impacts in the UK has increased at a faster rate compared to other countries, with a consequential deflationary impact on price. The UK is not therefore at a disadvantage compared to other countries without a similar competition remedy in place—rather, decline has been driven by the particular characteristics of the UK.

How would removal or relaxation of CRR affect the commercial PSB sector?

47. ITV’s investment in content is only one part of the commercial PSB story. Regulators and policymakers should also consider the impact of any changes to CRR on investment in high-quality UK programming from the broadcasting sector as a whole. The nature of the advertising market means that any gains that ITV might accrue from a relaxation of CRR are likely to mean losses for other commercially-funded public service broadcasters—with a negative impact on their ability to invest in UK content.

48. As discussed above, ITV is the largest commercial investor in UK-produced content (not including sports rights), spending nearly £700 million per year on originated UK commissions. By contrast Channel 4, with half the advertising market share of ITV, invests £340 million per year in UK content, while Five spent just
under £70 million on UK content in 2009. Any reduction or removal of CRR would simply allow ITV to add to its revenue position at the expense of the other commercially-funded public service broadcasters—and because of the relative scale of the broadcasters, a small incremental increase for ITV would represent a significant loss for Channel 4 and for Five.

49. Like any changes to the advertising minute rules, changes to CRR would affect the balance of the UK broadcasting ecology, as different channels invest in UK-produced content in different ways. For example, increased revenue for ITV1 would likely lead to increased investment in UK-programming suited to that channel, while a loss of revenue for Channel 4 would hit UK-programming in line with Channel 4's remit. Not all investment in UK-produced content has equal public value—while mass market entertainment programmes have their place in the broadcasting ecology, programmes that encourage innovation, nurture new talent, support independent producers and benefit the nations and regions are also vital, and the impact of any changes to CRR on these factors should also be taken into account.

50. In short, removal or relaxation of CRR would have a negative impact on the other commercially-funded public service broadcasters. This would damage the public service broadcasting ecology as a whole and reduce the diversity of content and viewpoints available to viewers.

To what extent do the current arrangements reflect the public interest?

51. Concerns have also been expressed that the CRR arrangements are overly-focused on competition issues, and do not sufficiently take into account wider public interest issues. The Government has stated that it is looking at the legislative framework to assess whether there is scope to move consideration of the CRR arrangements away from the Competition Commission and instead allow the Secretary of State to take decisions on the future of CRR, potentially considering issues beyond competition.

52. In Channel 4's view these concerns appear misplaced. Looking at the history behind the CRR arrangements, they were specifically designed to address public interest issues. In reporting on the effects of the merger in 2003, the Competition Commission specifically stated that the merger of Carlton and Granada "could also be expected to operate against the public interest" in relation to the future sale of advertising airtime. The current CRR arrangements therefore already take into account public interest issues.

53. Finally, Channel 4 believes it is important to avoid drawing a false distinction between competition issues and public interest issues. The CRR arrangements, while a competition remedy, do protect the public interest—in terms of competition in the advertising market, as identified by the Competition Commission, but also in a wider sense, ensuring that ITV cannot generate excess profits with the effect of limiting investment in UK-produced content by a range and diversity of competing public service broadcasters.

SUSTAINABLE INVESTMENT IN UK CONTENT IS ABOUT MORE THAN REGULATORY CHANGE

54. Finally, Channel 4 would encourage the Committee to look beyond regulatory change and consider other ways of sustaining investment in UK content by commercially funded public service broadcasters. Of course, regulatory change does have the potential to affect the viability of the advertising-funded PSB model. However, Channel 4 believes that broadcasters and policymakers should not be overly-focused on tinkering with external rules and regulations. In Channel 4's view, broadcasters should also seek to help themselves and generate additional revenues, by innovating in the services they offer advertisers, using technology to better understand audiences, and developing deeper relationships with advertisers.

55. Channel 4 has been at the forefront of advertising innovation, and has undertaken a number of exciting campaigns in recent years to provide advertisers with more value, and generate greater revenues for Channel 4 to invest in content. For example, in April 2010 Channel 4 partnered with a range of advertisers to allow comedian Jimmy Carr to “hijack” all the advertisements in a single break of Channel 4’s Comedy Gala. The comedian appeared in a range of popular ads and provided a witty commentary, which increased viewer recall and retention to the benefit of advertisers. Channel 4 has also successfully innovated in contextual advertising, advertising special events and narrative campaigns. Channel 4 believes that these types of innovations can help broadcasters sustain revenues for investment in UK content, and the potential of these developments should not be forgotten at the expense of regulatory change.

30 September 2010
Memorandum by Channel 5 Broadcasting Ltd (RTA 16)

INTRODUCTION
Channel 5 welcomes the opportunity to contribute this short paper to what is bound to prove a wide-ranging inquiry.

Channel 5 is predominately an advertising-funded business. As a free-to-air broadcaster we do not benefit from any subscription revenues; and while we do exploit other revenue streams, advertising remains our major source of funding now and for the foreseeable future.

As a public service broadcaster, we are required to ensure that at least half of our programme hours are devoted to original programmes. Therefore we invest significantly in new UK content; and this has to be paid for out of advertising.

Television advertising is regulated in a multiplicity of ways. The amount of advertising we can show is subject to the Audio-Visual Media Services (AVMS) Directive and Ofcom’s Code on the Scheduling of Television Advertising (COSTA). The content of the advertisements is regulated through the Advertising Standard Authority’s administration of the Television Advertising Code. The television advertising market is subject to competition law, one manifestation of which is the Contract Rights Renewal (CRR) Undertakings, which were recently amended by the Competition Commission. We believe that most of this regulation is proportionate and should only be lifted or amended after full and proper consideration of all the available evidence.

RECENT TRENDS IN ADVERTISING REVENUE
By far the most significant impact on advertising revenues in recent years was the effects of the global recession. Between 2007 and 2009, the TV advertising market in the UK fell by 17%. Although there has been a welcome recovery in the present year, the market is a long way from recovering to its 2007 level and a sustained recovery is far from assured.

Structural changes in the TV advertising market over the last decade have also had a substantial impact on revenues. The most important of these has been the growth of digital television, which has led directly to a growth in the number of commercial impacts as viewers have switched to channels with more advertising. Such a large-scale increase in the supply of impacts (in the absence of a large increase in demand for TV advertising) was bound to lead to a significant reduction in its price, and as a result the price of TV advertising is now lower than it has been since the 1980s. This trend can be expressed in this graph:

CHANGES IN UK NET ADVERTISING REVENUE (NAR) AND ADULT IMPACTS 2000 TO 2009

![Graph showing changes in UK net advertising revenue and adult impacts from 2000 to 2009]
A further significant factor has been consolidation of buyers and sellers within the TV advertising market. Agencies have merged or decided to act collectively, so that now there are just five major agencies in the UK. Partly in response to this, there has been a consolidation in the number of sales houses, which speeded up at least partly as a result of the recession; the seven separate sales houses from a year ago are in the process of reducing to just four. This consolidation on both sides of the market gives an obvious advantage to both buyers and sellers with scale.

Channel 5 does not believe the growth of advertising on the Internet has had a major impact on television advertising. This is partly because a lot of internet advertising is search or classified rather than display. But we also do not believe display advertising on the internet competes directly with television: advertisers use television to build brands, relying on television’s mass audiences and unique ability to build cover over a short period. Lacking these characteristics, the internet is not nearly as useful to advertisers for brand building purposes. The Internet and television should rather be seen as complementary media.

Our view that television and the internet are not close substitutes for each other is shared by Ofcom, which stated recently that “advertisers seeking to build mass awareness across a broad range of audiences quickly are not likely to view the internet as a close substitute for television at this time”;\(^1\) and by the Competition Commission, which said “We have not seen any evidence that suggests that the sale of television advertising is constrained by Internet display advertising”.\(^2\)

In light of this, we believe the Competition Commission and the OFT were correct in their recent reviews of the CRR Undertakings to define the relevant market as TV Advertising in the UK.

**Future Regulation of Television Advertising**

The most important change to the regulation of television advertising currently being countenanced is Ofcom’s forthcoming review of the rules on advertising minutage. At present, there are differential rules for Public Service Broadcasting (PSB) channels (ITV1, Channel 4 and Channel 5) and for all other channels. For example, PSB channels are only allowed an average of seven minutes of advertising an hour and have a further restriction of an average eight minutes an hour in peaktime; while non-PSB channels can show an average nine minutes of advertising an hour and have no peak time restrictions.

Ofcom has indicated that it believes these rules should be harmonised, with a single set of rules applying from around the time that the conversion to digital television is complete. Channel 5’s main concern is that this process should not lead to an overall increase in the number of commercial impacts in the market, as this would lead to a further deflation in the price of advertising and hence reduce the amount of money that can be invested in new production. Therefore, we would be opposed to any proposal to “level up” the current rules ie for the PSB channels to come within the scope of the non-PSB rules. We will examine closely whatever proposals Ofcom brings forward.

Product placement has long been proposed as a way to boost broadcasters’ revenues and Channel 5 has consistently supported its introduction. Following its approval by Parliament earlier this year, we anticipate that specific rules on the application of product placement will be approved by Ofcom in time for the start of 2011.

However, while we believe product placement is likely to provide television with a modest new revenue stream, we believe its impact on broadcasters’ revenues will be limited, especially in its early years. The market will take time to develop and is unlikely to come anywhere near rivalling spot advertising. (By way of comparison, sponsorship has been permitted for 20 years, but total sponsorship revenues across all channels are estimated to have reached only £180 million in this time).

It is also clear to us product placement is best suited to certain genres, such as drama and large entertainment formats; and therefore that ITV, as the broadcaster best placed to invest in such genres, will have a clear commercial advantage in product placement opportunities.

Channel 5 does not support the lifting of the CRR Undertakings. CRR was introduced to restrict the ability of ITV plc to price discriminate through ITV1’s unique ability to attract large audiences. We believe the Competition Commission was correct earlier this year to keep in place the CRR Undertakings, albeit in an amended form. This is because ITV1 retains unique advantages over all other broadcasters. For example, in 2009 of the 1,000 most watched programmes on commercial television, 982 of them were on ITV1.

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\(^1\) Ofcom, Airtime Sales Rules Review consultation, 29 March 2010 paragraph 4.65.

\(^2\) Competition Commission, Review of ITV’s Contracts Rights Renewal Undertakings Final Report, 12 May 2010, paragraph 5.16.
If CRR were to be lifted unilaterally, ITV would be able to exploit its natural advantages at the expense of its competitors. ITV would be able to win a larger slice of the TV advertising pie—but as a consequence there would be smaller shares for everyone else. So abolishing CRR would have the effect of reducing plurality and diminishing the ability of other broadcasters (including the other public service broadcasters) to invest in original content.

Therefore, Channel 5 believes that any changes to the regulation of TV advertising need to take account of the interests of all broadcasters and should focus on the ability of broadcasters to invest in quality programmes.

October 2010

Examination of Witnesses

Witnesses: Anne Bulford, Chief Operating Officer, Channel 4, Gill Pritchard, Director of Strategy, Channel 4, Martin Stott, Head of Regulatory Affairs, Channel Five, and Kelly Williams, Director of Sales, Channel Five.

Q253 The Chairman: Good afternoon. Thank you very much for coming in. We have a session probably lasting in the order of an hour or so. Questions will come from all sides, not just from me, I am glad to say. I wonder whether you could start by introducing yourselves. You are from just two organisations, so I am sure that it will be obvious to you who should be answering the questions. I think that most of the questions will refer to either Channel 4 or Five.

Gill Pritchard: I’m Gill Pritchard, Director of Strategy and Corporate Development at Channel 4.

Anne Bulford: I’m Anne Bulford, Chief Operating Officer at Channel 4.

Kelly Williams: I’m Kelly Williams, Director of Sales at Channel Five.

Martin Stott: I’m Martin Stott, Head of Regulatory Affairs at Channel Five.

Q254 The Chairman: Good. Thank you very much indeed. We’ll kick off fairly briskly. The total TV net advertising revenue for 2009 was £3,136 million. What are your expectations for total television revenue over the next five years, and how optimistic are you about maintaining your share of total television advertising revenue? That is addressed to both channels.

Kelly Williams: Predicting the future is very difficult. As we were debating before we came in, it is very difficult to tell you what is going to happen in January, let alone the next five years. However, clearly, as a business, we have to plan for the future. Our business plan is broadly based on 3% growth, which is broadly in line with RPI.

The Chairman: But share?

Kelly Williams: We have recently had new shareholders. We are quite optimistic about the future as a channel. In the past couple of years, we have lost share, but we are relatively confident that we will gain some of that back next year and we hope to maintain it over the following three to four years.

Q255 The Chairman: What were you at your peak?

Kelly Williams: We were about 9.5%.

The Chairman: And you have slipped to?

Kelly Williams: We will be 7.5% this year.

The Chairman: But you could get back to 9.5%? Kelly Williams: I wouldn’t say get back to 9.5%, but somewhere between the two is doable.

Anne Bulford: Over the past three to four years we have seen a substantial decline, from the peak in the advertising market of about £3.4 billion in 2007 down to £2.9 billion in 2009. That has come about as a result of two factors: the economic recession and the structural change in the market, as we have moved from analogue to digital. That has increased the number of impacts in the market. More people are watching commercial television and there is more inventory for advertising. The combination of those two things has resulted in an overall decline in the market through that period. In 2010, we have seen the market start to bounce back, which is partly to do with economic conditions but also with the fact that we are coming towards the end of digital switchover, with around 90%–92% of homes now taking their television through the digital networks. Therefore, we are hoping to see a period of much more stability in the market. In common with most analysts and industry commentators, we are expecting to see the market steady at a flat or around inflation level over coming years.

Q256 The Chairman: So 3% sounds a bit fierce to you, does it?

Anne Bulford: It’s a little bit fierce, but it is tremendously difficult to tell. We went into 2010 having had such an extraordinary period of decline through the last quarter of 2008 and 2009, forecasting a drop in revenue. At the time that seemed quite bullish, because our drop was not as steep as we had anticipated in 2009. There is general consensus in the industry that we will come out this year somewhere around +12. It is tremendously difficult to predict, but over the medium term we expect television advertising revenues to steady. We continue to come under considerable competitive pressure, but our objective is to hold our share.

The Chairman: And your current share is?
Anne Bulford: Our current share of the advertising market is around 25%.

Q257 Lord Gordon of Strathblane: Can I start with Channel 4? You say in paragraph 33 of your submission that Ofcom decisions relating to advertising minutage are about the most important issue. Are they even more important than CRR?
Anne Bulford: We think they are a very important issue. My colleague Gill will explain why we are so concerned about minutage.

Gill Pritchard: The minutage rules were introduced back in 1991 as a way of encouraging the growth of multi-channel television. They allowed non-PSB channels more minutes to generate more revenues. The situation today is very different, in that multi-channel television has now reached 92% of homes; that will soon become 100% of homes. At the same time, due to the decline in the PSBs’ share of advertising revenues, which is due in part to multi-channel growth but also to the general decline in advertising revenues, PSBs are under increasing financial pressure to maintain their investment in content. Channel Four is a publicly owned organisation. It maximises its returns from the commercial marketplace to invest in UK content.

Q258 Lord Gordon of Strathblane: If we can now turn to Channel Five. Just so that I am absolutely clear, do you favour equalisation of rules between the digital channels and the PSBs?
Kelly Williams: We do.

Lord Gordon of Strathblane: But you don’t want it to be levelled up; you would rather it were brought down. Could you explain the background thinking to that?
Kelly Williams: As Anne mentioned, over the last 10 years revenue in the TV market has declined in real terms, and the number of commercial impacts has grown by about 40%. The price of TV, as you are probably aware, is an outcome rather than something you set; it’s your revenue divided by impacts. Television has deflated at an enormous rate over the past 10 years. If you harmonised up, our fear would be that you would be pumping more and more supply into the market and making the deflationary effect even worse. Equally, less advertising is more beneficial, I think, to the viewing experience. As PSB channels, we also have our own digital channels, so we are suggesting that we harmonise down on our digital channels as well. So it is not just PSB versus digital; we have our own digital channels that have nine minutes per hour, which will go down.

Q259 Lord Gordon of Strathblane: I’m sure it won’t surprise all of you to know that last week the cable and satellite channels argued that the differential

should be maintained and that your reduced minutage was part of the privilege of being a PSB broadcaster. But, if that were to go, they would want it levelled up. Is it your view that a restriction in the amount of minutage will push up the price and benefit the cable and satellite channels as well? They claim that it will hit them rather hard.
Kelly Williams: Yes. Our view would be that, if you reduce the deflationary effect to TV, it should have a benefit to the whole market.

Q260 The Lord Bishop of Liverpool: We are very interested in the impact of regulation on programming. If harmonisation up were to happen, what sort of programmes would be lost on Channel 4 and Channel Five?
Kelly Williams: From a Channel Five perspective, if the deflationary effect in the market continues, less money will be spent on television advertising. Our biggest cost is our programme budget. The rest of our business is pretty much fixed costs. We have long-term deals on our acquired programming. Anything that we buy from the States, or our movies, is a long-term deal. So our commissioned programmes—our UK-produced programmes—is the part of the budget that would be hit the most.

Q261 The Lord Bishop of Liverpool: Would that be true for Channel 4?
Anne Bulford: Channel 4 is a state-owned, not-for-profit broadcaster, wholly funded from the market. We reinvest all the money that we earn from advertising in content. Consequently, if our advertising revenues come under pressure, then, as the biggest part of our budget by a long way, our programme budget is inevitably impacted. We spend something like £400 million a year on commissioning programmes. If harmonisation up were to happen, they would want their share of the privilege of being a PSB broadcaster. But, if that were to go, they would want it levelled up. Is it your view that a restriction in the amount of minutage will push up the price and benefit the cable and satellite channels as well? They claim that it will hit them rather hard.

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smaller, more diverse audiences come most under pressure when we are coping with lower returns from the market. We feel strongly that any adjustment to advertising minitnage should take that into account. I should like to reiterate that we also think that harmonisation down is the right thing for viewers. We have undertaken some consumer surveys. 65% of viewers surveyed opposed an increase in advertising on commercial channels, and 55% supported a decrease in the amount of advertising on the non-PSB channels. We think that there is a clear argument in terms of viewer interest and investment in programming, which is also in the viewer’s interest.

Q262 The Chairman: What would Channel Five’s view be on that? I know that you are against upward. Are you pro-downward?
Kelly Williams: Yes, absolutely.

Q263 The Chairman: So you are both in line basically. What would the detriment be of maintaining the status quo, therefore?
Anne Bulford: I think it goes back to what we were saying earlier. The reason for having the difference was to encourage the take-up of multi-channel television. That is rather superseded now. Our view is that to have this sort of intervention maintained when it has become out of date is unnecessary. We should set aside that regulation when it becomes out of date.

Q264 The Chairman: Can I have the Channel Five answer?
Martin Stott: I think it is more a question of how you justify differential roles for the public service broadcasters compared with the cable and satellite broadcasters. You need to ask why there should continue to be differential views.

The Chairman: There are two different stories that I’m hearing—one that Gill put forward and one that the non-PSB stations put forward last week—which is quite interesting.

Q265 Lord Gordon of Strathblane: In fairness to them, since they’re not here, I will reiterate what they said last week, which is that if you want an equalisation of platforms, the time for doing it is when your licences run out. It is part of the licence that you took on that you had the restriction in minitnage when the others did not. How would you reply to that?
Martin Stott: If you go back to the licence that was issued to us in 2004, you will see that a number of the requirements and rules that were in place then have changed. That is the nature of having a regulator such as Ofcom being able to intervene in the market and say, “This rule is no longer appropriate. We need to vary this set of obligations on this broadcaster”. The rules governing advertising are no different from that. When we took out a licence in 2004, nobody said that you had to stick by all the rules rigidly; there was always the space to seek changes, which we have done and which I think ITV and Channel 4 have done.

Q266 Lord Razzall: Anne, did you say that Channel 4 spends about £400 million a year on originated programmes?
Anne Bulford: Yes, on originated programmes.

Q267 Lord Razzall: Does that include Film 4?
Anne Bulford: It does, yes.

Lord Razzall: Because you have Channel 4 films and the separate Film 4 organisation, don’t you?
Anne Bulford: We have the Film 4 organisation, which acts as a development house and commissions for Film 4 under the brand for theatre release. For all films made under the Film 4 banner, we acquire the rights for UK transmission and therefore play them out.

Lord Razzall: So that’s the £400 million? Everything’s included?
Anne Bulford: Yes.

Q268 Lord Skelmersdale: Mr Stott, you talked about the market evolving over time, since 2004 particularly. Does that mean that there is still a role for the adjudicator to play?
Martin Stott: You mean the CRR adjudicator?
Lord Skelmersdale: Yes.

Martin Stott: That is a question about whether CRR is in place. If it is, one of the terms of the undertakings that the merged Carlton and Granada company entered into was that there should be an adjudicator to determine that the undertakings were stuck to.

Q269 The Chairman: Can I just probe a bit further, on COSTA, Gill? We had two different answers on why the commercial PSBs had seven minutes and the non-PSB channels had nine. You said that it was originally in order to encourage the non-PSBs, because they did not have the same coverage and so on, but that, now that 92% of people have access to digital, there was no need for it. Their view was that it was all about it not being right for public service broadcasting to have overlong advertising breaks. Where is it possible to establish the original reason for the differential?
Martin Stott: I think it is lost in the mists of time. I have looked into this and it is quite difficult to establish where differential rules came in. My understanding is similar to Gill’s: that it came about in the 1990s, when the multi-channel sector was first establishing itself. The view was that, in order to help it establish itself, there ought to be more flexible rules for those channels. Of course, now we are virtually in
an entirely digital world, and one of the things that one needs to bear in mind is that ourselves, Channel 4 and ITV are advertiser-funded broadcasters. We are free-to-air. Virtually all our revenue comes from advertising. The cable and satellite channels have a second source of revenue in the form of subscriptions, so they are not as dependent on advertising revenue as we are.

Q270 The Chairman: So we really have to take a view in the present about whether harmonisation is desirable. We can’t refer to precedent or history. Anne Bulford: I think there is one other factor that you may like to consider, which is that digital channels, until switchover is completed, do not have the same universal coverage as the legacy analogue channels. Once digital switchover is completed, they will all have the same coverage to UK homes, so there will be no differential there.

Q271 The Chairman: That’s very interesting. You’re saying possible harmonisation post-2012; they are saying that they do not want any harmonisation but that, if there was, it would not be before 2014. Anne Bulford: The disadvantage of digital channels in terms of their not reaching all UK homes goes away once digital switchover occurs. The Chairman: Exactly, but after 2012, there will not be an issue. Anne Bulford: That levelling has come about.

Q272 Baroness Fookes: Could I put a broader question to you? What do you feel are the benefits of holding a public service licence at all? Martin Stott: I think that this is laid out in Ofcom’s public service broadcasting reviews at some length. The main commercial advantages are to do with appropriate prominence on the electronic programme guide and guaranteed digital capacity on the digital terrestrial network.

Q273 Baroness Fookes: But you’re saying that that is what Ofcom set out? Martin Stott: We would concur with that. Those are the two main benefits of being a public service broadcaster in commercial terms.

Q274 Baroness Fookes: So that’s your view from Five. What about Channel 4? Anne Bulford: We agree with that view, but for us, as a state-owned corporation, public service broadcaster and not-for-profit organisation, that is our job. Our role and remit are laid out in statute in terms of providing public service content that appeals to diverse audiences. The way in which licences are structured for Channel Five and ITV, to balance commercial considerations against the benefits of the licences is a consideration for us but it is of the second order.

Q275 Baroness Fookes: Is it possible to give the benefits in financial terms? Anne Bulford: It absolutely is, and that task was undertaken by Ofcom as part of its review of public service broadcasting. It put estimates on the value of each licence at that time.

Q276 Baroness Fookes: Would you concur with the conclusions that they reached? Anne Bulford: They reached those conclusions probably 18 months or so ago. Of course, a number of things have changed since then, but we absolutely concurred with the principles of their approach.

Q277 The Chairman: Can you just remind us of the figures that they gave in both cases? Anne Bulford: No, I can’t. I would have to refer back. Martin Stott: No, not offhand, but we can let you know that2.

The Chairman: That would be useful. I do not know whether it appears in your evidence. The figure that was given even for ITV, as I recall it, was not massive; we were talking £40 million or £50 million.

Lord Gordon of Strathblane: It was outweighed by its expenditure on regional news.

Q278 Lord Razzall: As Five, do you really believe that being one place above Sky1 on the EPG justifies having a licence? In Channel Four’s case, it is two above Sky1. Martin Stott: That is a hypothetical question. One does not know what the alternative would be. At the moment, we are due appropriate prominence. If we did not have appropriate prominence, we do not know where we would be—and Sky declines to tell us.

Q279 Baroness Fookes: We have already spoken about COSTA. Do you think that it is a fair burden on you in return for the benefits? Do you feel that it is an unfair regulatory burden upon you? Kelly Williams: In terms of the number of minutes? Baroness Fookes: Yes, or in any other way, if you have some other point to make. We have already looked at the number of minutes.

The Chairman: It is the frequency as well as the amount. Martin Stott: We feel that the justification for having differential rules for public service channels and other channels no longer holds. Therefore, it would be better to do away with them. There is also the

2 The witnesses subsequently referred the Committee to the Second Public Service Broadcasting Review—Phase 2: preparing for the digital future, published in September 2008, in which Ofcom estimated the allocation of spectrum capacity to the commercial PSBs as worth £120m in total in 2012/13 and EPG prominence for commercial PSBs as worth in total a minimum of £30m.
advantage both for viewers and for all broadcasters that it would take some impacts out of the market. That would benefit the whole industry commercially. 

Gill Pritchard: We agree. The original rationale in promoting the growth of multi-channel has now receded as multi-channel is about to hit 100% of homes. In a fully digital world, we accept it may feel illogical to have different rules across the piece. In addition, as Anne mentioned, we have strong research to show that viewers welcome the reduction in minutes on non-PSBs. Conversely, they do not want to see more minutes on PSB channels.

The Chairman: So, a level playing field all round. Baroness Fookes: And a lower field. I would certainly say okay to that as an individual viewer.

Q280 Lord Razzall: But presumably you want to maintain the requirement regarding the electronic programme guide?

Anne Bulford: Yes.

Q281 Lord Razzall: So that's not part of the level playing field that you wish to have?

Anne Bulford: It goes back to public service broadcasters. The terms of their licence carry public service obligations.

The Chairman: They are what you get in return for being a public service broadcaster.

Q282 Lord Bragg: You both, 4 and Five, argue that removing CRR would have a negative impact on the other commercial public service broadcasters. Taking the financial impact first, what is your evidence for that?

Kelly Williams: Channel Five's view is that the removal of CRR has both negative and positive features. Our view is that the unintended consequence of CRR has been to bind ITV and, given that it is the market leader, effectively the industry, to trade share-of-broadcast deals. We believe that that has a negative effect on the overall television market. However, we also believe that an unconstrained, unregulated ITV would have a negative effect on the market.

Q283 Lord Bragg: So your views rule each other out. It is very neat, but it is not an answer. You have said that removing CRR would have a negative impact on the commercial public service broadcasters. What is your evidence? You have given me two views, but no evidence. That is a statement: it will have a negative effect.

Kelly Williams: The short-term negative effect for Channel Five of ITV not being regulated, given the market trading system, would be that it would take a bigger share of the market.

Q284 Lord Bragg: Okay. Can we stop there for a second? Maybe you want to come in on that, because I think you're both up a gum tree about this market idea.

Anne Bulford: Our view is that ITV1's considerable market power remains. CRR was introduced back in 2003, as everybody knows, at the point of the Carlton-Granada merger. ITV1 continues to have unique qualities, which means that, for advertisers, it is where they need to go. That has not changed. The need for the competition remedy remains.

Q285 Lord Bragg: I'm very sorry. I do not mean to be rude, but you have not answered the question. What is the negative impact? You are talking generalisations. We have heard all of those: some of the make sense and some of them don't. But you have said that it would have a negative impact. What is the negative impact?

Anne Bulford: The negative impact is that if ITV were to be unconstrained it would potentially use its power in the market to increase price. There is no evidence that an increase in price would result in an overall increase in the market; it would simply be a re-division of existing revenues, which would be at the expense of other players.

Q286 Lord Bragg: Can I put one or two points to you? Channel 4 is a strong market player now. Your sales have a 28% market share. Do you really need protection in the ad sales area? Don't you think that the lifting of CRR would help all commercial broadcasters to grow the market, that there isn't a zero sum here or a finite market? Increasing activity in ITV would help all commercial television. What arguments do you have against that?

Anne Bulford: It is not certain at all that taking off CRR would increase the market. We do not believe that CRR being in place has caused market decline since 2003.

Q287 Lord Bragg: It has caused a lot of decline. We have the figures.

Anne Bulford: Our view is that the principal reason for the decline in the market since 2003 is digital switchover and the increase in supply in the market. Commercial impacts in the period between 2002 and 2009 have increased by 35%. That, combined with the economic recession, is the principal reason for the deflationary effect on the market in that period.

Q288 Lord Bragg: That is arguable, but it still comes back to the same question. You are working on the basis that there is a finite pot. If CRR were lifted and people came in and competed more, the pot would grow. Is not the idea of it being finite an obstruction to the whole argument? Perhaps I may quote from your deputy chairman in a debate in this House just
a month or two ago: “As someone who has watched developments in this very specialised sector [he was talking about CRR] for a great number of years, it is clear to me that the Competition Commission struggles when it tries to deal with this very fast moving and complex area. I do not expect it to put its hand up and say that it cannot cope, but it would be helpful if the Government put their hand up for it”. In other words, he thinks, “Why don’t we look at CRR and probably get rid of it?” What do you say to that?
Anne Bulford: Well, our deputy chairman was speaking—
Lord Bragg: As deputy chairman. He declared his interest.
Anne Bulford: Of course he declared his interest. Channel 4’s position in relation to CRR has been consistent throughout. The deputy chairman was not calling for the abolition of CRR.

Q289 Lord Bragg: It reads like that to me. If you could interpret it a different way, I would be very interested.
Anne Bulford: He was speaking in favour of potentially bringing power back to the Secretary of State to look at CRR, which is different from lifting it.

Q290 Lord Bragg: I don’t agree with your interpretation, but we need not squabble about that. It seems to me that ITV’s revenue has decreased comparatively, and that Channel 4 has increased comparatively, is in a strong position and is getting a good deal out of the imposition of CRR. That is as may be, but what is wrong is that you still have the basic idea that if you take this protectionist view, you will somehow carve up the market better. I suggest a much more open idea, which is that the market is there to be expanded and that CRR is keeping it tight. In my view, you are doing yourselves no justice. Moreover, given Channel 4’s strength now, with a 28% market share, to say you need protection is a bit rich.
Anne Bulford: In 2009, ITV1 had a 38% share. Channel 4, the core channel and as the next largest channel, had 19%. The ITV group had a 45% share and the Channel 4 group share was around 25%. So ITV is still much larger. I do not think there is any argument about the dominance of ITV1 in terms of its ability to reach mass audiences.

Q291 Lord Bragg: So you are doing this for the public interest. You think that CRR is in place for the public interest, and that is the way it works. It has nothing to do with the great benefit to you compared with ITV.
Anne Bulford: CRR is a competition remedy, and it is a very straightforward one.

Q292 Lord Bragg: It was at the time. When do you think it will fall away? Do you think the time will come when it has done its job?
Anne Bulford: There may well come a time when it has done its job.

Q293 Lord Bragg: Your deputy chairman seems to think its time has come.
Anne Bulford: It remains the case that ITV1’s market position is pretty much as it was in 2003. CRR is a simple mechanism. When ITV1’s share goes down, its revenue is linked to that. When ITV1’s share goes up—not the whole of the portfolio—as indeed it has in 2010, ITV’s revenue goes up. Because of the way the market is traded, throughout this period ITV1’s price has actually gone up.

Q294 Lord Bragg: Except that ITV has less money to spend in real terms, and that has been the case for the past 10 years.
Anne Bulford: ITV1’s audience performance in the period has gone down, whereas Channel 4’s audience performance in the period has gone up. That is the critical and principal reason for our increase.

Q295 Lord Gordon of Strathblane: I have a supplementary question that builds on Mr Williams’ opening remarks. You said that CRR had both positive and negative effects. Are you tempted to agree with the view that CRR has depressed the cost of air time? If ITV’s cost of air time has been kept depressed, and they are the market leader, that reduces the value of air time for all of you. Arguably, a rising tide would lift all the boats. I want to explore that thought.
Kelly Williams: I agree with that. Our position is that CRR was put in place in 2003, seven years ago. It binds the whole industry to trading share of broadcast. That is not good for the industry. But what we have just been debating is whether CRR should stay or go. We think that CRR in its current format should change, but that the market needs to be protected. We are in a market of four players: ITV has 48%, Channel 4 has 28%, Sky has 16% and we have 8%. As a small player in that kind of market, we feel that we need protection.

Q296 The Chairman: Martin made the point about short-term effects, but I suspect that what we are really talking about is whether there should be some longer-term limitation on ITV’s market power—not through CRR, but with some other mechanism.
Martin Stott: Or some change in the way that the market works. CRR locks the whole market into the current trading mechanism. We would like to get away from the current trading mechanism, but abolishing CRR will not achieve that.
Q297 The Chairman: What is clear is that you take a very different position from Channel 4.
Anne Bulford: No, I don’t think we do. We are not wholly wedded to CRR. What we are concerned about is that there should be an appropriate competition remedy in place in relation to ITV1’s market power. If someone can come up with a better mechanism, that is fine, but so far CRR has surfaced as the least worst.
The Chairman: Okay, we will come back to you.

Q298 Lord Razzall: One of the reasons why Lord Bragg is focusing on this is because we have had a lot of conflicting evidence on this point from all sorts of people with different interests. Perhaps I could press you a little on this. The answers you have given are clearly based on judgment and not on evidence. As I say, we have had a lot of evidence, but one thing that most people agree with is that it is only on ITV1 that certain products can be effectively advertised, of which the two most obvious are launching a new brand if you are a Procter & Gamble or a Unilever, or if a newspaper group has a scoop on a Saturday and wants to make sure that everyone buys their newspapers on a Sunday. Only ITV1 can really do that. Putting a bit of a factual gloss on Lord Bragg’s question, apart from the obvious possibility that Express newspapers will launch their scoop on Channel Five on a Saturday night—whether that is going to happen or not, who knows—do you accept, first, that that analysis is by and large correct? Secondly, if it is correct, does it matter to you if ITV charges Procter & Gamble, Unilever or a newspaper group a lot more for their advertising if CRR comes up? What impact would that have on you? Taking Lord Bragg’s point, does that not simply mean that advertising revenue in total has gone up, but it has not affected Channel 4 or Channel Five?
Kelly Williams: The way television is traded currently is unique to the UK, in that we trade versus a station average price. If ITV1 charges more for its air time, because the price of television will always be the price of television—all revenue divided by all impacts—if its station price goes up, someone else’s goes down. It goes down because ITV has taken more revenue and we have taken less. So it really matters to us if ITV puts the price up. But I do not believe ITV has argued that that is what it wants to do.

Q299 The Chairman: Do you accept that view?
Anne Bulford: Yes, I think that’s the case. It is very hard to find evidence that the overall spend on advertising goes up simply because you put your prices up. Our experience is exactly as Kelly has described it. To go back to the first part of the question, we agree absolutely with the analysis. I think there is widespread consensus that ITV1 remains uniquely placed to appeal to mass audiences quickly.

Q300 The Chairman: I think we have to move on from this question. What I really want to get to, and I will bring in Lord Gordon in just a sec, is that you have said that you could live with CRR going, as long as there is an alternative that compensates. Can you tell me exactly what that proposal from you would be?
Anne Bulford: No, I am afraid I can’t. A lot of people have looked at alternatives to CRR and ITV have put forward proposals, but so far nothing has surfaced which would deal with that market power position. The remedy was put in place to enable the Carlton-Granada merger.

Q301 The Chairman: Is that true of Channel Five as well?
Kelly Williams: We haven’t got a solution because where we thought we had got to was a decision from the Competition Commission to keep CRR. We thought that that was the decision it had come to. Our view is that, as an industry, that is what we should do next. We do not advocate a market review because potentially that would take too long. We have just had some three or four years of reviewing CRR, but there must be a shorter-term review of an alternative to CRR. That would be Channel Five’s view. We are looking for something that would allow us to change the way we trade.
The Chairman: But you can’t be specific about it. I understand.
Q302 Lord Gordon of Strathblane: Specifically to Anne Bulford, on the issue of whether we are dealing with a zero-sum game, I understand your point that if ITV1’s advertising revenue goes up, by definition yours must come down.
Anne Bulford: That is the very high risk. That is our view.
Lord Gordon of Strathblane: If you think the market would remain static even with the removal of CRR, why do all the big advertisers want to retain it? Surely it is because it keeps the price artificially low for them.
Anne Bulford: It keeps ITV1’s price linked to its audience performance as the dominant market player. That is where advertisers need to go in order to build their mass campaigns. The concern is that ITV1, which is the place advertisers need to go, is in a position to put the price up.

Q303 Lord Gordon of Strathblane: Sorry, I hope I can finish off this point. If ITV’s price is artificially low and advertisers are benefiting from it, why would they pay more to go on other channels if they can get ITV for next to nothing, or at least at a reduced price? Surely that depresses the market for everyone.
Anne Bulford: Our analysis is that the market has been depressed in the period since CRR came in for quite a different reason.
Lord Gordon of Strathblane: Yes. I accept there are other reasons.
Anne Bulford: To return to Lord Bragg’s point about comparisons with international markets, they have had different rates of digital switchover and different issues in terms of supply. We have now reached the point where digital switchover has been largely completed and the increase in impacts coming into the market will start to tail off. It may then be easier to separate these different issues out, but that is our view.

Q304 Lord Skelmersdale: I think we have thrashed cash to death by now, so can I change the subject totally? Channel 4’s written evidence says that removing or relaxing CRR would ‘reduce the diversity of content and viewpoints available to viewers’. I did not understand that at all. Can you explain it?
Anne Bulford: I am afraid it is the same point that we have been rehearsing, which is that if there is a reduction in other commercial broadcasters’ advertising revenue as a result of an increase in ITV’s revenue, it would inevitably impact on Channel 4’s programme budget because of the proportions. Therefore, it would impact on our ability to serve diverse audiences with a range of programming.

Q305 Lord Skelmersdale: Yes, but which content and which viewpoints are you talking about?

Anne Bulford: The Channel 4-originated programming budget. We would have less money to spend across the range of our original drama, documentaries. All of it would be impacted if we have less money to spend.

Q306 Lord Skelmersdale: But you are talking about public broadcasting as a whole. That includes ITV, does it not?
Martin Stott: Isn’t the point that if CRR was abolished and nothing else changed, ITV would gain from that and Channel Five and Channel 4 would suffer.
Lord Skelmersdale: You have made the point very clearly.
Martin Stott: One thing that can be guaranteed is that Channel 4 and Channel Five would have less money to spend on original content. I am afraid that there is no guarantee that ITV would spend any more money on original content.

Q307 Lord Bragg: I am not absolutely sure that original content would be reduced. I do not think that this is a finite pot. I think that that is the game at the back of your minds and I do not think that it obtains.
Martin Stott: With respect, Lord Bragg, that is the nature of a share of broadcast deal. You are talking about dealing percentages of the total sum. If ITV gets a larger percentage of the total sum, it means that there are fewer percentage points left for everybody else. That is the nature of a share of broadcast deal.
Lord Bragg: But if you have a bigger cake, you get a bigger slice. If that slice is 8%, it is 8% of a bigger cake.

Q308 The Chairman: That is the argument: that there ain’t no bigger cake.
Kelly Williams: We are not arguing that. We think that there could be a bigger cake, we really do. That is why we want to unshackle ourselves from share of broadcast deals, which is what CRR does.
The Chairman: But you have short-term pain to get there.
Kelly Williams: But completely unshackling the market or allowing ITV to be unrestrained will, we think, have a detrimental effect on our revenue.

Q309 Lord Razzall: The trouble with that argument—you are not the first people who have made it—is that what everyone then says is “What we don’t want is a review because that will take too long”. This is a difficult one.
Kelly Williams: Our view a number of years ago was to have a market review. It did not come.

Q310 Lord Razzall: And it is now too late. Can I move on to something different? You probably saw, because it got a huge amount of publicity, that when
the chairman and chief executive of ITV appeared before us, they were slated in the media because they did actually say to us that the impact of CRR had forced them to sacrifice diversity in programming and to dumb down. Indeed, the Guardian described that as almost a Ratner moment. The obvious lesson is that you should not make one argument to one group of people when you have not quite satisfied the other group. Do you agree that that is what has happened, although not necessarily as a result of CRR, and have you been aware of a material change in ITV’s scheduling since 2003 when CRR was introduced? Perhaps you had better not answer this, but do you think they just said that to try to persuade us to remove CRR?

Martin Stott: I think there has probably been a narrowing of all broadcasters’ range of programming because we are in a more competitive age. As we have said and as Channel 4 has said already, because there are more channels and people are watching more channels, it is more competitive. Therefore, the sorts of programmes that one might have been able to put on when there were only five channels in most people’s homes cannot survive commercially when there are 40 or 400 channels in people’s homes. That has been the real change, and it has had more impact on our programming decisions, as well as on those of ITV and everyone else.

Q311 Lord Razzall: In an earlier question Lord Bragg mentioned a number of things that ITV used to do and now does not. I will not rehearse them again. What I cannot remember historically is whether those things stopped in 2003, whether they stopped subsequently or whether they stopped before then. The ITV case is that CRR is what has forced them to do this.

Anne Bulford: ITV is a commercial broadcaster with a long and distinguished tradition of very high-quality original programming that appeals to mass audiences. As we understand it, that is the basis of their business model. Some of the trends in the schedule, for example increasing the number of episodes of the most successful soaps, pre-date some of the CRR issues. I think that the trend towards schedules with more peaks in them had always been there. ITV has always had big hit shows in the schedule which have delivered mass audiences. That is the basis of the business model.

Lord Razzall: But some of the hit shows have dumbed down. ITV’s argument is that they have dumbed down as a result of CRR.

Lord Bragg: You have not answered the question. He was not talking about the hit shows because we know about them. He was talking about the shows that get somewhere between 2 million and 5 million viewers and deliver public service broadcasting results in a different way. Take the Yorkshire documentary department, which was the best documentary department on British television for many years. It was abolished because ITV said that it was too expensive to run. You can take their word for it or not, but it has gone. You have dodged this because you are saying, “We know about the high impact and they are good at it”. I would like a bit of fair play. It is quite obvious that they have dropped stuff and it is quite obvious that there is a reason for it. It might be CRR. That is what we are fiddling with, but we are hampered by never getting figures, enough evidence or commitment.

The Chairman: I think we need to move on because we have only 10 minutes or so left.

Q312 Lord St John of Bletso: We noted Ofcom’s review of the air time sales rules with the rescinding of the withholding rule and the conditional selling rule in September. Bearing in mind what we said before about the positive and negative impacts and effects of CRR, what would happen if CRR were to be removed and either the withholding rule or the conditional selling rule were to be reinstated?

Martin Stott: I think Ofcom made a very telling point in its statement, which is that it is quite possible for all broadcasters, if we wanted to withhold air time, effectively to do that. At the moment, we do not schedule any advertising minutes overnight because very few people are watching. If we wanted to reduce the number of advertising minutes we put into the market, we would just put a lot of minutes in programmes that people do not watch in the middle of the night. We do not do that because we have all sorts of commercial imperatives to maximise our impacts and therefore to maximise our commercial revenue. So the withholding rule, in a sense, did not prevent companies deciding to put fewer impacts in the market if they so wished, but none of us has chosen so to do.

Q313 The Chairman: Have you said all you wanted to say?

Gill Pritchard: Yes.

Q314 Lord St John of Bletso: My supplementary has partly been answered by Lord Gordon. If ITV had to sell all of its air time, thus preventing it from artificially raising its prices by withholding some air time, would this be a remedy for some of your concerns?

Anne Bulford: No, I do not think it would.

Martin Stott: The issue that CRR addresses is the question of ITV’s ability to price discriminate because of its unique access to mass audiences. That is what gives ITV its power. If you did not have CRR in place, ITV would be able to exercise that power to the detriment of its competitors. The withholding rule, frankly, is neither here nor there.
Q315 The Chairman: Thank you. I am afraid we have so little time that I am going to have to excuse myself to colleagues and leapfrog to another question. At least in principle, a fair market price for airtime on ITV1 could be determined through an online auction. If this happened, do you think that the revenue of ITV would be higher, lower or about the same as it is currently? We are postulating a different model.

Gill Pritchard: Channel 4 has a strong tradition of innovation and so we have looked quite closely at all the innovations that are coming along in the advertising sales space. The potential for an online auction is one that we have looked at as well. But our priority when looking at alternative mechanisms is to understand the extent to which they meet advertiser needs. The current system gives advertisers planning certainty in that it gives them the ability to plan a campaign and co-ordinate their marketing activity across a range of media well in advance. In turn, that enables them to launch major products. The online auction models currently available are unable to do that, so they are not able to offer advertisers that long-range planning certainty. Although we say, “watch this space”, and continue to monitor it, we do not think there is an alternative that can replicate the benefits of today’s model yet.

Q316 The Chairman: Is that Channel Five’s view?

Kelly Williams: Yes, we would agree. You could probably look at an auction model for one-off events, such as for big event programming.

Q317 The Chairman: As in the United States. Is it a good thing or not? I am not sure whether I got the flavour of that.

Gill Pritchard: If, in the future, and enabled by technology, it could evolve and offer longer-term planning certainty and reduce the transaction costs of doing business, we would definitely look at it. But there are other considerations around scheduling conflicts and advertising conflicts that make it quite a difficult challenge.

The Chairman: Okay, there seems to be a slight difference in nuance, maybe.

Q318 Lord Bragg: You say in Channel 4 that CRR is an example of competition regulation which is needed to protect consumers. How does it protect consumers as distinct from advertisers?

Gill Pritchard: Again, ITV still has clear market power through ITV1, and our belief is that if ITV1 is allowed to put up its price even when its share declines and exert its market power in doing so, there will be correspondingly less spend for other broadcasters and therefore a reduction in the public service output across other broadcasters.

Q319 Lord Bragg: I think what you’re saying is that it protects advertisers and not consumers. That is how I construe your answer to that question.

Gill Pritchard: We are protecting the plurality of public service content available from a wide range of broadcasters. That is in the viewer interest.

Q320 The Chairman: I am not quite sure whether you answered the question directly as to whether a change in the system to an online auction would benefit or disbenefit ITV.

Anne Bulford: I think the answer is that we don’t know. To move to an online auction system would require the development of a sophisticated model. It does not exist at present because of the complexity of what the advertiser is buying and the broadcaster is selling. It may evolve and it may be interesting, and I agree with the analysis by Five that for particular events, the big night at the Superbowl sort of thing, it could work.

Q321 Lord Razzall: Just moving on, I don’t think we need to expand any further on the acceptance that ITV has broad reach in that certain products can only be advertised on ITV to get the reach that the advertiser wants. But we have also had significant evidence that there is a premium attached to its airtime on Channel 4 because of the specific audience it is felt that that channel can reach—the parts that other beers or advertisers cannot reach. There is also the whole issue of digital TV, of course. First, do you accept that there is a premium, and secondly, do you expect it to continue?

Anne Bulford: Channel 4 sells specifically against demographics, particularly upmarket and younger viewers and the elusive group of light viewers. That has enabled us to command a premium in the market which allows us to bring in the revenue we do and then reinvest it back into programming. We hope very much that that differential in sales from Channel 4 will sustain.

Q322 Lord Razzall: You think it will? And where does that lead you in your programming? Does it lead to a tension between maximum audience size and looking for the best demographic spread of audience? How do you resolve that creative tension?

Anne Bulford: There are a number of tensions running through the Channel 4 schedule. One is the requirement to wholly fund our activities from the market, which means that there has to be a level of commercial success. There is always a trade-off between a big audience and having one that is focused on a particular group or demographic. It is the opposite challenge from our colleagues at ITV, where they look for improved demographics. It is very difficult to hold on to the mass audience. Resolving that tension is done through a myriad of
individual decisions about titles and ideas as they come through. It is not a straightforward matter.

Q323 Lord Skelmersdale: Following on from that answer, if you produce a blockbuster, a Monarch of the Glen or a Downton Abbey, how quickly does that affect your advertising revenues? Is it within the six to eight-week programme schedule or is it much later?
Anne Bulford: It may do if there is what is described as short money in the market, but on the whole, this year’s share of audience affects next year’s share of advertising revenue because of the way in which the share deals are traded.

Q324 Lord Skelmersdale: Are your contracts very long term?
Anne Bulford: What tends to happen is the share deals are agreed at the start of the year based very much on forecast performance, but current year performance is an important indicator. So it takes some time for it to come through.

Q325 The Chairman: Is that why they pour over the future schedules?
Anne Bulford: It is exactly, and it is why people talk about the lag effect.

Q326 Lord Skelmersdale: But you don’t know that something is going to be a blockbuster until it has actually started to be shown, do you?
Anne Bulford: If we knew that, we would all be very happy.

The Chairman: On that note, thank you very much. We have reached the witching hour. You may be pleased to hear that we have been so absorbed by your answers and supplementaries that we did not get to all the questions. Again, thank you. It has been very interesting.
In the evidence session on 9 November 2010, Channel 4 referred to viewer research investigating attitudes to different amounts of TV advertising. The key results from this research are reproduced below.

### Viewers don’t want any more advertising on PSB channels – with a third saying there is already too much advertising

Around a third say there is already more advertising than they are happy with on the PSB Channels. Over 2 in 5 say they’re not bothered with current levels but wouldn’t want any more.

Significantly more DTT viewers say “could go up” (16%) than DSAT/CAB viewers (12%)

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**Viewers’ attitudes towards current levels of advertising**

<table>
<thead>
<tr>
<th>Statistic</th>
<th>DTT Adults (%)</th>
<th>DSAT/CAB Adults (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not bothered but wouldn’t want any more</td>
<td>36%</td>
<td>35%</td>
</tr>
<tr>
<td>Could go up quite a bit before it bothered me</td>
<td>16%</td>
<td>12%</td>
</tr>
<tr>
<td>Present levels don’t bother but I would not want any more</td>
<td>43%</td>
<td>43%</td>
</tr>
<tr>
<td>Not really bothered by it</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>There is already more than I am happy with</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Don’t know</td>
<td>34%</td>
<td>37%</td>
</tr>
</tbody>
</table>

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**Breakdown by platform**

<table>
<thead>
<tr>
<th>Platform</th>
<th>All Adults</th>
<th>Terrestrial Adults</th>
<th>M/channel Adults</th>
<th>DTT Adults</th>
<th>DSAT/CAB Adults</th>
</tr>
</thead>
<tbody>
<tr>
<td>Don’t know</td>
<td>34%</td>
<td>36%</td>
<td>36%</td>
<td>35%</td>
<td>37%</td>
</tr>
<tr>
<td>Present levels don’t bother but I would not want any more</td>
<td>42%</td>
<td>43%</td>
<td>43%</td>
<td>43%</td>
<td></td>
</tr>
<tr>
<td>Not really bothered by it</td>
<td>6%</td>
<td>9%</td>
<td>6%</td>
<td>7%</td>
<td></td>
</tr>
<tr>
<td>There is already more than I am happy with</td>
<td>7%</td>
<td>9%</td>
<td>6%</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>Could go up quite a bit before it bothered me</td>
<td>16%</td>
<td>11%</td>
<td>12%</td>
<td>13%</td>
<td></td>
</tr>
</tbody>
</table>
Two thirds oppose an increase in the amount of advertising on PSB commercial channels

Extent to which support or oppose an increase to amount of advertising on PSB commercial channels

- Strongly support an increase
- Tend to support an increase
- No feelings either way
- Tend to oppose an increase
- Strongly oppose an increase
- Don't know

65% strongly oppose / tend to oppose an increase

26%

Strongly support an increase

5%

Tend to support an increase

2%

No feelings either way

1%

Tend to oppose an increase

29%

Strongly oppose an increase

5%

Don't know

26%

Increases in advertising on commercial PSB channels will result in disruptive changes in viewing behaviour

The results indicate that viewing habits would change as a result of increased advertising on commercial PSBs. Viewers would be more likely to avoid adverts and would spend more time watching other channels.

Switch over/PVR to fast forward adverts (net) 55%

Watch other channels with/without adverts (net) 36%

I would be more likely to switch over or do something else during the ad breaks 31%

I would spend more time watching channels that don't have advertising (e.g. BBC channels) 29%

I would be more likely to record programmes and watch them later to fast-forward through the adverts 27%

I would spend more time watching other channels that do have advertising (e.g. E4, ITV2, Dave, Sky1) 8%

Don't know 6%

None of these 9%
2 in 5 viewers (42%) say there is already more advertising than they are happy with

Over a third say that they aren’t bothered by current levels of advertising on commercial non-PSBs but wouldn’t want any more.

Those with satellite/cable are significantly more likely than all multichannel adults and those with DTT to say “there is already more advertising than they are happy with”

In fact, there is support for a decrease in advertising on commercial non-PSB channels

Over half (55%) of the UK public support a decrease in the amount of advertising on non-PSB commercial channels that would bring them in line with commercial PSBs

55% strongly support / tend to support a decrease
TUESDAY 16 NOVEMBER 2010

Examination of Witnesses


Robert Ditcham: Good afternoon. My name is Robert Ditcham. I am the CRR adjudicator.

Julian Gregory: I am Julian Gregory and I am the legal adviser to the office.


Robert Ditcham: The undertakings gave advertisers and media buyers the ability to fall back on their last negotiated contracts and to negotiate fair and

Q327 The Chairman: I warmly welcome you to today’s proceedings. I will ask you to introduce yourself in a minute, but first of all I need to explain to those in the room and on the webcam the procedure that we’re going to follow today. Clearly, we very much hope that you will be able to answer as many questions as possible in open court, so to speak, but we have had discussions with you and we understand that there are issues of commercial confidentiality in particular for which you wish to give your answers in private and follow up on some of the questions we have asked you with observations of a more confidential nature in our private session. We will try to make a note as we go along, but we will try as far as possible to follow up on those in the second session. I do not want people watching or at the back of the Kirk, so to speak, to misunderstand what we are about. You have put the case to us, Robert, that there are areas of a particularly confidential nature where you would prefer to have your answers given in private and we will go to that. From our point of view, we would obviously like to keep that to the minimum if we humanly can. Would you like to introduce yourselves?

Robert Ditcham: Good afternoon. My name is Robert Ditcham. I am the CRR adjudicator.

Julian Gregory: I am Julian Gregory and I am the legal adviser to the office.


Q328 The Chairman: Thank you very much and thank you in particular for having answered some of the questions in advance, which was helpful to allow us to formulate our questions, and for the way in which that was done. I shall kick off with a very broad question. You say that you monitor the operation of the market. In what form do you do this? Is it just a statistical return in your quarterly reports?

Robert Ditcham: The office monitors the operations of the TV advertising market. We have regular meetings with ITV and we engage in dialogue with the market generally and have regular meetings with industry stakeholders. We have to keep aware of Ofcom regulation and monitor developments in the sales and buying sides of the industry. We spend a lot of time monitoring the viewing and revenue figures of broadcasters and I’m generally immersed in the industry. In terms of monitoring the effectiveness of the undertakings, again we meet regularly with ITV and we meet quarterly with the sales side of ITV. Again, we have regular contact with Ofcom and produce quarterly reports to the OFT and to Ofcom, two of which are made public twice a year.

Q329 The Chairman: Do you have regular meetings with the advertising industry as well?

Robert Ditcham: Yes, we do. We keep in touch with the trade bodies, the IPA, who are the practitioners in advertising, and ISBA. Particularly leading up to the negotiations season we will engage with the advertising community and all the other sales houses to get a feeling for how the negotiations season could be unfolding.

Q330 The Chairman: The negotiations season is?

Robert Ditcham: Typically, it starts about now with a view to concluding business for the forthcoming year by the end of the year.

Q331 The Chairman: When the draft schedules are published and all that kind of thing?

Robert Ditcham: Typically, the UK advertising business tends to focus on annual contracts, so this is the appropriate time to be talking to people.

Q332 Baroness Fookes: You have explained how you monitor. Would you care to say how effective you think the monitoring of the undertakings has been? In other words, is it working and is it a success?

Robert Ditcham: The undertakings gave advertisers and media buyers the ability to fall back on their last negotiated contracts and to negotiate fair and
reasonable terms with ITV at any time, linking share of broadcast to share of commercial impacts. Certainly, over that period the undertakings have done what they set out to do. We have identified some unintended consequences, but I would appreciate it if I could possibly take that point outside the public session. To answer your question, they have achieved their objectives, certainly in terms of the specific formulas that were put in place.

Q333 The Chairman: Can I just clarify? What precisely would you like to take out of the public session?

Robert Ditcham: There are some elements, as time has gone on, that we would like to pick up on and explore, but again they tend to be opinions of ours that would potentially involve discussing confidential areas. They are also opinions that it will be not particularly appropriate for us to be discussing, given the job that we do.

Q334 Baroness Fookes: But the passage of time has meant that things have changed somewhat.

Robert Ditcham: I think inevitably things have changed, yes.

Baroness Fookes: So we could explore that further later?

Robert Ditcham: Absolutely, I would be very pleased to.

Q335 Lord Dixon-Smith: It seems that ITV was cutting back on investment in original content before the CRR came in. Was this simply a deliberate management strategy, or was it a strategy that they developed because they could see CRR coming?

Robert Ditcham: Again, our role is a very particular function. For us to comment on ITV’s investment strategy and its performance in a public forum puts us in quite a difficult position. I would like to answer that question a little later on if I may.

Lord Dixon-Smith: Fair enough.

Q336 The Chairman: If you gave an answer in open court, so to speak, do you think that would compromise your independence?

Robert Ditcham: Yes.

Q337 Baroness Deech: I hope you don’t find my question similar. I wanted to ask you about the current management, who say that they plan to promote a content-led strategy, but CRR is restricting their ability to do so. I don’t know whether you agree, but how can we reach a judgment on this? Is CRR restricting the ability of ITV to put more into content?

Robert Ditcham: Again, that puts me in a—

Q338 The Chairman: If you can’t answer or give an opinion on that, can you give an opinion on how we might best formulate an opinion ourselves?

Robert Ditcham: Clearly, how ITV spends its money on its content is something that you would all be very interested to examine. I guess that it is about coming out with the right sort of questions for ITV. I apologise that I’m not being particularly clear in helping you to answer that question, but I feel that it pushes me into expressing opinions that would not be appropriate.

Q339 The Chairman: You are right at the heart of these matters and in a sense you deal with the information that comes up from both sides very regularly. To some extent, this Committee is evaluating the information that is coming from different sides.

Julian Gregory: Robert is not saying that he is not prepared to offer an opinion; he is just saying that he would rather talk about it in the non-public session later on.

The Chairman: It should be possible to tell us what kind of information is crucial in the process, but not necessarily the weight that we should give to it.

Q340 Lord Razzall: Our problem is that we have diametrically conflicting evidence. Actually, it is not diametrically conflicting, but we have different evidence on all sides on this point.

Robert Ditcham: We have submitted our answers to your questions and we have got some thoughts on that, so I hope we can help you with some answers on that a little later.

Q341 Lord Stevenson of Balmacara: As I understand it, your remit is largely UK-based, so maybe you can answer this question. We have had evidence from ITV that advertising revenue has fallen more relative to the audience delivery than for equivalent mass audience broadcasters elsewhere in the world. Do you take into account international comparisons when you are assessing the impact of CRR?

Robert Ditcham: Certainly, with the questions that you have asked us and some of the answers that we have given we have tried to think about other markets and the impacts and cross references from them to the UK. We can pick up on some of those later. In terms of you trying to work your way through some of the difficult answers you have had from the various stakeholders, there are clearly a lot of global advertisers these days and a lot of media buyers who spend their money all over the world. So to answer some of these questions about how the UK compares with other markets, you have a good body
of people in the UK who should be able to share some of that experience with you.

The Chairman: That is a very good point, but again we get very conflicting views on that, even from those who operate elsewhere.

Q342 Lord Stevenson of Balmacara: It is very useful, as the Lord Chairman said, but my question is what you do about it. Have you looked specifically at any particular territories?

Robert Ditcham: Our remit is principally on resolving disputes with advertisers. It is very UK-focused and the issues that we are looking at relate directly to the undertakings and they have few if any reference points outside the UK.

Q343 Lord Stevenson of Balmacara: So that is a no?

Robert Ditcham: It is a no.

Julian Gregory: I think the Committee has observed that the rationale for the remedy was driven by the competition concerns of the CC at the time of the merger, which were based on the statutory competition provisions. The Committee has noted that there are potentially broader considerations that one could take into account, but the office is just implementing a remedy that is designed to address the competition concerns.

The Chairman: Yes, that is accepted because we have explored that public interest aspect quite extensively during the inquiry, but obviously we recognise that you are in a sense implementers rather than policymakers in that respect.

Q344 Lord Gordon of Strathblane: I am just trying to establish definite facts. Is it a fact that the cost per thousand, to use an old-fashioned term, of airtime on ITV has declined since the introduction of CRR?

Robert Ditcham: Yes.

Q345 Lord Gordon of Strathblane: Would you quantify that in any way?

Robert Ditcham: Since 2003, based on our estimates of where 2010 is going to end up, ITV’s costs have dropped by 7%—

Julian Gregory: 7.7%.

Robert Ditcham: 7.7%, against a marketplace at nearly 20%.

Q346 Lord Gordon of Strathblane: Widening that slightly, CRR in some ways might be thought to be protecting two lots of people—the advertisers and other commercial broadcasters who are not quite as big as ITV. If we ignore for a moment the interests of advertisers, might there not be a case that a rising tide lifts all boats, or is it a zero-sum game and if ITV gains, the rest lose? Is that inevitable?

Robert Ditcham: While the current airtime sales system is in place, with the way airtime is traded in terms of share of broadcast being the focus, it is certainly in large part a zero-sum game.

Lord Gordon of Strathblane: Yes, but that caveat of “while that system is in place” is quite important.

Robert Ditcham: Absolutely.

Q347 The Chairman: I am not quite sure that we have got to the nub of this. The question was asked about whether it is significantly lower in real terms now, but it is the linkage to CRR. Is that the actual results of CRR?

Robert Ditcham: Again, I apologise for wriggling a bit here. I think we have highlighted in our document that there are a number of factors in play, one of which is CRR. We would like to pick up on that in the private session. The only other point to make about the fortunes for ITV and the media market since 2003 is that in 2010 we have seen a big turnaround in revenue. We have tried to look at the market from 2010 back to 2003. I think we put that in the answers to some of the questions, which we would like to pick up with you.

The Chairman: I think we will want to explore that quite considerably in the private session, because it seems extraordinary that the prices have dropped and yet the argument is still being made that CRR should be maintained in all circumstances and so on—not even a modification is accepted by the advertising industry, which again is somewhat counterintuitive.

Q348 Lord Macdonald of Tradeston: Who has the oversight of your office? Who funds it and who monitors the adjudicator?

Robert Ditcham: It is funded by ITV. The budget is approved by Ofcom in consultation with ITV. In terms of my reporting lines, the office is independent, so it was always set up to be independent of Ofcom and it is so. I have meetings with Ofcom twice a month. I meet the chief executive of Ofcom three times a year. Those are the rules of engagement.

Q349 Lord Macdonald of Tradeston: I see that you haven’t had a complaint for a couple of years now. In other circumstances, were you a quango, you would probably be up for abolition at the moment. You are implementing a remedy, but it looks as though the remedy is in place. I know it is difficult in these circumstances, but is there a point at which you are no longer necessary?

Robert Ditcham: You’re absolutely right. February 2008 was the last dispute. Since 2003 there have been 15 disputes, so they are not something that there has been a lot of over time. Our office is there to deal with disputes when they come along. We still get a lot of guidance inquiries. To the year ending this April I think we had something like 30 approaches, with
questions on the undertakings that buyers needed answers to. The IPA and ISBA have raised this with us in some of the letters that they send to us that accompany our reports. In some respects, the undertakings are there and are understood. ITV conforms to them and complies with them. The adjudicator is a deterrent in many respects.

Q350 Lord Macdonald of Tradeston: Do you have the power to look at the terms of every contract, or can you only be activated when somebody complains to you?
Robert Ditcham: No, we have all the contracts that ITV has either in our office or at hand if we need to look at them.

Q351 Lord Macdonald of Tradeston: I suppose one of the most basic questions that we have come across is whether advertising revenue on commercial television is a zero-sum game. That is a view that does not hold in most areas of economic life. Do you think that it could be made to rise in the event of CRR being removed? Wouldn't that be a way of growing the whole cake for television advertising if there were more market freedom there?
Robert Ditcham: Could I answer that question a little bit later on in the private session?

Q352 The Lord Bishop of Liverpool: You may feel that you want to answer this question later on, too. It is about your attitude to the position of Channel 4 and Channel Five, who are much more ambivalent about the impact on advertising revenue, should the CRR be removed.
Robert Ditcham: My understanding is that Channel 5 was keen for it to be removed provided that something else was in its place. I think Channel 4 was probably a little harder-lined on the removal of CRR. Again, we don’t really have a view on whatever they say, because it is not really our position to have one, certainly not publicly.

Q353 The Lord Bishop of Liverpool: Can I ask you to comment on this point? CRR was brought in to deal with a monopoly situation and in the process seems to have created another monopoly, in that four media buyers have increased their market share from half to three-quarters. Does that concern you?
Robert Ditcham: In what context?
The Lord Bishop of Liverpool: In the context that it is narrowing the number of people in the market. If you only have four people controlling three-quarters of the market, that could lead to other things like price-fixing, for example.
Robert Ditcham: Again, that is something that Ofcom and the OFT would pick up on as opposed to us.

Q354 The Lord Bishop of Liverpool: But do you not observe anything that makes you concerned?
Robert Ditcham: I certainly think that we have some views on the issue of consolidating media buyers and the buying groups, but again they are probably best served in private session.

Q355 Lord St John of Bletso: You mentioned that audience fragmentation will tend to strengthen ITV’s bargaining position, but with the increased reach of the many non-PSB commercial channels after digital switchover in 2012, surely that will tend to weaken ITV’s bargaining position.
Robert Ditcham: You are talking about the increased reach of the non-PSB channels. I’m not sure that their reach is increasing greatly. We have now seen the multi-channel buildout happening. We have talked about this in more detail, but the smaller channels tend to be the ones that are adding frequency to the advertisers’ schedules as opposed to driving coverage. That has certainly been the case for a number of years and is still the case today. I am not sure how much weight should be applied to the smaller channels and their ability to deliver increased coverage at the moment.

Q356 Lord St John of Bletso: The question is really whether this tends to weaken ITV’s bargaining position.
Robert Ditcham: I would answer that at this moment by saying that the bigger channels have still got significant reach and coverage that would tend to be what they are bargaining over.

Q357 Lord Skelmersdale: If CRR didn’t exist, some other form of operation would have to be arrived at. In paragraph 45 of your written response you say that numerous practical issues would need to be resolved in order for an auction system to operate effectively. Can I suggest to you that if ITV were required to sell all the airtime on, say, its 1,000 highest-rating annual broadcasts through a transparent auction, and if advertising agencies were allowed to trade airtime through a secondary market, this might be a viable alternative?
Robert Ditcham: Again, we definitely have some comments to make on this. I think I would feel a little bit uncomfortable on whether it is appropriate for the office to be talking publicly about alternatives to CRR, and in particular an auction system. I am very sorry to say that, but if I could I would like to pick up on that a little bit later on. I would appreciate that.
Lord Razzall: I think we would like you to, because you would be the first witness who has indicated in any way that they think the current system should be changed.
Lord Skelmersdale: Could be changed.
Lord Razzall: Right across the board, nobody else is remotely interested in changing this arcane structure.

Q358 The Chairman: That is a very useful starting point for a further discussion, which you would prefer not to expand on at this point?
Robert Ditcham: If that is all right, Lord Chairman, yes.

Q359 Lord Razzall: You may not want to answer this in public, but there is a suggestion that fear of reprisals might prevent media buyers from bringing a dispute to you. Do you actually believe that the potential for ITV to penalise agencies that bring disputes deters media agencies from bringing potential disputes?
Robert Ditcham: I think we would have to be very careful about making any comments that could imply that one side is weaker than the other. I would rather take that one outside the public session.

Q360 Lord Razzall: Do you want to comment in public session on the fact that there are so few complaints to you?
Robert Ditcham: I picked up a little earlier on the issue of bringing disputes to the office. A lot of disputes are resolved before they get to us. It is an interesting area and I would be a lot more comfortable picking up on it a little later.

Q361 Lord Dixon-Smith: Is there a hint there somewhere that the fact of your existence provides a resolution to something that might otherwise be a dispute? The fact that you are there means that they sort out before they get to you.
Robert Ditcham: People understand the rules, which have now been in place for seven years, so they are even more familiar with them. It is definitely the case that people will not have a problem because they know where it is going to head and they get on with business.

Q362 Lord Gordon of Strathblane: You are regarded as a sort of nuclear deterrent?
Robert Ditcham: That is the only time I have been described like that.

Q363 The Chairman: That is a question I think you can answer in public. How strong is the deterrent effect?
Robert Ditcham: The undertakings were quite prescriptive about this. They talked about the buyer and the seller trying to resolve things before they got to the hassle and time of going through an adjudication process and a dispute. I think that if people can resolve things before coming to the office, they will do so. That should be encouraged.

The Chairman: Okay, thank you. We are now going to go into private session for the next period.

Evidence was taken in private.

Memorandum by the Incorporated Society of British Advertisers (ISBA) (RTA 6)

1. SCOPE AND LAYOUT OF THIS RESPONSE
From the Call for Evidence, it is our clear understanding that this inquiry relates to the economic regulation of TV advertising and not to the rules governing advertisement content.

Many others respondents will doubtless offer detailed commentaries on expenditure and forecasts so we do not propose to add to that volume.

Instead, we will confine our comments to what we see as the critical components of the market’s operation before responding to the specific questions in the Committee’s Call for Evidence. In these comments, we will seek to address the questions in the Call for Evidence:

— How much of the recent decline in television advertising was due to migration to the internet and how much was due to the economic recession?
— Can television compete successfully in the medium-term with the internet and other media for advertising?
— Whether the current level of regulation of television advertising is appropriate.
— What the financial impact might be on television companies if changes are made to the regulation of scheduling and sales of television advertising or if product placement is introduced.
— The extent to which the CRR undertakings limit ITV’s ability to compete in the production of quality programming.
— The extent to which the reduction or removal of the CCR undertakings would affect the commercial public broadcasting sector.
— The extent to which current arrangements reflect the public interest.
2. About ISBA

ISBA is the not-for-profit representative body of British advertisers. It counts some 450 advertiser companies in its membership, including eight of the top 10 and 22 of the top 25. Its members account for some £10 billion, or 50%, of total marketing communications annually, and almost three-quarters of all expenditure on UK commercial television. See www.isba.org.uk for more information.

ISBA has therefore been closely and actively involved in many regulatory discussions concerning the UK’s media over many years, including more recent consultations on all the matters discussed below.

3. The BBC

Although it does not carry advertising on its UK broadcast channels, it is not possible to have an effective discussion of the UK TV advertising market without first considering the significant influence of the BBC.

The Corporation was founded in 1926 by wireless receiver manufacturers to address a fundamental market failure - that without programme material being broadcast, nobody would buy their receiver sets. Over time, ISBA has argued consistently that it has burgeoned into a multi-media corporation whose activities sprawl way beyond its public service remit and the mission set out by former Director General Lord Reith to “inform, educate, entertain”.

In both TV and radio, The BBC competes with commercial broadcasters to provide popular entertainment. From early days as publisher of the Radio Times, it has built on successful spinoffs of already successful programmes like *Top Gear* to become one of the UK’s largest and most successful consumer magazine publishers. It has also developed one of the most significant online presences of any UK entity.

Perversely for a public corporation paid for through the licence fee which is a hypothecated tax, the BBC is not subject to the same depth or breadth of regulation as its commercial counterparts. This manifests itself in all kinds of ways, from spontaneous overnight reformulation of its radio stations in a manner prohibited to its commercial counterparts (which are subject to very detailed regulation by Ofcom) to continuous forays into areas of the market well-served by the commercial sector, such as magazine publishing and online media.

The Corporation continues to compete head-to-head with commercial broadcasters in areas where there is no clear market need, perhaps the most conspicuous example being in popular entertainment on Saturday evenings.

Much has been said and written about the BBC’s roles as a national institution and in keeping standards in broadcasting high. We do not consider either of these laudable objectives is best served by such behaviour.

We had hoped that the transition from the discredited Governors to the new BBC Trust a few years ago might herald more effective governance, but this has sadly not been the case. The BBC has certainly indulged in no less excess under the Trust than under its previous governance.

All of these factors create significant market distortion for the commercial media players in these spaces. The most striking example is in television, where the UK is unique in having a publicly-funded, “public service” broadcaster which does not carry advertising and which enjoys 30.25% share of viewing to its channels.1 (Many other developed countries have state broadcasters, but we are aware of none which enjoy the combination of freedom from advertising support and such a significant share of viewing).

The existence of the BBC leads to the blunt economic truth that 100% of demand for TV advertising airtime is chasing the 69.75% of total viewing to commercial channels to which it has access.2 Since advertisers seek to reach and influence viewers, anything which effectively removes viewers from the commercial sector’s reach has a profound impact. UK TV advertising is in effect a “forced market”. (And Radio more so, as the advertising-free BBC gains more than half of all listening).

4. UK Commercial TV

Up until 1982, the UK only had a single commercial channel comprising 14 regional stations—ITV. Viewers can now choose from more than 500 broadcast TV channels in the UK. Other media too have proliferated, and more recently have been joined by a virtually limitless supply of online media channels, including myriad online TV channels.

Perhaps surprisingly, the advent of online since the 1990’s has neither hampered this proliferation, nor revenues, significantly. TV remains the most important channel for advertisers seeking to reach and influence mass markets. Its combination of scale and audiovisual impact remains un paralleled, especially when it is used

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in combination with other media whose attributes complement and reinforce it, such as online. In our members’ view, television and online perform different functions and are not competitive but complementary.

Within television, ITV—and to a lesser extent, Channel 4—are most sought after by advertisers and command the highest prices for their airtime. In ITV’s case, this is because of the sheer scale of commercial audience it can achieve. In Channel 4’s case, it is because of the unique profile of some of its audiences.

To understand the economics which drive the commercial (advertising-funded) media one must first consider how advertisers use them.

Whichever media channel or channels they choose to use, advertisers invariably seek to maximise the proportion of their selected target market which sees a commercial a specified number of times. Too few and the message may not be fully understood or recalled, too many and it may begin to irritate, leading to diminishing returns.

(The one notable exception to this is direct response advertising, which tends to seek to achieve continuous exposure to relatively small audiences, thereby delivering consistent and manageable volumes of calls to call centres. A peaktime spot reaching millions of viewers has little value to these advertisers as it merely serves to flood their call centres’ lines with large numbers of calls they cannot handle, and on which they can therefore not capitalise).

The proportion of audience reached, expressed as a percentage, is called “coverage”. The average number of opportunities viewers have to see the advertising is known as “frequency”.

Any spot on any TV channel contributes frequency, but only channels with large and diverse audiences can build mass coverage, and this is why ITV (and to a lesser extent, Channel 4) are more attractive to most advertisers and enjoy revenue shares ahead of their audience share, whereas other, more niche channels do not.

Media is usually the largest component cost within an advertising campaign, so it is not surprising that most major advertisers take a very keen interest in it. However, for a variety of practical reasons, the overwhelming majority do not plan or buy their media themselves, but instead enlist the help of specialist media agencies.

As the number of channels has proliferated, so —one might think— has advertiser and media agency choice and competition for their budgets. However, this has not been the case for two reasons:

— First, as we showed in depth to the Competition Commission’s recent review of Contract Rights Renewal, because only a very few channels can deliver—and only one, ITV, significantly —the mass coverage advertisers seek.

— Second, because commercial airtime is not sold by each channel but by sales operations owned by and attached to the major broadcasters. The number of these has never been great and recent consolidation has seen the emergence of only three major players:

— ITV Sales handles airtime sales for its own channels and GMTV, which it also owns. It is expected to take 46.4% of all TV advertising expenditure in 2011, making it the dominant player in the space.

— Channel 4 handles its own airtime sales and from 2011 will also represent UKTV’s channels, with a forecast 27.8% share of total TV advertising expenditure.

— BSkyB’s Sky Media handles airtime sales for all of its own and many third party channels carried on its platform, and has recently acquired airtime sales for Viacom’s and Virgin Media’s channels. It is expected to take 17.8% of total TV adspend in 2011.

— Five continues to sell its own airtime and is expected to take 7.4% of 2011 TV adspend. Its new owner, Northern & Shell, which also owns the Express and Star newspapers, OK! and other magazine titles, is expected to leverage its position by cross-selling and bundling its media.

— The small remaining slice of TV adspend—0.9%—will be contested by Turner Broadcasting and a few very small independent sales houses representing small numbers of very niche channels.3

— The “supply side” of the market—ie the sales points—is much more consolidated than the “buy side”. Media agencies have seen significant consolidation over the past decade and less than 10 buyers now account for over 80% of the market, but the advertiser base is still very fragmented, with the UK’s largest advertiser accounting for less than 5% of total TV advertising.4

This is why ISBA supports broadcaster calls for the legacy regulatory burdens which genuinely hamper their ability to compete for audiences (such as overly tight programming remits and quotas), but also continues to argue that economic regulation continues to be absolutely necessary in the market for airtme sales.

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3 Source—Group M/MediaCom estimates, Sept 2010
4 Source—Nielsen NMR.
Scant attention is often given to the second-and third order implications of the economic regulation of television. By this we mean the impacts on advertisers (second order) and on their customers and consumers (third-order).

If necessary regulations are removed and broadcasters’ sales houses are allowed thus to leverage higher process, this will have adverse impacts on many UK businesses. They will in turn have to pass at least some of any increase in input costs, such as the cost of advertising, on to their consumers. In other words, concessions to a single vociferous and influential sector can lead to much wider detriments.

5. **Contract Rights Renewal**

The relatively scarce supply and attendant low level of competition in the market for prime airtime led ISBA to argue for and win appropriate protection for advertisers when ITV plc was formed from the merger of Granada Television and Carlton Communications in 2003.

The Competition Commission (CC) recognised that ITV plc would have a clearly dominant position in its market, and introduced a pricing remedy which became known as Contract Rights Renewal, or CRR. This pricing remedy was of ITV’s own invention, and was chosen in preference to an alternative proposal from the then-regulator, the Independent Television Commission, just before its powers passed to a nascent Ofcom.

The key strength of CRR was and is the introduction, for the first time, of a positive incentive for ITV to optimise its audience performance. (Hitherto, the relationship was perverse -falling audiences meant that advertisers chasing audience targets either had to face shortfalls which might adversely affect sales, or had to spend more to reach them).

CRR (and the Independent Adjudicator whose office oversees the remedy’s workings and adjudicates in cases of dispute between ITV and media buying agencies) have proved to be an unusually durable and effective competition intervention. Both are considered successes in competition circles and are cited whenever solutions are sought in other markets.

CRR has been reviewed thoroughly over the last two years, first by the Office of Fair Trading and Ofcom, and then by the CC. Once again, ISBA made significant input. The CC concluded that although ITV’s market share had declined somewhat, it remained dominant and that the CRR remedy remained necessary.

The CC also recommended that CRR was varied to include time-shifted and high definition versions of ITV1.

ISBA readily supported this appropriate and logical development.

This Inquiry’s Call for Evidence follows closely on from Government’s own dedicated and highly-skilled competition regulator’s. We, along with many in the advertising media industry, believe that the CC has developed a particularly good understanding of this market.

In summary, CRR creates a positive performance incentive for ITV. It prevents ITV from leveraging its dominance to command ever-higher prices for static or declining audiences. But contrary to its claims, it does not prevent it from investing in content proportionate to its success—just like any other broadcaster.

Moreover, it has been widely recognised that there are significant barriers to entry to mass-TV broadcasting. ITV enjoys massive scale advantage which has its roots in a time long before out-and-out commercial (and BBC) competition for audience.

6. **Airtime Sales Rules**

Ofcom recently consulted on its intention to remove its long-standing airtime sales rules governing two particular areas: “withholding” and “conditional selling”.

The withholding rule applied only to public service broadcasters, and required them to make their very best endeavours to sell all of their commercial airtime, thus allowing the market to “clear” at its natural price. (This rule was introduced some 20 years ago previously in response to certain ITV stations serially withholding airtime to force its price, and thus their revenues).

The conditional selling rule prevented airtime sales houses from leveraging the sale of weaker, less desirable airtime by demanding its purchase alongside stronger, more desirable airtime. (Again, this rule had its origins back in the time when each ITV station also sold channel 4’s airtime in its region).

Ofcom argued its beliefs that “sufficient economic incentives now exist to prevent broadcasters from withholding airtime”, and that there is sufficient recourse for advertisers to resist or appeal against conditional bundling/selling.

5 eg Competition Commission reports 2003 and 2010.
ISBA, on behalf of its advertiser members, stressed the importance of ensuring that each channel’s market clears at a natural price determined only by advertiser demand for its airtime and by the audience it delivered. We therefore called for the maintenance of both rules, but from the outset it was clear that Ofcom was minded to overturn these important rules. In the event, and to ISBA’s grave disappointment, it did so.

It may be that the continued presence of CRR acts as “sufficient economic incentive” for ITV, but we believe that, without these rules, other broadcasters could try to force their prices by withholding airtime, as might ITV if CRR were withdrawn.

Advertisers balance the mix of channels they use to deliver optimal coverage and frequency at the keenest price. In practice this means using ITV, and perhaps Channel 4 as the principal coverage building channels, and numerous other stations with relevant audience profiles to delivery frequency cost-effectively.

Following the removal of the rules, we expect to see quite extensive conditional selling and leveraging of channels, particularly in the light of sales house consolidations. We believe that this could well lead to our members being asked to pay higher prices for weaker stations’ airtime in order to access prime airtime on stronger channels. If the price of these “cost-reducing” stations’ airtime rises, so will overall prices leading to the second-and third-order detriments referred to at the conclusion of section 4 above.

7. Product Placement

Another recent development is Government’s decision during the Parliamentary legislative “wash-up” which preceded the General Election to allow paid product placement in TV programmes.

Perhaps somewhat surprisingly for an organisation whose aim is to protect and enhance advertiser freedoms, ISBA recommended caution during the several lengthy Government and regulatory consultations which preceded this decision.

Given that product placement occurs within programmes, and not between them like advertising or sponsorship, we suggested that the implications needed to be thought through very clearly.

Whilst broadcasters argued vociferously that they needed to be allowed to develop new revenue streams, we pointed out that unpaid “prop placement” had operated on all channels, including the BBC’s, for many years without incident or complaint.

The higher costs of paid product placement, on the other hand, would lead advertisers to expect greater prominence for those placements, in turn challenging undue prominence rules and in extreme cases possibly leading to attempts to influence programme content.

We also argued that broadcasters might well try to close down unpaid “prop placement” in order to channel advertisers into more lucrative paid product placements.

In the event, Government decided to permit paid product placement and Ofcom is currently consulting on its implementation. Disappointingly and quite unilaterally and without consultation, Government at the same time extended the specific rules which govern the scheduling of advertising alcoholic drinks, foods deemed to be high in fat, salt or sugar (HFSS), and gambling by prohibiting them from engaging in any paid product placement.

Not only do we consider this unexpected intervention to be disproportionate and discriminatory, but we also believe that it will hamper broadcasters looking to bolster their revenues, however modestly, with paid product placement. This is because we consider that the programmes that are most likely to appeal to advertisers as the most suitable environments in which to place products are regular shows with large audiences, in other words serials and “soap operas”. Since these typically revolve around a pub and a corner shop, these ill-considered prohibitions could, at a stroke, prevent most relevant candidate paid product placements.

At this stage, it certainly seems that we were right to urge caution.

8. Summary

— No effective examination of the UK’s media markets, particularly Television and Radio, can be undertaken without first considering the enormous impact of the BBC on them.

— Despite the proliferation of channels over recent years, clearly dominant players still exist in the market for commercial airtime

— ISBA and its members, which represent almost 75% of all TV advertising spend, are concerned by the recent dilution of TV advertising regulations, particularly in the light of recent consolidation in airtime sales.
— We strongly refute the notion that CRR prevents ITV from investing in content proportionate to its success. Rather we consider that it remains an appropriate, proportionate and absolutely necessary intervention to protect the advertisers which fund the commercial media in large part from predatory pricing on the part of a clearly-dominant ITV.

— For the reasons we set out above, we are not optimistic as to the incremental revenues which might flow from the legalisation of paid product placement, at least in the short term.

September 2010

Examination of Witnesses

Witnesses: Bob Wootton, Director of Media and Advertising, ISBA, Michael Hutchings, Consulting Competition Lawyer to ISBA and Mary McGovern, Media Manager, Procter & Gamble.

Q364 The Chairman: Welcome and thank you very much coming in. First I ask you to introduce yourselves. Obviously, Mary comes from a slightly different direction and we have fewer questions directed specifically at you. You may or may not be glad to hear that, but if you feel moved to comment on a question that is essentially directed at either Bob or Michael in their ISBA incarnation, please do. The interesting point about P&G is the difference between the way that it operates and the way that the majority of advertisers operate. At the same time as you introduce yourself, Bob, I wonder if you could tell us a bit about ISBA, who you represent—and just as interestingly who you don’t represent.

Bob Wootton: Thank you. Good afternoon. I hope my voice is going to hold. It did not exist at about midday so it has come back a bit. Indulge me if you will. I will speak as loud as I can. I am Bob Wootton. I am director of media and advertising at ISBA, which is the representative organisation of British advertisers. Would you like me to speak to that question now or let me introduce my colleagues first?

Q365 The Chairman: I think we will just follow up with the question about the organisation.

Bob Wootton: ISBA is a small organisation that has been in existence for 110 years. It has 21 staff and a turnover of about £2.5 million. We are a non-profit membership organisation comprising about 430 or 440 of Britain’s leading advertisers. As you might imagine, we tend to appeal to the larger advertiser more than the smaller, but our membership comprises quite a mixed gathering. In answer to your very disarming question, it is probably easier to define ourselves by who isn’t in membership. The three largest non-members of ISBA at the moment are Reckitt Benckiser, Ford and DFS.

Q366 The Chairman: Not because they necessarily do direct deals outside media houses with ITV, but simply because they don’t see the need to belong to a trade body?

Bob Wootton: One of the crosses that anybody like us bears is that much of the work we do is for the many even if we are paid for by the less than many. It is an occupational hazard and some of those companies simply don’t see the need to participate financially. The cost of that is that they don’t influence our policy.

Mary McGovern: I am Mary McGovern. I work for Procter & Gamble looking after the media for the UK and Ireland. I have worked there for over 30 years. I am here with my ISBA hat on, but if you want to ask questions specifically about Procter & Gamble, that is absolutely fine.

Michael Hutchings: I am Michael Hutchings. I am an independent solicitor practising on my own account. I have provided competition advice to ISBA for about 12 years, including throughout the inquiry into the merger of Carlton and Granada and subsequently.

Q367 The Chairman: Thank you. I will kick off the batting, if that isn’t a mixed metaphor. Do you agree that advertisers are not only now able to buy many more impacts, but are also paying much less for each impact?

Bob Wootton: No. It is quite true that the price of commercial television advertising airtime has not inflated over the long term, but it is no cheaper than it has ever been, nor is it much more expensive than it has been for some time. But its recent drop in price is entirely due to market forces—in other words, the prevailing state of the economy, which drives advertising demand, and at the same time the amount of audience that generates.

Q368 Lord Gordon of Strathblane: Leaving aside the potential reasons, on which there could be disagreements, as a matter of fact, has the cost per thousand, to use an old-fashioned term, come down in recent years?

Bob Wootton: I think the cost per thousand in 2009 was cited as the cheapest that television airtime had been since about 1985. It has certainly varied and it has certainly had peaks and troughs, but it hasn’t come down consistently over that time.

Q369 Lord Gordon of Strathblane: Since 2003, de facto, it is lower?

Bob Wootton: Probably at the moment, yes, as an echo of the economy we have just suffered.
The Chairman: We might ask you to give us your definitive view. If we can’t do that now we will follow up. I think that is an important factor. We are not necessarily asking your view about the causality of it, but the facts are very important in this instance.

Q370 Baroness Fookes: Your organisation says that the consolidation of media sales houses has prevented the cost of advertising from falling in line with the growth of multi-channel TV. I can’t quite understand why that should be.

Bob Wootton: The consolidation of sales houses means that gradually you are finding either more of the weaker stations bundling together, or the weak being bundled with the stronger. In each case that means that the sales houses will try whenever they can to leverage as best they can the sale of the weaker stations within their baskets against the stronger. This doesn’t raise the ceiling price; it raises the floor price. That’s what happens—or at least that is what is hoped for or intended—when sales house consolidation takes place. I should say that much of the consolidation I am alluding to has taken place during 2010 and its impacts are going to be felt around now, when airtime is traded for 2011, and they will materialise during 2011. At the moment this is informed speculation.

Q371 Baroness Fookes: Do you suppose that that will continue to be the case, that there will be just a few big players, or do you foresee more coming along as the economy, we hope, improves?

Bob Wootton: I doubt that many more will come along. The market is characterised at the moment by consolidation. There are a few stations that are economically rather unviable for large sales houses to handle and there are two or three very, very small boutique sales houses in the market that handle those channels specifically. I anticipate that the market certainly won’t deconsolidate. It hasn’t got very much further to shake down. Obviously there are certain broadcasters that won’t lie along others. There are certain repulsive forces between broadcasters that mean that they can’t converge all the way. We’ve really only got four significant sales houses.

Q372 The Chairman: Do you want to ask the supplementary point? There is the consolidation of the media agencies, so why don’t you consider that to be a relevant factor?

Bob Wootton: We got used to talking about countervailing buyer power in the competition inquiry. I have a few comments about that. There has undoubtedly been a consolidation in media agencies, but they are not nearly as consolidated as broadcasters, for example broadcast sales houses. The second thing that I observe here, which is very important, is that the buying power of a consolidated media agency is much less than you might imagine. The reason for that is very simple, and Mary might want to add to this. A media agency represents a basket of quite a lot of clients nowadays. Those clients have quite different businesses, objectives and interests. Therefore, if a media agency were to take an extremely tough negotiating position with any particular media seller on behalf of any one of its clients, it would probably compromise another of its clients. So although you might imagine from looking at the bald statistics that media agencies have shaken down almost as far as the broadcasters, their leveragable countervailing buyer power is much diluted for this reason.

Q373 The Lord Bishop of Liverpool: It is worrying that the CRR was brought in to deal with a monopoly and seven years later we seem to have a monopoly with media buyers, so that they increase their market share from 50% to 75%. What impact does that have on their purchasing power?

Bob Wootton: The first thing, forgive me, is that CRR was introduced to deal with the merger of Carlton and Granada that led to a television entity that had 52.6% of the commercial television airtime market. As you know, that has since declined somewhat, but ITV has managed to retain a very strong position indeed. If you take ITV alone I think it is about 38%. If you take ITV’s family it is still up at 46%. That is one player with those kinds of shares. Four media agency groupings now account for something like 70% of buying power. That is 70 divided by four, which is quite different from 52 or 46 divided by one.

Q374 The Lord Bishop of Liverpool: But is there any collusion between those four media buyers? Do they get together? Do they talk about price? How does it operate?

Bob Wootton: Quite the reverse. There is absolutely cutthroat competition. You know because they are pitching to your business all the time. Mary McGovern: Discussions about price are very jealously guarded by all the individual agencies. They are all in competition with each other and wanting to attract clients from different agencies into their basket. The other important thing is that looking at the various channel and product mixes that they have, they will have to service all those individual clients within their basket. So to have that ultimate penalty with any individual channel of saying that they will pull out if they don’t get satisfactory terms, the number of clients they would have to line up to agree to that would be huge and it would be impossible. I can’t imagine it would ever happen. In terms of leveraging that power, the reality is that I don’t think any individual agency would be able to
do that with any individual channel. They all have a very diverse set of clients.

Q375 Lord Macdonald of Tradeston: But surely they have a gatekeeper’s power here. They may have hundreds of advertisers, but that’s out of hundreds of thousands, so they would probably want to take the small and medium-sized advertisers who don’t have enough money to justify the effort that they would have to put in. Perhaps it is all right to the top layer of companies, but not for allowing the smaller companies on to national television.

Mary McGovern: The entry price of national television in some of the multi-channels is incredibly cheap and therefore the agencies would never turn them away because it gives them an ability to look after those clients, which is what they want to do. It is not a question of them only picking off big clients and then the small ones don’t get represented. Most agencies have a broad portfolio right the way through the line.

Q376 Lord Gordon of Strathblane: Is it generally accepted that the cost of advertising would rise if CRR were removed?

Bob Wootton: Among my constituency it is beyond acceptance; I think it is a firm conviction.

The Chairman: An article of faith?

Bob Wootton: More than that. You are talking about a bunch of people who, between them, provide commercial television with 70%-plus of its revenues, many of whom, like Mary and me, have more experience than it is polite to admit to.

Q377 Lord Skelmersdale: You say that the sales houses would automatically go for leverage in higher prices. First of all why and secondly by how much?

Bob Wootton: On the first answer, I don’t mean to be facetious at all, but they are in business. That’s why the different sales houses will leverage their prices in different ways. ITV would leverage its price, absent CRR, by leveraging the power and the uniqueness of ITV among advertisers. A consolidated sales house like, for example, Sky, who picked up the Viacom business earlier in the year, would have as its objective for Viacom’s channels—which were trading at a steep discount because they were a weak player in the market—merely to bring the Viacom channels up to the ambient Sky level. Both, for different reasons, are equally inflationary.

Q378 Lord Skelmersdale: Can you put any amount on this? Have you any judgment on how far this will go?

Bob Wootton: Our view about ITV, absent CRR, is very clear. We have said ever since CRR was introduced—our position has not changed—that if it was lifted, ITV would attempt to stiffen their prices by at least 10%. They would probably go in and pitch for more, but they might land at something like 10%.

Q379 Lord Gordon of Strathblane: You have correctly pointed out in your evidence that there are secondary and tertiary effects of that on advertisers—and on consumers, because the cost will be passed on to them. If you look at it from ITV’s point of view, the obverse of what you have just said is that they have less money to spend on quality programming. Given that Parliament set up ITV as a monopoly, given the benefit of a public good of quality programming, is that not another factor that needs to be taken into consideration?

Bob Wootton: I do believe it is, but there are several things to consider. First, as you probably well know, because some of you have been involved with ITV, it continues to have the largest programme budget of almost any broadcaster around, so it already has a tremendous toolkit. That will fluctuate according to its market fortunes. It will also modulate, because the very same ITV that was set up for those reasons was once upon a time the only commercial game in town and it had to be everything to everybody—and it was. Nowadays, the environment in which it sits means that it does not have to be absolutely everything to absolutely everybody. There are arts channels, music channels and magazine channels. Things have moved on a bit.

The final point is that your question begs the assumption that an increase in ITV’s revenues would flow to programmes. That is something that advertisers would very much wish for, but it is a very reckless assumption.

Q380 Lord Gordon of Strathblane: There are two points to be made on that. If CRR were removed and ITV gave a guarantee that it would go on more programming, would you drop your objection to the removal of CRR? Secondly, even if ITV didn’t want to do more programming, surely if their revenues were higher it would strengthen Ofcom’s hand in insisting that they continue to do regional news, for example.

Michael Hutchings: Can I just answer one bit of that? ISBA does not stand for or against CRR. When ISBA was intervening in the original merger, CRR was proposed as a remedy by ITV and ISBA responded to it. ISBA has responded all the way through on the basis of the regulatory inquiries and has put forward the position of advertisers. I suggest that the question is slightly rephrased. Of course Bob will answer the question, but we are dealing within the context of a regulatory review that we did not initiate. On one point, the Government didn’t legislate to create ITV; the Government legislated to remove a barrier, which enabled Carlton and Granada to come together and form a private merger.
It wasn’t a Government-directed merger; it was a private merger, which then led to the regulatory inquiry.

**Q381 Lord Gordon of Strathblane:** Just for clarification, what I meant by creating ITV was the original ITV in 1955.

**Michael Hutchings:** I am sorry.

**Q382 The Chairman:** Therefore, are you saying that you believe in regulation of ITV’s advertising market, but it doesn’t necessarily have to be CRR?

**Bob Wootton:** First principles: ITV would not have you believe this, but believe it or not, advertisers celebrate ITV’s successes all the time. We are delighted about some of the successes that they are delivering right now. If only we could get the world to understand that when we talk among ourselves we regularly celebrate their success, because their success with viewers is our opportunity to reach and influence those viewers positively. It is an entirely virtuous circle. We therefore want to see a strong-performing ITV; we just don’t want to see an ITV that can go out and basically clobber us by leveraging its dominance. That is our position.

I am in the public arena as saying that CRR may be for now but it isn’t for ever. Furthermore, we have had a number of meetings with ITV over many years. They have clearly been very unhappy about this remedy that they have saddled themselves with and we have invited them to table alternative proposals. That invitation remains and I reiterated it to their chief executive last week. Our door is open at any time to entertain such proposals, but we are very clear that there has to be this performance relationship, because the long history of ITV when it was a monopoly was that it used to benefit from performing poorly. It made more money out of delivering poorer audiences at one point.

**Q383 The Chairman:** That is a very interesting phrase—performance relationship. I would therefore ask you, if a rise in advertising revenue could be guaranteed to flow into programmes, would you drop your objections to CRR?

**Bob Wootton:** We would certainly look for assurances that the money would flow into content, as part of any proposal. That would be necessary, but it might not be sufficient.

**Q384 Lord Razzall:** But you wouldn’t be against us recommending that undertakings were obtained in a solemn and binding manner, to coin a phrase beloved of my Labour friends?

**Bob Wootton:** Having watched your session with ITV and your line of questioning, I suspect that we have more uniting us than dividing us on this one.

**Q385 Baroness Deech:** Can I clarify a point from earlier? You must have done the studies. Is there a direct relationship between content and people going out to buy the stuff that is advertised? I often wonder about the impact of the advertising. It could be that the greater the quality of the programme and the more ABC people you have watching it, the less susceptible they are to buying it. I’m not typical, but you could advertise something to me and I would completely ignore it. What is the relationship between a quality programme and people going shopping?

**Mary McGovern:** A quality programme is quality to whoever wants to watch it. It might not be what you or I would consider to be quality, but if the masses who watch it have an appointment to view that programme, they will watch it. There is an absolutely direct link of the power of television.

**Q386 Baroness Deech:** Is there a relationship between the mass market and going shopping, or between quality and going shopping?

**Mary McGovern:** It depends what your definition of quality is. We will try to match up the target audience with our products and we then find out where that target audience is viewing. Procter & Gamble makes a lot of household products and we are looking for a fairly broad audience, perhaps members of families or what we would call housewives.

**The Chairman:** That is a very interesting response.

**Lord Razzall:** And you will not know whether you have been subliminally influenced when you go into a shop.

**Mary McGovern:** Nobody thinks they are influenced by advertising.

**The Chairman:** Mary, I wanted to follow up with a couple of questions directly to you. I think it would be helpful if we could deal with those Procter & Gamble questions.

**Q387 Lord Macdonald of Tradeston:** Procter & Gamble is obviously a huge operation and in a unique position, in that you are probably the only large advertiser that negotiates directly with the broadcasters. How did that come about? Why did you do that rather than going in with one of the buying houses?

**Mary McGovern:** I’ve been with Procter & Gamble a long-time, but I wasn’t there when that decision was made. It was about the time of the birth of ITV, I think. We’ve always believed in advertising and marketing products, and having control over where that money goes is important. There has been no reason not to sustain that direct relationship with other media owners as we have gone through the years.
Q388 Lord Macdonald of Tradeston: What is your advertising share? What's your percentage of commercial television?

Michael Hutchings: I think that's probably a matter of commercial confidentiality. Mary may be prepared to disclose that, but unless it is a matter of public knowledge I don't think it ought to be recorded publicly.

Lord Macdonald of Tradeston: It's quite big.

Bob Wootton: There is the recorded spend in the public arena.

The Chairman: You normally see that in the trade mags, don't you?

Mary McGovern: It's around about 5 or 6%.

Q389 Lord Macdonald of Tradeston: You've got this enormous buying power and yet you are protected by the CRR mechanism in United Kingdom, although you're obviously a global company. You are protected and you can take your money out of ITV—

I think you have just announced that you're putting huge amounts onto the internet—without ITV being able to respond to you as they would in any other marketplace.

Mary McGovern: How we spend our advertising money between different media is decided by the team on the basis of understanding that it all starts with the consumer. You can't just eliminate major players in a particular medium and think that you can replace that with other media.

Q390 Lord Macdonald of Tradeston: You don't usually have a vast company like yours protected by this mechanism, the CRR, which ensures that you can reduce how much you're giving, but continue to have the terms that you were given six years ago.

Mary McGovern: Because we negotiate directly. If CRR didn't exist, arguably P&G would probably be able to negotiate our way into a competitive ITV and maybe protect ourselves to some degree.

Q391 Lord Macdonald of Tradeston: So it doesn't matter too much to you?

Mary McGovern: I am not saying it doesn't matter. Obviously when prices increase in ITV they increase in television overall. That means that our prices also go up. One of the interesting things about working in this huge global company that I represent is that keeping an eye on costs is absolutely key. A lot of costs are stripped out and we are constantly being challenged to deliver with lower cost year-on-year. Therefore, when we see any increases beyond natural market forces, we have to go back to the company and renegotiate or talk about why we are not making better savings year-on-year. We were a very strong supporter of CRR when it was brought in. We have also seen the way that ITV has a monopoly and can take us on. At the end of the day, 95% of advertising that goes into the TV market is not P&G; we are only 5%. I don't know if that helps.

Q392 Lord Macdonald of Tradeston: Do you have anything like this protection in any other market in the world?

Mary McGovern: The TV markets, particularly worldwide, are completely different country by country. They don’t have this thing called the BBC in all places, for example, which takes a lot of advertising potential out of the market.

Bob Wootton: In our written submission I was at pains to point out this difference. There are lots of developed countries with developed advertising markets and developed state broadcasters and we can’t find anywhere—perhaps you can—where the state broadcaster has such a share of viewing or listening and does not take commercials. We are a uniquely forced market.

The other point is that CRR merely allows an advertiser to track ITV's performance. An advertiser can only take out the proportion of their spend that they are allowed to, because ITV's delivery has declined by the same amount. That is why this performance relationship is so important and why when CRR was introduced it was a really important development, because it moved from the perverse performance regime of the old ITV to the same positive performance relationship that every other broadcaster now faces. Every other broadcaster succeeds on the basis of their performance as ITV is now there too. It is right and proper that we have one market.

Q393 Baroness Fookes: Mr Wootton, you said earlier in the session that your door was open to ITV and that you had renewed an invitation to them only last week. Am I right in assuming that that was to discuss alternatives to the present regime?

Bob Wootton: Whenever we meet with ITV—we meet them fairly frequently—the idea of finding an alternative to CRR is close to the front of their minds, so it is very easy for them to mention it and for us to say that our door is always open. Perhaps it is a little too much history, but last week was the first formal meeting with the new chief executive. I reminded him that his predecessors, who had instated CRR, had beaten down our door to discuss alternatives, but had arrived with no proposals. We believe that it is fundamentally their prerogative to table viable proposals and it is our duty to receive them. We could get very excited if they came up with the right answer.

Q394 Baroness Fookes: But you don’t feel any obligation to present alternatives to them?
Bob Wootton: No.

Michael Hutchings: I think it is worth reminding the Committee that, as far as I know, ITV first approached the Office of Fair Trading to request a review of CRR in 2006. It wasn’t until the end of last year that they came up with anything approaching an alternative, called RPA, which they then re-presented in another form after the end of the formal consultation period.

Q395 The Chairman: What does RPA stand for?

Bob Wootton: Rules for the protection of advertisers.

Michael Hutchings: That was an alternative mechanism that the Competition Commission decided was not within their jurisdiction to review.

Q396 Baroness Fookes: But it could be within our jurisdiction.

Michael Hutchings: It could be. Maybe we should come back on that, because they presented RPA 1 and then what we call Son of RPA, which was so late in the day that it was after the end of the official period.

Q397 Baroness Fookes: Could we see this?

Michael Hutchings: It was publicly announced.

Q398 The Chairman: Would the current management be aware of this?

Bob Wootton: They co-authored it.

The Chairman: The current management?

Bob Wootton: Sorry, no. But then again, this is only a matter of months ago. This is not a long time back.

Q399 Lord Razzall: The reason we ask is that from all the witnesses we have heard, you are the first people who have mentioned it.

Bob Wootton: These were a pair of submissions at the 11th hour, during the Competition Commission’s phase of the two-year review.

Q400 The Chairman: When you say pair, do you mean the father and the son?

Bob Wootton: Yes. One came in fairly short order after the other.

Lord Razzall: When we interviewed ITV, they never indicated that they had come up with an alternative proposal.

The Chairman: In fact, we asked them quite a lot—you saw the open session—and pressed them very hard on what they would put in place of CRR.

Lord Razzall: Perhaps we should put it down to the new management not having had time.

Michael Hutchings: It’s in Appendix J to the Competition Commission’s report on the review. It’s all there in the report, but we’ll come back to you anyway with details of it.

Q401 Lord Razzall: The Competition Commission never mentioned it either.

Michael Hutchings: I think Diana Guy mentioned it once, maybe in their submission.

Q402 Lord Skelmersdale: We have already slightly covered this. You gave me a rather sharp response about commerce and the fact that these firms were in business. Are there any firms among your members or among the individual advertisers such as Procter & Gamble who have enough clout to prevent the leverage of 10% that you mentioned?

Bob Wootton: If there was one, I would imagine that it was sitting next to me. This is the largest television advertiser and the most consistent large television advertiser in the land. My answer would be, most likely not. Do you have anything to add Mary? It is bordering on your own confidential business.

Mary McGovern: Yes, that’s what I’m worried about. As a big advertiser, we inevitably have some clout, but we operate within the trading arrangements of ITV, which is a discount of station average price.

Q403 Lord Skelmersdale: But you could move your advertising somewhere else, for example. I would regard that as clout.

Mary McGovern: The issue with moving advertising elsewhere and how important ITV is for us is the same as I outlined earlier. Most of our brands are mass brands. There is only one place on TV to get mass audience, and that’s ITV.

Q404 Lord Skelmersdale: So you are saying that they’ve got you over a barrel.

Mary McGovern: They have. We could do without them on some brands where we have particular audiences, such as the very young, where maybe we can pick up quite a lot online or develop a completely different strategy, like a social networking strategy, to get to plenty of them in a different way. But in essence, most of our business is mass market, and that means that we need a strong ITV. As Bob says, we are not interested in beating ITV up. We are interested in a strong ITV delivering lots of audience, rich in the sort of people that we want to hit with our advertising. They are in a very particular position to deliver that.

Q405 Lord Gordon of Strathblane: Given P&G’s universal presence throughout the world, you’d be in a very good position to tell us what the comparative cost per thousand was in this country compared with other developed markets in 2003, and what it is now.

Mary McGovern: There is no such thing as a single cost per thousand, because we’re not buying one audience and we don’t buy that same audience in the same proportion year after year in any country. As with everything in media, the devil is always in the
detail. We can look at overall share of ITV and so forth. I don’t carry those numbers in my head, I’m afraid.

The Chairman: I’m going to move swiftly on and deal very quickly with the next question.

Q406 Lord Dixon-Smith: I wanted to ask a slightly different question. If Procter & Gamble are operating independently all over the world, you obviously deal with a number of different regimes. Are there regimes elsewhere that you prefer to the one that you have here?

Mary McGovern: I don’t buy P&G media globally. I only look after the UK and Ireland. The important thing to note is that the TV markets in every country globally have a completely different setup. Nothing is like the UK. It is unique. Equally, every country has its own little quirky stuff. Also, we don’t have the same model for how we operate within that media market.

Q407 Lord Dixon-Smith: I will revert to the question I should have asked. I just thought it was worth pursuing that and I’m sorry that you were not able to answer it, because it would have been very helpful. If you can’t, I don’t suppose anybody can. Do you have evidence that the public agree with you that having very slightly cheaper products, if you can do that, more than compensates for having fewer high-quality television programmes? Are the public more satisfied with mass cheapness, or do they really appreciate quality and the fact that it’s limited?

The Chairman: It may be a question you can’t answer, because we have a rather different definition of quality. I think you made that clear earlier.

Mary McGovern: That’s right, but we also have a lot of pressure on the costs of our products. It’s not just about how much we invest in advertising. There is a lot of retailer promotion and own-label brands. Our competitors have very fierce pricing policies that we have to compete with in that marketplace. So it is not direct.

Q408 Baroness Deech: Imagine that there was going to be an online auction as the new system for advertising. I know there are problems, but let’s park those for a moment. Do you think the revenue of ITV would be higher, lower or about the same as it is at the moment?

Bob Wootton: I’m going to take quite an independent stance on this. ISBA does not have a position on this, but I will by all means apply my experience. I would be amazed if they got the same revenue out of an online auction system as they do out of a human-intermediated sales system. I’ll give you two reasons. Online auctions have two attractions. One is that they put all the buyers and all the sellers together. That’s the brilliance of eBay. It turns the whole world into a potential market for stuff in your loft. That doesn’t work here because all the buyers and all the sellers know each other and you can get them all in this room. So that advantage doesn’t work. The second thing about online auction mechanisms is that they invariably create buyer’s markets. Usually, they inform the buyer, giving them constant, dynamic benchmarking. You notice that very few purveyors of scarce and premium products tend to allow themselves to be intermediated online, because they see much greater advantage in marketing the scarcity of those goods to their greater financial advantage through human intermediation and salesmanship. I am not just talking about ITV here; I could be talking about Channel 4, the Daily Mail, the Times, the Sun or Vogue. If I was their senior management, I would be sackable if I proposed going to an online auction, whereas if I was Google, selling a very long tail of limitless inventory to a very long tail of very small businesses, I would obviously go for an online auction. So, it is horses for courses, but for this kind of basket of media that we are talking about, I think it would be insanity.

Q409 The Chairman: You have explained the detriment. Would you support an online auction?

Bob Wootton: This is interesting, because you would imagine that we, as representatives of buyers, would jump to a buyer’s market outcome. But our position is slightly more complicated than that, because we also recognise that it is getting increasingly expensive for media to maintain their investment in high-quality content. As advertisers, we want high-quality content to deliver high-quality audiences. So just making that headlong rush for the bottom, prima facie, might seem to be exactly where we were coming from, yet it’s not. We want these media to perform, and we know that to perform they have to invest, so to simply go out scalping them is not our objective.

Q410 Lord Macdonald of Tradeston: We have heard from many witnesses that the opaque nature of the system presents an entry barrier to competition to the kind of advertisers that you represent.

Bob Wootton: It doesn’t represent a barrier to those kind of advertisers. It might represent a barrier to some smaller advertisers, because it’s pretty complicated, but as Mary has said, the biggest barrier to entry in this market, hitherto, had been that television reaches a lot of people and each spot was therefore quite expensive. In the new television market and in the market that you are going to see next year with IPTV, a very small enterprise will be able to buy airtime for a few pounds. There will still be the problem of the slightly greater cost of filling the space they have bought with a convincing advertisement. That will be a little more expensive, but the real barrier to entry has been—
Lord Macdonald of Tradeston: I meant a barrier to entry for smaller companies. As you know, it is a fact of economic life that big companies quite enjoy strong regulation, because it keeps out the competition, while maintaining standards.

Q411 The Chairman: Who are we protecting through CRR? Is it the larger companies rather than the smaller? Are we really protecting the larger buyers?
Bob Wootton: No, as far as I can see, CRR protects every advertiser who can jump whatever prevailing barrier to entry there is. That barrier to entry, if anything, has dropped somewhat. Remember that ITV is still trading in large audiences. Its small audience spots are other channels' huge ones. Remember that the barrier to entry is contingent on the nature of the channel. In ITV's case, the barrier to entry is created by its sheer magnitude, which in turn is attractive to mass advertisers. I am generalising to simplify.

Q412 Lord Stevenson of Balmacara: This follows on from that last remark. We have talked about the fact that ITV is the one area of the market that generates these vast coverages that advertisers seem to want, but we don't seem to know quite what that is in terms of volume. Could you share what you think? ITV have argued to us that its so-called dominance applies to a very tiny part of the market—advertisers who are looking to build the same sort of coverage. What proportion do you think we are talking about here?
Bob Wootton: I think we have to be careful that we don't generalise this argument. Once upon a time, ITV was the only place you could go for commercial audiences. But this is the way advertisers plan their advertising. They might think that the extremes are seven or eight, 10, 12 or 14. In other words, its peak is already in browned-off territory. You are delivering the same aggregate result spending the same money, or maybe a bit less, but you are getting quite a different result. It's a more complicated argument, but this is the way advertisers plan their advertising media exposure, so it speaks to the heart of why they do it.

The Chairman: Thank you. Apologies to colleagues, because we are getting slightly short of time, but we should move on to Lord Macdonald's question.

Q413 Lord Macdonald of Tradeston: I ask for your views on COSTA, on the scheduling of television advertising. Do you favour the harmonisation of the rules and the number of minutes of advertising? If so, do you favour harmonising upwards or downwards, and why?
Bob Wootton: First of all, we believe that the differential that prevails is no longer defensible. The reasons for the differential no longer exist, so we support harmonisation on an intellectual basis. If we support harmonisation, the question is at what level. We have spoken about this at some length at ISBA and there are mixed views, but the centre of gravity of those views is around harmonisation somewhere in the middle. If you think that the extremes are seven and nine, then somewhere around eight is probably a pretty good place to start. We don't support downward harmonisation, because that withdraws advertising inventory from the marketplace and will therefore force the price of the market. It would also play into the hands of ITV, and to a lesser extent Channel 4 and Five, because it would basically stifle the other channels of inventory that they can sell. Nor do we support full upward harmonisation, because we think that might deflate the market again, which you might think that we would want, as buyers, but if it was too deflationary it would challenge the whole business of sustainability.
Q414 Lord MacDonald of Tradeston: What do the viewers tell you of their preferences?
Bob Wootton: We haven’t done any viewer research on this, but there is some much more important empirical research. Sky have just celebrated their 10 millionth home subscribed. Virgin have between 3 and 4 million subscribers. So that is about 14 million homes with very enhanced television viewing, and all but 4 or 5% of the population have now got digital TV, which means they have got Freeview, with 30 channels, of which at least two dozen operate regimes of nine minutes rather than seven. The whole population has voted with its wallets to buy technologies and delivery systems that deliver channels that have lots and lots more advertising. It doesn’t look to me as though the population is really allergic to channels with nine minutes of advertising—not by dint of how they have used their wallets. Therefore, if we’re proposing something in the middle, on the basis of that logic we think it’s very unlikely to be offensive to viewers.

Q415 Lord Razzall: Did I understand you to say that if there was harmonisation down, that would benefit ITV?
Bob Wootton: And Channel 4 and Five.
The Chairman: It is contrary to their evidence.

Q416 Lord Razzall: ITV’s evidence is that if there is harmonisation, they would prefer harmonisation up. That was their evidence to us.
Bob Wootton: I must have misread that.
Lord Razzall: They costed the differences.
The Chairman: So we have a completely different perspective from both ends of the industry.

Q417 Lord Gordon of Strathblane: In your own interests, referring to what you talked of earlier about reaching frequency and browned-off territory, I’m quite sure your members would be happier to be part of a three-minute break than a five-minute break. You just get lost in a morass of advertising. Surely a slight decline in advertising revenue gives greater prominence to the advertiser, and is therefore to the benefit of your members.
Bob Wootton: Indeed, we have factored this into our discussions. That’s why we haven’t gone gangbusters for a nine-minutes-everywhere-thank-you-very-much solution. We have factored that in. But of course the argument is also about the composition of a break. You could have a three-minute break with three 60-second commercials or 18 commercials of 10 seconds—God forbid. The composition of each break depends on the commercials and the composition of each hour. It obviously works within the averages and the overall limits, but then broadcasters quite rightly move inventory around to optimise audience and therefore revenue.

Michael Hutchings: As I read it, the answer that Archie Norman gave to Baroness Deech and Lord Bragg, when the Competition Commission came they did not alter their position

Q418 Lord Gordon of Strathblane: Moving on to a slightly different subject, as you know, your letter to the adjudicator and IPA’s were reproduced in their evidence to us. IPA say that ITV have been maintaining what they call a robust approach, which is not quite playing dirty, but comes fairly close to it, with talk of conditional selling and so on. Have you any experience of that?
Bob Wootton: Yes, ITV are definitely taking a more robust approach as the economy comes back. ITV flexed a number of their terms and conditions in the marketplace during the economic slowdown because they wanted to be more receptive to the scant revenue that was available, and I wouldn’t blame them for that. As revenue has come back, they have restiffened their terms and conditions quite abruptly in about September. But they are only their published terms and conditions, so I am not being critical. They are just playing fairly hardball, but hardball is fine. Apart from that, on the conditional selling point, as you know the rules outlawing it were only overturned in September. ITV have argued that while CRR remains in place there is no incentive for them to operate outside those rules. We hope they are right. I have asked my members to start collecting evidence on each of their accounts in case they are not, but we hope they are right. By the way—this is actually to the withholding of airtime rather than conditional selling, but while we are there—ITV argue that while CRR is in place they wouldn’t withhold. That’s a jolly good reason for why CRR should remain in place. ITV in its old days used to withhold airtime in a spectacular fashion.

Q419 Lord Razzall: This is a slight peculiarity. In your written evidence you say that scant attention is often given to the second and third order implications of the economic regulation of television. By this you mean impacts on advertisers and on their customers and consumers. Despite a barrage from Baroness Deech and Lord Bragg, when the Competition Commission came they did not alter their position
that when they recently reviewed CRR, the only interest they took into account was that of advertisers. How do you reconcile what you’re saying with what they said?

Michael Hutchings: May I answer that? The Competition Commission had a very narrow brief under the legislation and they were only allowed to review whether this remedy still worked in the light of changed circumstances. They were not permitted to look at any wider issues at all. Fundamentally, going back to the original remedy put in place in 2003, it is complicated by the fact that that was under the old legislation, the Fair Trading Act, which had a public interest test. Under the public interest test, that was primarily a matter of competition—between advertisers for advertising space and between broadcasters. Fundamentally, though, it should be borne in mind that under the old test and under the new test, the key mantra for competition regulators is consumer welfare. I think the justification that has been borne out by this remedy is that this CRR remedy has kept a lid on advertising prices, which has directly flowed through to the price of goods and services that are advertised. I think Mary will confirm that. Conversely, if advertising rates went up, that cost increase would flow directly through to the price of goods and services that are advertised. I think Mary will confirm that. Conversely, if advertising rates went up, that cost increase would flow directly through to the price of goods and services. That’s point number one—consumer welfare. Secondly, CRR has kept a lid on what you might call the discrimination and manipulation factors, which has enabled other broadcasters to remain in business and to enter the market. Of course, what would have happened without CRR is a matter of speculation—what Professor Barwise would call the counter-factual—but there is evidence, as Bob has pointed out, that there are a great number of other smaller channels that have remained in the market.

Lord Razzall: Sorry, but to press one more point, you say in your written submission that scant attention is often given. Scant attention by whom? I understand that the Competition Commission had a very narrow brief. Who is giving scant attention? Certainly this Committee isn’t.

Bob Wootton: We sometimes struggle to get attention for the advertiser point of view among the other regulators in this space, most specifically with the OFT and Ofcom.

Q421 The Chairman: But on this occasion they almost did it to the exclusion of everything else.

Bob Wootton: Well, I have a very short story. We had to fight our way through the better part of a year with OFT and Ofcom to make sure that they were sufficiently persuaded to refer this back to the Competition Commission. The industry’s view is that the Competition Commission has a unique understanding of the way that this market operates and could show the other regulators a trick or two in terms of grasping it.

Lord Razzall: As you can see from the pressure that came during the evidence of the Competition Commission, a number of colleagues on the Committee did not understand why this wider programming question and investment in programming did not come into the public interest definition, hence the interchange in the Committee.

Bob Wootton: Yes.

Q422 The Chairman: Mary, can I give you the last word? What is your view on the price of products, which was a very interesting salient point that Michael introduced?

Mary McGovern: The impact of how we sell advertising?

The Chairman: Yes, the impact of CRR on the price of your products.

Mary McGovern: As I said before, it’s not a direct correlation, because we have all sorts of pressures on our products, but obviously the more money we invest in advertising, although we are hoping to build business, the more costly that is. Because we are always looking at our cost bases, the more we have to spend in one area, the more impact it has in other areas and we have to make sure that that matches up. We can’t just take a direct correlation that, if we are going to spend more on advertising, therefore that immediately gets translated into product cost. It’s not as simple as that.

The Chairman: Thank you. That was a very fastball question at the end. Thank you very much. We are just getting into our stride. It has been a very interesting session. Thank you very much indeed.
Memorandum by Ofcom (RTA 10)

SECTION 1—INTRODUCTION

Introduction

1.1 Ofcom welcomes this opportunity to submit evidence to the inquiry of the House of Lords Select Committee on Communications into the regulation of television advertising with particular reference to the Contract Rights Renewal (CRR) mechanism.

1.2 As the independent regulator and competition authority for the UK communications industries, our principal duty, set out in section 3(1) of the Communications Act 2003, is:

— to further the interests of citizens in relation to communications matters; and
— to further the interests of consumers in relevant markets, where appropriate by promoting competition.

1.3 TV advertising rules have evolved over time to address a number of issues, such as the protection of consumers from over-exposure to advertising and enhancing competition in the sale of TV advertising airtime.

1.4 We have responsibility for a number of areas related to the Committee’s inquiry, including the content of advertising, the amount and frequency of advertising and rules on product placement. We have recently removed rules which influenced how broadcasters could sell their airtime. Some of these responsibilities stem from purely domestic legislation, while others are set within the framework of European Union (EU) legislation.

1.5 We have a co-regulatory partnership with the Advertising Standards Authority (ASA) to determine which products and services can be advertised and the manner in which advertising is scheduled and promoted. The ASA is responsible for managing complaints about broadcast advertising, other than complaints about political advertising, Premium Rate Services, gambling, teleshopping and programme sponsorship/product placement, which remain Ofcom’s responsibility.

1.6 The ASA’s Broadcasting Committee of Advertising Practice (BCAP) undertakes Ofcom’s functions with respect to setting, reviewing and revising of advertising standards codes. The BCAP Code is designed to inform advertisers and broadcasters of the standards expected in the content and scheduling of broadcast advertisements and to protect consumers.

1.7 In addition, we are involved, along with the Office of the Adjudicator, in the administration of rules which apply to how airtime is sold on ITV1 (ie the CRR undertakings), although ultimate responsibility for these lies with the Competition Commission. We may also be asked to provide advice on mergers which impact on broadcasting and TV advertising markets.

1.8 In order to fulfil our duties, we aim to research and review markets regularly, and in this capacity we continue to monitor developments in relevant advertising markets.

SECTION 2—COMPETITION FROM THE INTERNET

Introduction

2.1 In this section we focus on two questions asked by the Committee:

— How much of the recent decline in television advertising was due to migration to the internet and how much was due to the economic recession?
— Can television compete successfully in the medium-term with the internet and other media for advertising?
**Overall trends in advertising**

2.2 Figure 1 below shows how nominal advertising expenditure by medium has changed between 2004 and 2009. These figures are in nominal terms. It can be seen that advertising revenues in general rose over the period to peak in 2007, with TV advertising revenues broadly static over this time. Since then overall advertising revenues have fallen so that the total UK advertising market was worth £14.5 billion across all sectors in 2009, down from £16.6 billion in 2008 (a decline of 12.7%). Within this, TV advertising spend (which comprises advertising revenue plus the costs of producing advertisements) fell by £0.4 billion between 2008 and 2009, from £3.9 billion to £3.5 billion.

2.3 By way of contrast, online advertising grew through the downturn to reach £3.5 billion in 2009, rising from £3.3 billion in 2008. However, its rate of growth was slower during the downturn than in previous periods (6% in 2009 compared to a five year compound annual growth rate of 34%). Online advertising spend is now similar in overall terms to that on TV advertising.

2.4 It is also helpful to consider these trends in overall advertising expenditure in conjunction with Figure 2 which shows the share of advertising expenditure by medium. TV expenditure as a proportion of overall advertising expenditure has remained relatively constant over the period (at around 24%). In contrast, spend on internet advertising as a proportion of overall spend has increased substantially from 5% in 2004 to 24% in 2009. Over the same period, spending on other advertising and newspaper advertising has declined.

***Figure 1***

**ADVERTISING EXPENDITURE BY MEDIUM, 2004–09 (CURRENT PRICES)**
Migration of TV advertising spend to the internet

2.5 It is difficult to be definitive about the extent to which the recent decline in TV advertising revenues might represent a structural shift ie a migration of advertising revenue away from TV to other media such as the internet rather than a cyclical decline as a result of the economic downturn. However, in the following sections we describe how TV is attractive to advertisers because it is able to reach large numbers of people in a short period of time and is able to combine sound and moving pictures. This makes it particularly valuable for advertisers promoting time limited offers and large scale brand building. In contrast although the internet can combine sound and moving pictures, it may not be as efficient at reaching large numbers of users in a short period of time. It is instead particularly good at targeted search activities. Indeed it is possible that, rather than the two media directly competing for advertising revenue, they may currently be viewed as complements by many advertisers.

2.6 It is the case that over the period 2004–07, expenditure on TV advertising remained static in nominal terms and hence declined in real terms once inflation is taken into account. However, the data also suggests that a majority of the recent decline in TV advertising in nominal terms coincides with the economic recession rather than a migration of advertising expenditure to the internet. For example, we note that over the past five years, in nominal share terms, TV has remained largely constant (at around 24% of total share), suggesting that the recent decline in TV advertising expenditure is not structural and that there has not been substantial internet and TV substitution. If anything, these data tend to suggest that the newspaper sector has suffered most from a structural shift to the internet.

2.7 Although we do not have the full year results for 2010, there appears to have been a significant upturn in TV advertising so far in 2010. For instance, Guardian Media reports that television advertising is up about 15% compared to 2009.

2.8 We now look at several reasons why it is difficult to give a definitive answer about the extent to which there is a structural decline of advertising revenue away from TV.

Decline in the price of advertising

2.9 The price of advertising is usually given in terms of a Cost per Thousand impacts\(^1\) (CPT) and calculated in terms of advertising revenue divided by impacts. Given that over the period 2003–09 there has been an increase of around 24% in the volume of adult impacts (as penetration of multi-channels has grown), other things being equal, this would have the effect of reducing the price of advertising, as measured by CPT. Since advertising expenditure also fell over this period, one would expect the price of TV advertising to have fallen

\(^1\) Each occasion an advert is seen by a viewer counts as one impact.
substantially, in terms of CPT. We note that real price reductions over time have been a common feature of many markets (particularly communications markets such as fixed line telecoms, broadband internet, mobile etc); declining TV advertising revenue is not necessarily an indication that there has been a significant switch away from TV advertising to other media.

**Features of different types of advertising**

2.10 When considering the appeal of TV advertising to advertisers it is worth distinguishing between different characteristics of advertising. Advertising is typically divided into classified and display advertising. Classified advertisements are generally grouped within a publication or featured on the internet under headings classifying the product or service being offered. These adverts are usually text-based and can consist of as little as the type of item being sold and a telephone number to call for further information. Generally no pictures or other graphics are featured within the advertisement, though a logo may occasionally be included. A sub-category of classified advertising is found on the internet: paid-for search advertising. Search advertising is delivered by means of a keyword search and accounts for the bulk of internet advertising. Search engines identify key words and use these as the basis for directing an advertising message to the “searcher” or potential customer.

2.11 Display advertising is advertising that combines visual imagery, sound and movement. It may include text with other graphical information, such as logos, photographs, diagrams, moving images, location maps and audio elements.

2.12 As we stated in our recent Airtime Sales Rules consultation,2 advertisers still believe TV is an important medium that may not be easily replicated by other media. This is both because of the features offered by display advertising and because TV viewing is an extremely popular leisure activity,3 which allows advertisers to reach large numbers of viewers simultaneously. This means that TV advertising can deliver:

- near universal reach, which is important for manufacturers of Fast Moving Consumer Goods, such as detergent, toiletries, foodstuffs etc;
- the ability to reach a large number of consumers rapidly, which is important for goods that have a limited duration (eg newspapers, promotions and sales); and
- targeted mass marketing of particular demographic groups.

2.13 In contrast to this, the internet is not yet a significant medium for display advertising. The majority of advertising on the internet is classified and search-based advertising (80%) compared to display advertising (20%). Internet display advertising did grow by 11% last year from £637m in 2008 to £709m in 2009), defying the recession.

**Take-up of TV and internet services**

2.14 In addition while TV is in virtually every home in the UK (TV penetration is around 98%)4 internet penetration has reached around 70% of homes. In addition whilst those with a home internet connection are increasingly representative of the UK population as a whole, internet take-up remains more prevalent among particular demographic groups—for example 85% of AB households have the internet at home but only 49% of DE households. As a result the internet does not yet offer the same level of mass, broad demographic appeal as TV and advertisers seeking to build mass awareness across a broad range of audiences quickly are not likely to view the internet as a close substitute for TV at this time.

2.15 This was the conclusion of the recent Competition Commission review of the CRR undertakings and was supported by a number of stakeholders, including advertisers and broadcasters, during our Review of Airtime Sales Rules.

**Prospects for medium-term competition between TV and internet advertising**

2.16 As already noted, advertisers value TV for its unique ability to deliver display advertising and to deliver an advertisement to a large number of people, across a wide range of demographic groups, in a short period of time. We have also noted that internet advertising does not yet appear to deliver these objectives.

2.17 However, as set out in our Airtime Sales Rules consultation, there may be scope in the future for internet display advertising to begin to impose some form of competitive constraint on behaviour in the UK TV advertising sector. Since the internet is also able to deliver display advertising and to an increasing number of

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2 http://stakeholders.ofcom.org.uk/consultations/asr/summary

3 Viewing per head in all homes has remained between 3.60 to 3.75 hours per day over the past six years. Source: CMR 2010, http://stakeholders.ofcom.org.uk/market-data-research/market-data/communications-market-reports/cmr10/

people (as internet penetration increases) it is feasible that advertisers will view the internet as a close substitute to TV advertising in the longer term. If, for example, internet uptake increased towards the level of television penetration or if the internet was able to build mass awareness quickly across a broad range of audiences, advertisers may switch money away from TV. In addition the internet may have particular appeal to advertisers in order to reach particular demographic groups, eg young viewers.

2.18 However we believe that over the next few years at least, TV is likely to continue to maintain a distinct role in advertising campaigns. We note that the Competition Commission, in its final report on the CRR undertakings, concluded that it “saw no evidence that the sale of television advertising was constrained by Internet display advertising, or would be likely to be constrained in the near future”.5

2.19 In addition during our consultation on Airtime Sales Rules, we asked for stakeholders’ views on whether they believed internet display advertising could become a closer substitute to TV advertising in the next three to five years.

2.20 Six of the seven respondents agreed with the analysis in our consultation document that internet display advertising was not yet a close substitute for TV advertising. In addition, most of these respondents were unclear or sceptical as to whether it would act as a constraint in future. For example:

— The Institute of Practitioners in Advertising stated “we believe that the growth areas for digital advertising will continue to be rooted in search, direct response and social media. The actual brand display market online only represents a tiny fraction (1.3%) of total advertising spend and this is showing no signs of significant growth”; and
— Discovery stated, “It is unclear as yet what the effect of the nascent video on demand market will be on the online display advertising market but... at this stage, it is not yet relevant to the UK broadcast advertising market”.

SECTION 3—APPROPRIATE LEVEL OF REGULATION AND THE PUBLIC INTEREST

Introduction

3.1 This section considers the Committee’s questions about the appropriate level of regulation, the impact of possible changes to regulation and the extent to which the current arrangements reflect the public interest.

3.2 As noted in the introduction, we have a number of responsibilities in the area of TV advertising and regulation has evolved over time to address a number of different objectives, some set by Parliament, others determined at the EU level. In some cases regulation is designed to promote competition in the sector and in other areas we have rules to protect consumers from over-exposure to advertising. In addition, we have the duty to secure the availability throughout the UK of a wide range of TV and radio services which (taken as a whole) are both of high quality and calculated to appeal to a variety of tastes and interests. Linked to this, we are also required to have regard to the desirability of promoting the fulfilment of the purposes of public service television broadcasting in the UK. We consider that the issue of the appropriate level of regulation and the issue of the public interest are closely linked.

3.3 We are committed to regularly reviewing our regulation, to take into account sector developments and to ensure that rules remain fit for purpose or, if possible and appropriate, are removed. We believe it is important to remove regulation no longer required to protect citizens and consumers, to enable sectors to develop and to give industry players more flexibility. We think this is likely to have positive impacts on innovation and investment which could deliver benefits for citizens and consumers and serve the public interest. For this reason, we have already removed a considerable amount of unnecessary regulation, as explained below.

3.4 The following sections provide an overview of regulation for which we have specific responsibility, setting out how the regulation has evolved and prospects for how it might change. Regulation of the content of advertising has been carried out by the Advertising Standards Authority on our behalf for a number of years, so this is not dealt with below.

3.5 In addition, as requested by the Committee, we comment on:

— The extent to which the CRR undertakings limit ITV’s ability to compete in the production of quality programming; and
— The extent to which the reduction or removal of the CCR undertakings would affect the commercial public broadcasting sector.

3.16 As a result, we removed the Airtime Sales Rules on 1 September 2010.

3.7 The TWF Directive provided a framework for Member States to develop their own more detailed rules. In the early 1990s a distinction was made between public service channels and non-PSB channels with the public service channels being subject to stricter regulation, explicitly to protect the quality of the viewer experience. The main public service channels are allowed an average of seven minutes an hour across the day (subject to a maximum of 12 minutes in any one hour). In addition, peak-time restrictions limit advertising between 6pm and 11pm to an average of 8 minutes an hour, subject to a maximum of 12 minutes in any one hour. The non-public service channels are permitted nine minutes of advertising an hour on average (subject to a maximum of 12 minutes in any one hour) in line with the maximum allowed under the TWF.

3.8 Many broadcasters have taken advantage of the single market in broadcasting to locate in the UK. As a result, we now license nearly a thousand channels which serve every EU Member State, as well as many neighbouring countries in the rest of Europe, Africa and the Middle East. We apply the same advertising rules to both domestic and non-domestic channels.

3.9 In the UK, the Independent Television Commission (ITC) developed the initial Rules on the Amount and Distribution of Advertising which we inherited. We initially refrained from making significant changes to the ITC rules, as discussions about changes to the EU framework were already underway. These discussions resulted in major changes to the TWF Directive, which became the Audiovisual Media Services (AVMS) Directive in December 2007.

3.10 We then undertook a comprehensive review of the advertising rules. Following consultation in early 2008, we removed the old ITC rules, and introduced a much shorter and simpler Code: COSTA. This removed outdated or unnecessary rules that had little or no beneficial impact, either on viewers or broadcasters (eg a ban on ad breaks after the epilogue), and in some cases, were unhelpful, both to viewers and broadcasters (eg a rule requiring a 20 minute interval between internal ad breaks—this sometimes forced broadcasters to schedule breaks shortly after the programme started or before it finished).

3.11 We also prepared for a more fundamental review of whether the amount of advertising on public service channels should continue to be regulated more strictly than other channels, or whether a new common set of rules should be adopted. However, in the light of the economic downturn, both broadcasters and advertisers expressed concern that changes could be destabilising to all broadcasters, and we decided to delay this review.

3.12 Given the signs of recovery in TV advertising spend (though revenue has still not reached 2007 levels) we have resumed preparations for this review. As part of this, we are considering whether the original rationale for stricter regulation of public service channels still holds, and are attempting to analyse the consequences of establishing common rules for the different groups of broadcasters.

3.13 More specifically, we have begun to look at what the effects would be on viewers, broadcasters and advertisers of different sets of common advertising rules. There are a number of possible alternatives to the status quo, including applying public service advertising rules to all channels (or vice versa), allowing all channels the maximum permitted by the AVMS Directive (12 minutes of advertising every hour) or applying a common solution that places limits on all broadcasters below this 12 minute maximum. Our intention is to consult on these possible alternatives in due course.

**Airtime Sales Rules**

3.14 The Airtime Sales Rules were two distinct rules relating to how broadcasters sold TV airtime. The “withholding rule” meant that all airtime available on ITV1, C4 and Five must be sold. The “conditional selling rule” applied to all broadcasters, prohibiting them from forcing advertisers and media buyers, who want to buy airtime on one channel, to purchase airtime on additional channels.

3.15 The Rules were intended to ensure fair and effective competition in relation to the interaction between broadcasters and media buying agencies/advertisers. We recently consulted on the ongoing need for these rules and concluded that there are few incentives to withhold airtime. We also concluded that it is more appropriate to treat possible conditional selling by broadcasters on a case by case basis rather than rely on rigid ex-ante rules to control potential anti-competitive behaviour by broadcasters.

3.16 As a result, we removed the Airtime Sales Rules on 1 September 2010.
CRR undertakings

3.17 The CRR remedy is part of the undertakings intended to address competition concerns arising from the Carlton and Granada merger in 2003. At the time the Competition Commission found that the proposed merger would have an adverse effect on future competition for the sale of TV advertising, in that the merged Carlton and Granada sales houses would be able to force media buyers to commit more of their TV advertising budget to ITV1 and/or accept a higher price. The CRR remedy was designed to address these competition concerns. Its main features are as follows:

— Advertisers and media buyers have the right to fall back to “protected contracts”—these initially were contracts agreed between advertisers and Carlton and Granada before the merger;
— While advertisers are able to use their protected contract terms, they are not obliged to do so. If they so choose, advertisers can instead negotiate changes with ITV plc. Where new terms and conditions are negotiated, CRR obliges ITV plc to offer fair and reasonable terms;
— Advertisers and media buyers have the right to automatically reduce the proportion of their spending on ITV1 (share of broadcast commitment) if ITV1’s share of commercial impacts (SOCI) falls. The way in which spend will vary with performance is determined by the Audience Ratchet Mechanism (ARM). The ARM also operates in the opposite direction. So if ITV’s performance in terms of SOCI increases, ITV can expect advertisers to increase share of broadcast commitments; and
— Advertisers and media buyers have the right to bring disputes over the fairness and reasonableness of terms offered by ITV plc to an independent adjudicator.

3.18 Ultimate responsibility for the undertakings rests with the Competition Commission. In order to consider removal or amendment to the undertakings the Office of Fair Trading (OFT) must refer a case to the Commission.

3.19 The last review of undertakings was launched by the OFT in January 2008 and referred to the Competition Commission for consideration in May 2009. The Commission concluded its review in May 2010 finding that, despite a number of sector changes since the remedy had been introduced, there is still an ongoing need for the CRR remedy to provide protection to advertisers and media buyers. The only changes made were to extend the definition of ITV1 in the undertakings to allow impacts from ITV +1 and ITV1HD to be included in the ratchet mechanism. We contributed to this review and made our own submission to the Commission but ultimately it was for the Commission to determine if the undertakings should be retained, varied or removed.

3.20 This conclusion was based on the Competition Commission’s analysis of the market strength of ITV and the extent to which this has eroded since the introduction of the undertakings. The Commission concluded that ITV would still be able to raise advertising prices because it is the only broadcaster able to deliver mass audiences quickly to advertisers. We had noted that this ability to increase revenues from buyers might be—at least partially—offset by potential increases in buyer power since the undertakings were introduced. Buyer power refers to the ability of buyers to constrain the power of any particular sales house. We might expect buyer power to exist if there were very few media buyers and each comprised a large proportion of any sales houses’ revenue. In this scenario, even ITV might be limited in its ability to charge high prices for fear of losing a significant proportion of revenue. We noted that since 2003, many media buying points were now owned by larger groups or were negotiated on a group basis. This has led to the development of more powerful media buyers (eg WPP/GroupM), which purchase advertising across a wide range of media and on behalf of a number of advertisers.6

3.21 We are aware that during this review ITV plc suggested that the structure of the CRR remedy limited its ability to invest in “quality” programming and instead incentivised it to develop popular programming which simply sought to maximise viewers, which was not entirely in ITV’s strategic interests. Specifically ITV argued that CRR causes advertisers to focus solely on SOCI in negotiations, where previously a range of factors would have been considered. It was argued that this has led to ITV investing in programming in the daytime schedule, encouraging repeats of high rating programmes (eg soaps), reduced ITV’s ability to take risks and reduced its incentive to commission brand building programmes (such as high quality dramas). However, we understand that the Competition Commission was not persuaded by the arguments presented by ITV.

3.22 We discussed this issue with ITV during the course of the review and we too were sceptical that CRR had distorted ITV’s programming decisions as significantly as it suggested. Firstly we did not receive any evidence to suggest that ITV has refrained from investing in particular types of programming specifically as a result of the CRR obligations. Moreover it seems clear that ITV would continue to deliver programmes which were

6 Most advertisers use media buyers to buy advertising on TV. Only a very limited number of companies with large advertising budgets purchase airtime directly.
very attractive to viewers even if CRR were not in place. For example programmes such as “X-Factor” and “Britain’s Got Talent” are very effective at delivering large audiences quickly and are important to ITV in attracting advertising revenue; the more viewers a broadcaster can deliver to advertisers the more popular a broadcaster will be with advertisers.

3.23 The financial implication of this regulation for broadcasters is a complex area. We understand that ITV suggested to the Competition Commission that it faces a substantial cost from the undertakings. However, we note that there would be no guarantee that if CRR were to be lifted any extra revenue would be reinvested in programming or specifically public service programming. Under the Communications Act, we do not have the power to require a particular level of investment in public service programming or in programming generally. Quotas are framed in terms of hours rather than investment level and apply only to a limited number of programme genres.

3.24 Other broadcasters have expressed concern that removal of the regulation would result in a redistribution of income away from them in favour of ITV. This is based on the analysis that in the absence of regulation ITV would be able to extract more revenue from advertisers (away from other broadcasters, including other public service broadcasters).

MARKET REVIEW OF TV ADVERTISING

3.25 In its final CRR Review report published on 12 May this year, the Competition Commission noted that a number of characteristics in the market may “prevent, distort or restrict competition”, and concluded that there should be “a wider review of the market for selling television airtime”. In particular, it noted: “CRR operates in a complex and opaque environment conditioned by the existence of SOB deals, media agency umbrella deals and the SAP trading mechanism. These characteristics of the market continue to have potentially anti-competitive effect”. Some respondents to our consultation on removing the Airtime Sales Rules echoed these sentiments.

3.26 As noted in our recent review of Airtime Sales Rules we have given careful consideration as to whether we should launch a broad market review. We agree that the trading model is complex and there is limited transparency of prices. This reflects in part the bespoke nature of deals between media buyers and advertisers and also the way airtime is negotiated, ie media buyers and advertisers commit shares of their future advertising expenditure in return for a share of future impacts from broadcasters.

3.27 It is possible that the features identified by the Competition Commission, if combined with market power, could interact in such a way that prevents, reduces or distorts competition in the TV advertising sector. On the other hand, we note that it is also plausible that the characteristics of the trading model are efficient responses to the specific features of the TV advertising market and the uncertainty and transaction costs that key players face.

3.28 To date we have not received any evidenced complaints in relation to the issues raised by the Competition Commission and there is a lack of clarity about the nature and scale of any broader competition problems arising from the way airtime is traded or in relation to consumer harm which might arise as a result. As a result, if we were to launch a market study, we would be undertaking it on our own initiative.

3.29 We have also had regard to the resource requirements that we expect a market study into the TV advertising sector to entail (for both us and industry players) and the uncertainty that a market study would be likely to impose on the sector during the course of a review. In these circumstances, our current position is that the launch of an own initiative market study into the issues raised by the Competition Commission cannot be justified as a matter of administrative priority at this time.

3.30 Should we receive any reasoned requests from stakeholders for a market study into the operation of the trading model or other aspects of the TV advertising sector then these will be given careful consideration. In addition, we will keep our decision not to launch a market study of the TV advertising sector at this time under review. We will closely monitor any stakeholder concerns and wider changes as a result of market developments and any effects from removing the Airtime Sales Rules and the changes to the CRR undertakings, which may cause us to consider again our decision not to launch a market study of the TV advertising sector at this time.

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7 SOB is the Share of Broadcast and represents the proportion (by value) of an advertiser’s or media buyer’s television advertising spend received by (or committed to) a particular channel.
8 SAP is the average price per impact across a channel (or sometimes range of channels).
9 The Competition Commission’s report can be found at: http://www.competition-commission.org.uk/rep pub/reports/2010/557ITV.htm
10 The statement concluding this review can be found at: http://stakeholders.ofcom.org.uk/consultations/asr/statement/
PRODUCT PLACEMENT

3.31 The historical prohibition on product placement on TV was based on the principle that there should be a clear separation between editorial content (programmes) and advertising. The purpose of this prohibition was to protect consumers from surreptitious advertising (as prohibited by the TWF Directive). Although the AVMS Directive confirmed the prohibition of product placement it did introduce a derogation which permits member states to allow product placement in specific programme genres, subject to certain restrictions. The UK’s Audiovisual Media Services (Product Placement) Regulations 2010 amended the Communications Act to enable product placement in certain types of programming on UK TV.11 The Act requires Ofcom to introduce new rules for product placement, and also set out a range of detailed requirements12 in relation to product placement.

3.32 The Regulations came into force on 16 April 2010, but the UK Government made clear that product placement would not be permitted until we had consulted on detailed changes to the Broadcasting Code.

3.33 We launched a consultation on product placement on 28 June 2010. It set out our proposals for rules to implement the requirements of the amended Act in relation to product placement. We also proposed revisions to those related rules we considered to be impacted by the introduction of product placement (eg sponsorship). The consultation closed on 17 September 2010.

3.34 Our intention is to issue the revised Broadcasting Code by the end of 2010. We have also consulted on whether stakeholders would prefer the rules to come into force when the revised Code is issued, or after an implementation period. If there is an implementation period, product placement in UK programmes would be permitted from early 2011.

3.35 In the impact assessment set out in the Government’s most recent consultation on product placement it was estimated that allowing product placement would deliver economic benefits to broadcasters in the region of £25–30 million pa.

24 September 2010

Examination of Witnesses

Witnesses: Ms Kate Stross, Director of Content, and Mr Stuart McIntosh, Partner for Competition, and Ms Siobhan Walsh, Competition Group, Ofcom.

Q423 The Chairman: Thank you very much for coming in. I am Tim Razzall, the deputy to the deputy chair of this committee. That is no rudeness to you. It is just that that’s the way the dice have fallen. Perhaps you could each say who you are by way of introduction, and then we will go round the table with questions. When we get to the questions, please feel free—whichever one of you feels it appropriate—to answer them. Could you each say who you are?

Siobhan Walsh: Hello, I am Siobhan Walsh. I work in the competition group within Ofcom and was responsible for running our input to the review of CRR undertakings and the recent review of airtime sales rules.

Stuart McIntosh: I am Stuart McIntosh. I run the competition group and Siobhan is one of the members of my team.

Kate Stross: Kate Stross, director of content at Ofcom, very much involved with the PSB review, regulation of PSBs generally and thinking about the rules on advertising miniturage.

Q424 The Chairman: Thank you very much. Perhaps I can start off the first round of questions. By the way, at the beginning, before the public sections, we had presentations from Ofcom to tell us how the industry worked. Those were very useful to everybody. I think you touched on your public service review, where you calculated the value of regulatory assets—such as electronic programme guide prominence, and the privileged access to spectrum for commercial PSBs—and you made some forecasts for the future. Could you expand a bit on what you think those regulatory assets are? Have you quantified their value, and how do you think this will change over the next two to four years as the current licences come to an end with digital switchover?

Kate Stross: I will take that one if I may. Historically, the greatest asset the public service broadcasters had was access to analogue spectrum, which enabled them to earn advertising revenue from every home. That is obviously diminishing very rapidly as digital switchover progresses, so its value is relatively much

11 Under the amended Act, product placement is permitted in films, TV series, entertainment and sports programming. However, it remains prohibited in all children’s programmes and in UK-produced current affairs, consumer and religious programming.

12 In particular, the Act prohibits the product placement of tobacco and prescription-only medications in all programmes, and prohibits the product placement of alcohol, gambling, food or drinks that are high in fat, sugar and salt, other medicines and baby milk in UK-produced programmes. Permitted placed products must not affect the editorial independence of the broadcaster, be promoted or given undue prominence.
lower today and essentially will be all but gone by the end of 2012. That has been a very significant change in value. The public service broadcasters have also been given, in ITV and Channel 4's case, privileged access to digital terrestrial spectrum for which they have to pay only the cost of operating the multiplexes which are the delivery system. They do not have to pay a market rate and that represents significant value to both of them, which we would expect to be enduring value at a relatively consistent level. The public service broadcasters also have access to what is called due prominence on the electronic programme guide—a high position on the guide. That is a little bit more difficult to value. How you value it really depends on what you believe the alternative would be if they were no longer public service broadcasters. ITV, in particular, has argued that with the programmes that they make and the popularity of their service they would retain a privileged position on the electronic programme guide even if they were not a public service broadcaster, so they certainly make the argument that that has little value to them. Those are essentially the elements of value. There is more DTT capacity, which has also been awarded to the public service broadcasters for their HD services. Again, they pay just the costs of operating that capacity rather than a market rate for it.

Q425 The Chairman: Obviously, in return for that the PSBs, particularly ITV and channel Five, have certain public service obligations imposed on them. You might just touch on what you think those are, then go on to say whether you envisage them being reduced in tandem with the value of the regulatory assets going down, which you have touched on. 

Kate Stross: The obligations essentially take the form of programming quotas. There are programming quotas for news, current affairs and—in ITV’s case, in particular—regional programmes, which are probably the most costly part. On those quotas, it is essentially Ofcom’s ability to set them, and we have said in the past that, with the declining value of the public service broadcasters’ regulatory assets, we would expect to review the level of quotas to ensure that the costs and benefits of being a PSB are broadly in balance with each other.

Q426 The Chairman: And you would do that at the time of the review of the licences? 

Kate Stross: We have done it in the past, so we have reduced regional programming obligations, and yes, we will continue to do so in future.

Q427 Earl Onslow: You said that the cost of the value of a licence was basically the amount it costs to run it—the cost to operate the digital. What is the difference in the two values? As I understand it, the right to broadcast on an analogue channel X is worth Y, while it costs Z to do it. You are claiming the value Z, but what is the difference between that and Y? Do you see what I’m getting at?

Kate Stross: Yes, I do. These are numbers that we haven’t actually published. They are based on confidential information from the broadcasters. ITV and Channel 4 have access to half a multiplex each, in essence, and we estimate that the value of that to each of them is probably in the low tens of millions, but it is not a figure that we have actually published so far.

Q428 Lord Dixon-Smith: My question is more or less the same, because you mentioned this question of them paying operating costs for digital spectrum against market costs for that. I just wondered, first, how you made the distinction and, secondly, what the distinction was.

Kate Stross: Well, there is a market for slots on digital terrestrial multiplexes and we are able to gather evidence on what the market cost is. We also know what it costs to run the engineering of a multiplex. There is one further element to value, which is that the multiplexes that the public service broadcasters are carried on have better coverage than the commercial multiplexes, so you get access to about 8% more homes than a commercial multiplex. So we look at the costs of operation, compare that with the market rate for these slots, in effect, and take into account the benefits of the extra coverage. That is the figure that I was quoting in the low tens of millions.

The Chairman: Shall we move on a bit?

Q429 Lord Gordon of Strathblane: I wonder if you can help us, because we are getting conflicting evidence, which may not surprise you, from advertisers and ITV on just how dominant ITV is. Advertisers say, “Oh, we all can’t do without it”. ITV, on the other hand, says that the number of people who uniquely need ITV’s wide reach and large number of impacts very quickly is only really 1.65% of its revenue. Is the truth somewhere between the two or is somebody kidding us?

Siobhan Walsh: This is what we struggled with throughout the whole of the CRR review. Undoubtedly, ITV is still uniquely able to deliver mass-audience programmes. Advertisers have told us that that is very important for them in meeting their campaign objectives and that a very large proportion of their campaigns require ITV1 to deliver them. They didn’t give us any evidence as to how much. I think that the 1.65% is an interesting figure that ITV has presented. They presented that to us during the review.

Lord Gordon of Strathblane: They did?
Siobhan Walsh: They did, but it was based on a pretty restrictive definition of what kind of campaign requires a mass audience. Really, it was focused on campaigns that require delivery of a certain number of impacts within a very short time period, so it is the weekend—

Lord Gordon of Strathblane: With newspaper scoops.

Siobhan Walsh: Yes, where you're advertising your newspaper and so on. There is no standard definition of what a mass audience is or which campaigns require delivery of a mass audience, but we would probably expect it to be slightly broader than ITV has suggested. Certainly, advertisers have unanimously said to us that it is a significant proportion of their spend, but I really can’t give you a figure because nobody's presented evidence.

The Chairman: But there is a serious difference between what ITV told us and what the advertisers tell us.

Q430 Lord Gordon of Strathblane: You must to some extent have felt that the balance lay with ITV, because in your evidence to the OFT etc you said that there is a strong case for concluding that the CRR remedy is no longer necessary or appropriate.

Siobhan Walsh: We felt that the sector has certainly changed and evolved since 2003. There are more opportunities to obtain impacts elsewhere than ITV1 and that, combined with the fact that there has been this consolidation of media buyers—so, perhaps, an increased negotiating strength of media buyers—indicated to us that there is a good chance that, at the very minimum, CRR should be relaxed. We did, however, say that you may require some safeguarding because of this strength that ITV has in terms of delivering mass audiences.

Q431 Lord Gordon of Strathblane: Can I put one final supplementary? If one were minded to do something about CRR, I think that most people feel that something should be put in its place. Can you help us with the suggestions that you were looking at?

Siobhan Walsh: Again, we went out with a number of suggestions and nobody, including ITV until the very last moment, would consider alternatives to CRR. At the very last minute, ITV presented an alternative: a remedy which was based on a fair and reasonable type of offer that they would have to give to media buyers and advertisers. But through most of the review, they were arguing for a complete removal and really would not engage in discussions about alternatives. We also consulted with other stakeholders about what could replace CRR and nobody came up with anything. It was quite frustrating.

Lord Gordon of Strathblane: We share your feeling.

The Chairman: Bishop, are you happy to move on to the impact of COSTA, or its non-impact?

Q432 The Lord Bishop of Liverpool: Yes please. You have said in your submission that you reckoned that, over the last five years, ITV has reduced its investment in original programming by £700 million. ITV has suggested to us that that is because of CRR and the COSTA regulations. What is your assessment of its view?

Siobhan Walsh: If I take the CRR regulation, again we had quite a frustrating engagement with ITV on this issue. It proposed that its investment had gone down due to the fact that its revenues were down, which was due to CRR. When we asked what it would have done differently, or how its schedule would have looked different in a world without CRR, it was not able to present us with any evidence on decisions that had been made because of CRR as opposed to other factors. From what we can see, the reduction in investment from ITV on production has not been inconsistent with reductions in investment from other PSB broadcasters within the UK, so it is not clear that you can really pin it to a CRR problem. Kate may be able to comment a bit more on the COSTA.

Kate Stross: If I may just comment on the figure, the £700 million that you quote is probably an industry figure rather than that of ITV.

The Chairman: I thought that it was your figure.

Kate Stross: Sorry—it is a figure across the industry rather than being just ITV’s reduction. ITV has never argued to us that the minutage rules cost it money. I think that is because it is very difficult to tell whether they do, given that the CRR remedy is in place. So it has not made the argument but one can understand why. Clearly, its minutage is more constrained than that of the non-public service broadcasters.

Q433 The Lord Bishop of Liverpool: Is it your view that if CRR and COSTA were removed, the revenues would increase and they would invest more in original programming?

Kate Stross: We, as a regulator, do not have the power today to impose an obligation to invest on ITV or any other public service broadcasters. Our quotas are in terms of hours of output, not in terms of investment level. They apply to particular programme genres—news and current affairs, principally—or to originated UK content. At this point we can’t impose an investment level. If ITV felt that it was in its commercial interest to invest more in the schedule, I have absolutely no doubt that it would. But it would make an assessment of whether the incremental investment delivered a commercial return to it.

Stuart McIntosh: If the CRR were relaxed and ITV took advantage of it, one can be reasonably confident that it would probably be able to increase its revenues, which may or may not flow through to investments and programming.

The Earl of Onslow: Could you speak up?
Stuart McIntosh: I was just saying that if the CRR were relaxed, one could probably expect that ITV’s revenues would increase. Now, whether it would invest that in programming would be for it to determine commercially. On COSTA, however, it is a little bit more ambiguous because there are various options for changing the arrangements and regulations that are applied to airtime. In some circumstances, that could increase advertising revenues; in some circumstances, it could actually reduce them for the industry as a whole. Then there are still some uncertainties about what would happen in terms of the relative balance between ITV and the other broadcasters.

The Chairman: This probably leads into your question, Anthony.

Q434 Lord St John of Bletso: ITV was quite emphatic that the removal of CRR would result in more investment in UK content and more diverse programming. Do you think that this is furthering the public interest, even if it is to the detriment of the advertising industry?

Stuart McIntosh: Perhaps I will have a look at it. There are a couple of issues here. One is the technical review of CRR and the context in which one does that. The second is how one interprets the public interest. Reading through some of the earlier proceedings, I see that you have discussed the public interest question in relation to CRR with the CC. That was specifically tied to the impact on competition and a concern about what might happen after the merger to the prices and terms on which advertisers would buy advertising minitage. In that context, looking at CRR and whether it was appropriate to either change or relax the regulations had to be looked at in relation to the initial concern about competition. Thus when we considered that issue prior to it being looked at by the OFT, those were the factors that we primarily had in mind. We are conscious of the wider considerations, but one needs to be aware that the existing legal framework for the review of the undertakings does not readily allow those factors to be taken into account. Indeed, if we were to look more broadly at this in the context of a market study under the Enterprise Act, it is not altogether clear that that would allow us to look at it more broadly, either. We can see the argument in principle for being concerned about investment in high-quality and diverse content. However, the linkage between that and what one can do in relation to CRR is not direct.

Q435 Lord Bragg: ITV has said that its schedules offer less diversity. That is true; we need not argue about that. Do you think that the removal of CRR could be used to bring leverage to ITV and reinvigorate what used to be a very strong set of cards in the public service area?

Stuart McIntosh: It could do. However, it would probably involve the need for legislative change and for the Government to be explicit about what they would like to see emerge in that context. The other thing that we would need to be mindful of is the potential for regulation to become a quite intrusive intervention in programming policy. That may not be appropriate, depending on the ultimate goals. To some extent, over the past 10 years, it has probably been going in the opposite direction.

Q436 The Chairman: I do not follow that. Let us suppose that the Government were minded to take our recommendation that CRR should be removed, with undertakings being provided by ITV about innovative new programming. That would not require legislation. ITV would either give those undertakings or not. If it did, do you think that Ofcom, with ITV’s agreement, could monitor those undertakings?

Stuart McIntosh: I am not a lawyer, I am an economist. However, as I understand the legal position, at the moment only the Competition Commission can remove those undertakings.

The Chairman: Yes.

Stuart McIntosh: That would need to happen.

Q437 Lord Gordon of Strathblane: Perhaps I may ask a supplementary to Melvyn’s question. While you might require legislation in order to be more intrusive in regulation, you could be slightly more severe than you have been—understandably, in recent years, because of ITV’s financial position—in enforcing the obligation to produce regional news or other sorts of programmes, or training, or any of the other obligations under the Communications Act that you have soft-pedalled on, for obvious financial reasons.

Stuart McIntosh: Yes, if the Government thought that was an appropriate trade-off to consider.

Lord Gordon of Strathblane: You could do that.

Q438 Lord Bragg: Do you think that you have been too soft and stepped back too much? Because a lot of us do.

Kate Stross: It is a hard one to call. ITV has looked in particular for reductions to its regional programming obligations.

Lord Bragg: And children’s programmes.

Kate Stross: The changes that it has made to its children’s output were not changes that Ofcom could do anything about. Our ability to impose genre-by-genre quotas disappeared when the Communications Act was passed in 2003. We cannot impose quotas for children’s programmes. We said publicly that we regretted very much ITV’s pulling out of the genre on
ITV1, but we could not do anything about it, even though we tried. On the issue of regional programmes, the obligation to produce regional news and non-news for every single ITV region simultaneously is extremely expensive. That was the first argument that ITV put to us for a relaxation of regulatory obligations, and we had to accept it in light of the diminishing value of access to the analogue spectrum.

**Q439 Lord Gordon of Strathblane:** But if CRR were to be removed and its revenues went up, that argument would be less strong, would it not?

**Kate Stross:** It would.

**Stuart McIntosh:** We obviously need to be mindful of the impact of an increase in the share of advertising revenue of any of the broadcasters.

**The Chairman:** Let us move on to the international aspect.

**Baroness Deech:** In the light of time, is that really important?

**The Chairman:** Probably not, because we have had the same answer from everybody. Would you agree that international comparisons are not relevant because of the existence of the BBC? That is basically what everybody said. Perhaps you should ask the next question.

**Q440 Baroness Deech:** We have heard on the whole rather one-sided views from lots of witnesses. What is the public interest that CRR seeks to protect? Is it there for the advertisers, the broadcasters or the audience?

**Stuart McIntosh:** I will talk about it in straightforward technical terms. It was put in place initially because of concern over the impact of the merger, and over competition. There was no broader consideration of how this would affect programming and whether it might be to the detriment of viewers. It was essentially concerned with the impact on competition, and the concern that prices might be raised, or that media buyers and advertisers would find themselves at a disadvantage when conducting negotiations with a merged company. So the focus has been largely around competition issues. That in a sense has been the definition of the public interest in this context.

**Q441 Baroness Deech:** But if you approached it afresh and said that you were starting with the public interest, whatever that is, would you have CRR? Forget the advertisers; you are there to protect the public interest. Does that demand CRR or not?

**Stuart McIntosh:** I am not sure that it necessarily demands CRR. If obligations are going to be placed on a regulated company to produce programming that it would otherwise choose not to do commercially, a way has to be found to pay for that. In the PSB context, that has largely been done in relation to the regulatory assets that have been made available to the PSBs, which have been able to balance the costs of meeting those obligations against the benefits. In this case, we would be talking about them potentially being able to use their market power in order to fund other worthy investments. That would be quite unusual.

**Q442 Lord Gordon of Strathblane:** Perhaps I might intervene. The 1955 Act of Parliament that created ITV, or Channel 3, gave it a monopoly of television advertising in exchange for delivering a public good—public service broadcasting. If it was valid then, it must be valid now, when the monopoly has diminished more than somewhat.

**Stuart McIntosh:** Except that obviously the world has moved on in the choice and availability that is out there for viewers and consumers. There is a lot more competition for advertising. It is not quite so easy to shore up that advertising model around one company.

**Q443 Lord Gordon of Strathblane:** I would have thought that the position was even clearer. If Parliament was prepared to give ITV a total monopoly in exchange for good programming, it must surely be prepared to deliver them an impaired monopoly in exchange for good programming.

**Stuart McIntosh:** Possibly so, but it is a very different world today from that of the 1950s.

**Q444 Lord Skelmersdale:** If CRR were removed, what impact would it have on non public service broadcasters?

**Siobhan Walsh:** We do not have a clear sense of what would happen. One argument that has been consistently played to us, and which you have already heard, is that of the zero-sum game. If ITV can extract a greater proportion of advertising spend from media buyers and advertisers, that would be to the detriment of other broadcasters. Whether that is true, we have no sense. Equally, people have argued to us that what advertisers care about is the delivery of a certain amount of impact, so if the price varies, they will still aim to achieve that same amount of impacts—so if the price goes down, they will withdraw revenue from the market once they reach their desired level of impacts. What the outcome would be is very difficult to say. We are in a world with CRR and comparing it to one without is quite difficult.

**Lord Skelmersdale:** You are, but I suggest that we are about not to be.

**Siobhan Walsh:** Very possibly. I will say that CRR seems to have distorted the negotiations over what is spent with which broadcaster. We understood during the CRR reviews that all broadcasters, including
Channels 4 and 5 and some other channels, go into negotiations seeing what amount of money can be withdrawn from ITV, and just negotiate around that amount that can be released as a result of CRR. In a world without CRR, you might expect there to be a more active negotiation about how much money is spent with different broadcasters.

Q445 Lord Skelmersdale: As a result of that, will the cost of advertising go up or down?
Siobhan Walsh: The overall cost?
Lord Skelmersdale: No, the cost to the individual companies.
Siobhan Walsh: To the extent that CRR bites—and we think that it has held down some prices—you would expect prices to increase, certainly among programmes that are very popular with audiences. The ability to charge more for delivering what advertisers want in terms of fast mass audiences would increase. It is not clear what other impacts would be delivered. Other rates may go down, so the overall price to ITV is difficult to calculate.

Q446 The Chairman: We have had conflicting evidence on this. Some have said that rates would hardly alter, but members of the advertising industry have said that prices would go up by 10 per cent. Where do you stand?
Siobhan Walsh: I do not think that we have come up with a figure. We probably would not be in exactly the same place as the advertisers, because, even with CRR, we have seen some increase in ITV’s premiums. It is not clear that CRR is absolutely controlling the price that ITV can charge.

Q447 The Earl of Onslow: That was the supplementary that I wanted to ask. We have had a fall in advertising revenue, which has now bounced back up again. Therefore, CRR may have a marginal effect, but the economic demand for advertising has a much bigger effect. I suggest also that it is sold by totally ridiculous methods. The arguments of the early Byzantine church are simple by comparison.
The Chairman: You are allowed to say, “I agree”.
Siobhan Walsh: On the first point, I agree. I certainly agree with the sentiment that it is an old, complex and not particularly transparent system. I would not dismiss it out of hand as being inefficient, because some features are important to both sides of the sector in reducing transaction costs and uncertainty.
Stuart McIntosh: One of the things that we set out in our document when we reviewed this was a concern that the working of CRR has potentially constrained the evolution of the market. One reason why we thought it was certainly worth considering relaxing CRR in some form was that it would introduce more fluidity and potentially lead to differing arrangements for selling at least some of the advertising, if that was in the interests of buyers and sellers. The current arrangements constrain that.

Q448 Lord Dixon-Smith: Others have raised the question of whether ITV would invest any additional revenue accrued as a result of the possible changes that we are discussing in content, rather than passing it on to shareholders. If we remove the present regulatory properties, what hope is there for Ofcom to impose content and investment requirements on ITV as a quid pro quo?
Kate Stross: We could increase the volume quotas that they are subject to, but within the current regulatory framework we cannot impose spending quotas. The Communications Act defines the quotas that we can impose on hours of output. The only areas where we could impose quotas would be regional output, news and current affairs, UK origination, the use of independent companies and production outside London. We cannot go outside the set of genres defined in the Act.

Q449 The Chairman: No, but we are rather naively assuming that the Government or the Competition Commission could negotiate and enter an arrangement with ITV—after all, CRR was originally ITV’s idea—in return for which ITV would give various undertakings that you would be able to monitor. I understand that you could not impose these undertakings unilaterally under the existing legislation, but we are assuming a world in which it agrees to accept undertakings, perhaps in return for CRR being removed.
Lord Dixon-Smith: To put it more bluntly, it sounds as though you feel that you are holding an air pistol rather than a Colt revolver.
Kate Stross: The Government are clearly able to agree undertakings with ITV; there is no question about that. I will make the observation that the sector is developing extremely fast and one reason that the Communications Act was structured in the way that it was, was the fast-changing nature of the sector. One should be wary before imposing detailed obligations on ITV, because one is constraining its ability to adapt as the market adapts. There is a careful balance to be drawn.
The Chairman: On the other hand, CRR was ITV’s idea.
Kate Stross: Yes.
The Chairman: Let us move on to fair market price.

Q450 Lord Gordon of Strathblane: I am keeping an eye on the screen. If CRR went, would you want to reimpose some of the other restrictions that you have recently lifted? Would you require ITV to sell all its airtime, for example?
Everybody, ranging right across the board, said that anybody who wants the system to change would be a Byzantine way of selling advertising. We on the committee all think that this was a Byzantine way of doing something.

Lord Onslow said that this was a Byzantine way of selling advertising. We on the committee all think that this was a Byzantine way of doing something.

 ques: "Lord Dixon-Smith: Why do you think that non-PSB commercial people say that they want nine minutes, which would give them a higher price than they could the nine minutes."

Lord Dixon-Smith: Why do you think that non-PSB commercial people say that they want nine minutes, which would give them a higher price than they could the nine minutes.

Kate Stross: This is a very difficult area. In general, the public service broadcasters have a broad consensus that if non-public service broadcasters were allowed only seven minutes an hour, there would be an increase in the size of the market. The non-PSBs do not agree with this. These things are inherently very difficult to analyse and predict. It is understandable that there are different views. We have tried to undertake an analysis, but these things are difficult to predict. One is trying to understand behaviour through econometrics, which is a difficult science.

Q452 The Chairman: Perhaps I may follow-up here. We have heard consistent evidence about one thing. Lord Onslow said that this was a Byzantine way of selling advertising. We on the committee all think that, although we have not discussed it, there is consensus. Yet we have heard no evidence from anybody who wants the system to change. Everybody, ranging right across the board, said that they did not want the system to change. One reason they gave is that holding an inquiry into the alternatives would take too long. I suspect that there is a consensus emerging in this committee on the question of why Ofcom cannot be asked to do a review in, say, six months or less. Why would it take so long to review the alternative methods of selling advertising? We are all bemused as to why advertising is sold in this way. It seems locked into issues that go back perhaps not quite to the Byzantine period, but certainly a long way. I ask bluntly: could you do an inquiry and take a lot less than the three years that everybody suggests would be required?"
that we do not have? In the latter case, that would potentially involve a referral to the CC.

**Q454 Lord Skelmersdale:** Are you saying that you are not the right organisation to start such an inquiry?

**Stuart McIntosh:** If you want to do this in six months, the route that I have described does not address that need.

**Siobhan Walsh:** But legally, the CC cannot launch its own inquiry.

**Stuart McIntosh:** The CC is dependent on being requested to initiate an inquiry, either by ourselves, the OFT or the Secretary of State.

**The Chairman:** The alternative to this is that the Secretary of State does the six-month consultation and then legislates.

**Q455 The Earl of Onslow:** I have been away and read last night the construct of how the advertising industry works in television. I admit that I was completely bamboozled. One thing struck me as being seriously against the public interest. A media company buys a chunk of time that it then sells on to somebody else. That chunk of time is given a discount dependent on the percentage that is bought. Therefore, the interests of the advertiser are completely ignored under those circumstances. For that reason alone, the system deserves an inquiry of the first order. Can you tell me if there is anywhere other than Hong Kong where they use anything faintly resembling the same system?

**Lord Dixon-Smith:** Beijing.

**Stuart McIntosh:** We did not look specifically at this in the context of the CRR review, but I think, subject to confirmation—I will go back and check after the hearing—that there are other markets that use similar systems. I think that a similar arrangement applies in the US, for example.

**The Chairman:** It would be very useful if you could let our people know, because it is very relevant.

**Stuart McIntosh:** Before we leave the topic, I will say that we are at one with you in thinking that the current system can be very arcane and complex; we will be dependent on the percentage that is bought.

**Q456 The Chairman:** No, the industry itself created it.

**The Earl of Onslow:** When two or three people of the same trade or profession gather together—

**The Chairman:** But not necessarily in the Garrick Club.

**The Earl of Onslow:** I have a feeling that was said by Adam Smith.

**The Chairman:** Bishop, perhaps you would like to move on to COSTA, because we are running out of time.

**Q457 The Lord Bishop of Liverpool:** Do you think that the consumer—the viewer—is best served by this arcane system?

**Stuart McIntosh:** That is a very difficult question. We seem to be saying that in answer to quite a lot of your questions. I apologise, but it is very difficult. A system can be very arcane and complex; we will be concerned about whether it is working in the public interest if there is evidence of market power and if something significant is distorting the actions of some players in the market. CRR was put in place because of the view that there was an increase in market power in that part of the market. CRR was designed to address this. If that is the case, ultimately the interest of the consumer is being looked at. We have not looked at it in the context of how other aspects of the market work. In the course of doing the work on CRR and more recently, none of the other participants in the market—none of the ultimate purchasers of advertising time—has ever come to us and said, “We have a big concern about the way this is working, and we are losing out as a result”.

**The Chairman:** No, all the evidence that we have had is that nobody wants to change the system apart from the fuddy-duddies on the committee.

**Q458 The Lord Bishop of Liverpool:** Is the disparity in advertising airtime between the public service broadcasters and the satellite broadcasters likely to end with the expiry of PSB licences?

**Kate Stross:** We are looking at this area. The original thinking behind the disparity was that the then regulator felt that it was incumbent on it to regulate the quality of the viewing experience provided by public service broadcasters. Therefore, it limited the amount of advertising that commercial public service broadcasters could show.

[Division Bell]

**The Chairman:** I will shout a bit. Perhaps you could finish your answer. While you are doing that, perhaps the members of the committee, rather than going away and keeping our guests here for another 15 minutes, could think about any questions they would like to put quickly.

**Kate Stross:** The then regulator did not believe that it was appropriate to regulate for quality on the non-public service broadcasters. That was really based on the PSBs’ privileged access to the analogue spectrum. With that coming to an end in 2012, this is an area that we should look at before the end of the licence period.

**Q459 Lord St John of Bletso:** Very briefly, our understanding is that viewers would prefer less advertising time—ideally around seven minutes of it. Have you conducted any research into viewer attitudes to the quantity of television advertising?
Kate Stross: We have. Viewers will always tell you that they prefer less advertising, but if you look at their behaviour, they watch ever more television on non-public service broadcast channels, which show more advertising, and they watch the most in peak time. Even with public service broadcasters, you will often find 12 minutes an hour of advertising in peak time. What viewers tell you in research and their behaviour are slightly at odds.

Supplementary memorandum by Ofcom (RTA 19)

International Trading Models

Little public information is available about different international trading models of TV airtime. What is clear is that there is no “standard” international model for trading airtime, although there are similarities and some features which are common to the way in which airtime is traded in several countries, including the UK. Some of these similarities are described below, based on discussions with a number of TV sector players. We also include some details about three international trading models—France, Germany and the U.S.

We note, as a backdrop to this overview, that all European countries are subject to maximum 12 minutes of advertising per hour (under the AVMS directive), while the U.S. has no such restriction. None of the countries we have examined has an obligation to sell-out all airtime, which gives sales houses greater flexibility to restrict or release supply during the year. In addition differences in the way airtime is sold seem to be related to the way broadcasting sectors in different countries have evolved rather than regulatory intervention.

Negotiations between Advertisers, Agencies and Broadcasters

— Most models of trading, including that of the UK, are based around negotiations, rather than on the basis of a fixed price per impact or viewer. In addition most inventory is traded on the basis of annual negotiations, with some held back for spot sales during the year. We believe that only a small proportion of inventory in some territories is sold via auction.

— As with the UK, broadcasters will hold ongoing discussions with agencies throughout the year to determine the precise placement of specific campaigns within this annual deal.

— Although the nature of the negotiation will differ by country, typically they will centre on the level of discounts from a nominal “price” that media buyers or advertisers can obtain for advertising campaigns in the year ahead, in return for some broad spend commitment. Discounts are negotiated on the basis of both share and volume deals and may be defined in terms of price commitments, cash or free inventory, depending on the territory. The level of discounts obtained will reflect volume of spend, specific demographic and slot requirements, seasonality and other features of demand.

Transparency and Complexity of Deals

— Transparency of pricing varies by country. Some national markets appear relatively transparent, based on, for example, rate cards. However the scope and detail of rate cards varies significantly by territory and broadcaster and deals may be significantly more complex than implied by the existence of a ratecard.

— As with the UK, in many cases the final bespoke deals that are negotiated may not be completely transparent and often include an element of commission or unaccounted-for incentive payments. Even where ratecards exist, the final price agreed will almost certainly be “off-ratecard”, reflecting the detail of the negotiation around placement, frequency, time of day, programme identity, sequence of slots etc.

— Rate cards are not published in the vast majority of countries, although France is an exception.

The Chairman: Thank you very much for attending. We just about managed to get through the questions that we wanted to ask. We might have drifted a little longer, so the vote was probably a good thing. If there is anything that you want to add to what you have said, please send it to the clerk. The answer about the other countries that use the Byzantine system would be very helpful.

Stuart McIntosh: Not quite the same Byzantine system.
**Individuation Sale of Some Slots**

— In several countries part of the schedule of advertising airtime is sold on a slot basis. For example a certain proportion of the highest-rating programmes in the UK are sold on an individual basis—known as “specials”. This mirrors the reservation of spots in the Superbowl in the US. Similarly in France, France Télévisions, the Government-owned broadcaster, runs an (anonymous) online auction for certain dayparts, although not peak slots (relatively recent changes to regulation mean that FT can no longer advertise during peak hours).

— We do not believe any system has adopted slot trading or an auction method for the sale of its entire schedule of airtime (or even most of its schedule).

**Role of Media Buyers**

— Generally media buyers play a major role, both in negotiating annual deals and planning campaigns with broadcasters on behalf of advertisers. In some countries advertisers negotiate directly with media owners, although as with the UK, this appears to be generally limited to large advertisers. One exception to this appears to be Italy, where significant trading is undertaken between advertisers and broadcasters, although we note that on the sales side airtime sales is dominated by a single company, Belusconi’s Mediaset.

— A number of media buyers operate in many national markets, eg WPP, Omnicom and Publicis.

**Tracking/Measurement**

— All countries trade on the basis of measured metrics (for advertisements rather than programmes). Metrics track coverage of an advertisement or campaign for particular demographics, enabling, for example, advertisers to gauge what percentage of a particular viewing group (such as 16–34s) have seen a particular advertisement. We have been told that BARB measurement of TV impacts in the UK is one of the most comprehensive and detailed measurement systems in the world, enabling broadcasters to offer the sale of very detailed demographic groups.

**Price Premium for Major Broadcasters**

— We believe that TV advertising expenditure is dominated by mass-market brands in most countries, whose reliance on reach continues to drive advertising strategies. As a result, channels with the highest viewing figures (even if declining in absolute terms) are able to justify charging a premium to advertisers.

**Notable Differences with the UK**

There are also some aspects of international trading models which differ from what we observe in the UK. These differences do not appear, on the whole, to reflect different regulatory approaches—indeed, in many cases, there is limited or no regulation of the way in which airtime is sold.

— As noted, in many countries the basis of trading is a ratecard. Annual negotiations determine discounts to these prices, but baseline prices are effectively fixed in advance from month-to-month. This is different to the UK system of variable prices, which are only determined retrospectively on the basis of total revenues generated and total impacts delivered.

— Although discounts to prices are negotiated on the basis of both volume commitments and share (of budget) commitments, the former is more prevalent in Europe and the US. The UK and we understand Hungary are exceptions, although we also believe that some deals in Germany are based on share commitments (subject to restrictions indicated below).

**France**

— Broadcasters and advertisers negotiate annual discounts on published rate cards. Deals reflect volume commitments and the nature of specific demands for slots.

— The vast majority of airtime is sold within annual deals, allowing advertisers to guarantee access to inventory in advance and secure discounted rates on the basis of commitments. Additional inventory is released and sold month by month at the discretion of broadcasters.
— France Télévisions runs a month-by-month online auction for some of its daytime inventory—this tends to be inventory within popular daytime programmes, e.g., tennis tournaments. Since there is no advertising in peak airtime, the volume of airtime traded this way is relatively small (approximately 20%).

— Broadcasters reserve inventory throughout the year to accommodate late demand (at prices determined at that time) and to make up shortfalls in audience delivery.

— Nearly all trading is done between media buyers and broadcasters (integrated sales houses), and media buying is dominated by the major integrated agencies.

— The system delivers line-by-line transparency between media owner and advertiser, even if deals are negotiated via an agency deal—to ensure an explicit financial relationship between owners and advertisers.

**Germany**

— The German system is based on annual negotiations between broadcasters and media agencies or advertisers. Discounts to rate card prices are negotiated on the basis of share and volume commitments.

— 85% of airtime tends to be traded via annual deals and the remaining 15% (“freespace”) traded throughout the year, depending on market conditions and the need to respond to under-delivery of impacts during the year.

— The German Cartel Office restricted share deals in 2007, as it viewed the payment of discounts (either in cash or in-kind) as anticompetitive; there is now greater transparency with media owners able to distinguish between direct client deals and agency deals, and rules/practices are in place to ensure fair treatment of smaller budget advertisers.

— Nearly all trading is done between media buyers and broadcasters, and media buying is dominated by the major integrated agencies (led by Group M, with a 45% market share).

**United States**

— National networks sell around 80% of their advertising inventory upfront through annual negotiations around discounts to rate card prices. The balance of airtime is sold on an ongoing basis throughout the year (termed “scatter”), to meet late demand from advertisers.

— Networks auction a limited amount of “premium” airtime, notably in one-off events, for example slots in the Super Bowl.

— Local stations trade local spots on an ongoing basis, including spots in syndicated content, delivering national coverage.

— As with the UK, some large advertisers will deal directly with the media owners, but only if they have sufficient scale and negotiating power; as a result, most trading is undertaken via agencies.

30 November 2010
Memorandum by the Institute of Practitioners in Advertising (IPA) (RTA 5)

The IPA welcomes this opportunity to submit views to the Select Committee on the regulation of TV advertising.

SUMMARY

I. BACKGROUND

(a) The IPA in Advertising is the trade body and professional institute for UK advertising agencies, with a membership accounting for 85% of the UK’s advertising agency business.

(b) As an organisation, we are vitally concerned with the health of UK media (TV, press, posters, online etc) since these provide the vehicles through which our members deliver their clients’ commercial messages to the public.

(c) Having said this, we are also extremely wary when ownership is consolidated in any medium such that this might threaten the ability of our members to buy time/space in an open and competitive environment.

II. SCOPE OF RESPONSE

(a) We do not believe ourselves qualified to pass judgement on whether the entirety of UK regulation in the television sector is appropriate—however, we would draw a distinction between:

(i) Outmoded restrictions from a bygone age, when commercial broadcasting was viewed with suspicion and authorities believed it should be rigorously controlled (eg the prohibition of product placement);

(ii) More recent regulation relating to competition issues, which we believe remains valid to prevent the danger of abuse from a dominant player.

(b) Recognising our restricted expertise and our direct interest in maintaining a competitive marketplace, the following paper therefore concentrates on the Contract Rights Renewal Mechanism as a key element in the Select Committee’s Review—highlighting our belief that little has changed to diminish ITV’s market dominance since the remedy was introduced in 2003 and concluding, as a result, that the need for CRR remains as vital now as when it was first implemented.

III. THE STRENGTH OF ITV AND THE RATIONALE FOR CRR

(a) The Contract Rights Renewal Mechanism was introduced following the merger of Carlton and Granada in 2003 to prevent the ITV sales force abusing its position of power. As such it recognised:

(i) ITV1 possessed a dominant share of advertising revenues (52.7%) 

(ii) Its immense strengths as an advertising channel were unmatched by any of its competitors;

(iii) These strengths made it unsubstitutable by any other channel, or combination of channels;

(iv) The historically aggressive stance adopted by the ITV salesforce meant that without some form of protection, there would be a real risk of the broadcaster abusing its share/ non-substitutability to the detriment both of advertisers and its broadcasting competitors.
IV. ITV'S POWER HAS NOT DIMINISHED OVER TIME AND NEITHER HAS THE NEED FOR CRR

(a) Despite the arrival of online advertising, television—as a whole—has retained its vital importance for advertisers.

(b) Although the TV sector has grown dramatically in terms of channel availability since 2003 (2003: 300 channels; 2010 500 channels), almost half the population (47.7%) has access to only 45 channels.

(c) Within the market, the big players (ITV1, Channel 4 plus Digital, Five and Sky) continue to dominate—with ITV1 actually strengthening its “must have” status for major advertisers.

<table>
<thead>
<tr>
<th>% Top 1000 Advertisers in the UK</th>
<th>Spending on ITV1</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003 87.6%</td>
<td>2009 95.6%</td>
</tr>
</tbody>
</table>

(Source: NMR)

(d) By trading its “Family of Channels” (ie ITV1 + ITV2,3,4) in terms of pricing/value and access to audiences, ITV’s dominance remains undiminished, with the broadcaster still almost double the size of its nearest competitor in terms of share of revenue (“ITV Family”: 45.3% versus “Channel 4 Family”: 23.8%).

(e) Likewise, ITV1 continues to be unsubstitutable based on:
   (i) Its continued and unchallenged ability to deliver mass audiences rapidly;
   (ii) Its exceptional programming environment (big, “famous” programmes capable of generating “water-caller” discussion);
   (iii) Its continued size and status (which grants status to new brands and reinforces the status of established products).
   (iv) While ITV has shown it is theoretically possible to buy around ITV1 using a basket of channels, the above factors make this impractical in real terms.
   (v) The creation of “media agency buying groups” has not countered ITV strength, with the largest such group (Group M) only accounting for 29% of total TV expenditure, while the freedom of action of such operations is restricted by:
       — Clients who have their own direct deals with ITV;
       — The requirement to recommend the most effective channel mix for individual clients, within which use of ITV1 will be essential.

V. CONCLUSION

(a) We do not believe that ITV’s power has reduced sufficiently, such that the removal of CRR would not open the gates to market abuse, allowing the broadcaster to leverage its size and unique audience characteristics to increase its revenues by:
   (i) Additional share demands;
   (ii) And/or additional volume demands;
   (iii) Price rises on ITV1 and its other channels.

(b) Which, in turn, would mean agency/advertisers would have three options open to them:
   (i) To accept arbitrary ITV price rises;
   (ii) To move monies out of the ITV “Family of Channels” and suffer punitive price increases on the monies remaining with ITV;
   (iii) To move all the monies on to other non-ITV owned channels owned channels.

(c) Of the above, it would be difficult for large advertisers, physically to transfer their monies into other channels (Channel 4, and Sky already put an expenditure limit on deal rates for big advertisers).

(d) Likewise, it would be commercial suicide for agencies to inform their clients that they could not secure ITV1 airtime or state this could only be achieved significant cost premium.

Advertisers and agencies would thus be forced into paying whatever ITV wished to charge—precisely the anti-competitive situation which CRR was set up to avoid.
VI. Post Script
Finally, we are not convinced that CRR is the brake on creative programming, which ITV has claimed.

We believe that the trend toward more soap operas/overtly populist programming to maximise audiences had begun prior to the Carlton and Granada merger.

CRR simply takes account of the size of audiences, which is and always has been the basic trading currency in commercial television.

The skill of the commercial programme controller is to commission programming, which is both creative and appeals to mass audiences. If he/she wishes to test out formats, it should be possible to do so on ITV2/3/4 in the same way as the BBC will use its digital channels for such purposes.

If ITV’s goal in seeking the removal of CRR is to be able to charge the same or more for air-time than delivered audiences would justify—and to use its unconstrained market power to force advertisers to accept this—this is clearly an objective which neither agencies nor advertisers could ever accept.

Main Paper
I. About the IPA
The Institute of Practitioners in Advertising (the “IPA”) is the trade association and professional institute for UK advertising agencies. Our 265 corporate members are primarily concerned with providing strategic advice on marketing communications, including creating and/or placing advertising. Based throughout the country, they are responsible for over 85% of the UK’s advertising agency business and play a pivotal role in advising the nation’s companies on how they should deploy their total marketing communications spend of £42 billion.

II. Scope of this Response
As the trade body for UK advertising and media agencies, we do not believe ourselves qualified to make valued judgements as to whether the overall level of current regulation on TV advertising is appropriate.

However, having said this, we would draw a distinction between:

(a) Constraints left over from a bygone age, which viewed commercial broadcasting per se with suspicion and believed its activities should be rigorously controlled. (This would cover things like the current product placement rules, which we believe are outmoded and will soon be removed anyway.)

(b) More recent regulation relating to competition issues, which we believe remains valid and should be maintained to prevent the risk of abuse by a dominant player.

This, then, explains why, in the immediate past, we have firmly supported the removal of the product placement rules on television and the liberalisation of the broadcasting code on radio—while vehemently opposing the abolition of the Contract Rights Renewal Mechanism.

III. Our Stance towards Competition Issues
One of the fundamental roles of the IPA—enshrined in the Terms of Reference of its main media policy committee (the Media Futures Group)—is that it should “promote and ensure the continuation of cost-effective commercial media” for its members and their clients.

The Institute has therefore always been very wary of the concentration of media power in any medium.

Thus, in 2003 we expressed our profound concerns over the market dominance which would have resulted from the merger of Carlton and Granada and, together with ISBA—the advertiser trade body—were instrumental in pushing for the safeguards against potential sales abuse, which emerged as the Contract Rights Renewal Mechanism.

Since that date, our members have been protected, to an extent, from the possible adverse effects of the merger by this arrangement, with the IPA providing regular reports on its effectiveness to the CRR Adjudicator—including the highlighting of instances where ITV has sought to work round the mechanism, either in potential breach of the Undertakings or through the leveraging of its digital channels.
IV. How we Propose to Approach this Paper

Given the broad nature of the Select Committee’s inquiry, rather than spend time considering things like product placement or airtime sales rules, where decisions have already been made, we propose to concentrate on what we believe to be the key issue under examination—the Contract Rights Renewal Mechanism—and why, to our knowledge, all but one of our member agencies continue to believe it plays a critically important role in ensuring the fair running of the UK television market.

In so doing, we are conscious that a lot of this work will be going over old ground, drawing on submissions previously made in this context to the OFT and to the Competition Commission.

Having said this, we believe the observations we made then remain valid—although, for general readership purposes, we have not included some of the more detailed computer-generated schedules which our members generated to counter the various ITV hypotheses which were floated at that time.

V. Why is CRR Important and Why is it Still Valid Today?

(a) Background

As Members will be aware, the Contract Rights Renewal Mechanism was introduced to prevent the ITV sales force abusing its position of power after the merger of Carlton and Granada in 2003.

The decision by the Competition Commission to impose this remedy recognized:

(i) That ITV1 possessed unique strengths as a communications channel, unmatched by any of its competitors;
(ii) That these strengths made it unsubstitutable;
(iii) That the historically aggressive stance adopted by its sales force in airtime negotiations meant that, without some form of robust protection, there would be very real risk of abuse.

In 2007, ITV contested these original criteria, stating that:

(i) The TV market had moved on;
(ii) It was now only one of many broadcasters;
(iii) The constraint was severely and adversely affecting its financial health and business future.

The IPA sought to show that this was not the case and that the need for the remedy remained as valid as ever.

Following its deliberations, the Competition Commission concurred with this view—a decision with which we continue to agree.

(b) Has anything changed in the media/TV market since 2003 and, if so, has this reduced ITV1 (and ITV’s) dominance, such that CRR is no longer necessary?

We believe that the simple answer to this is “no” for the reasons outlined below:

(i) While the overall media market has changed significantly since 2003, the importance of TV remains undiminished

The last seven years have clearly seen a major new arrival in the sector in the form of internet advertising.

From the chart below, it is apparent that online growth has taken share from all the other main media—other than “out-of-home” and cinema.

However, the greatest “hits” have taken place on direct mail, regional press and radio—with the first two of these possibly losing direct business to the perceived greater accountability of the Internet.

TV as a whole, however, has maintained its key position.
THE PATTERN OF ADVERTISING SPEND ON DIFFERENT SOURCES OF ADVERTISING
TOTAL ADVERTISING EXPENDITURE 2009 vs 2003

<table>
<thead>
<tr>
<th>Medium</th>
<th>2003 Share of Total %</th>
<th>£ms</th>
<th>2009 Share of Total %</th>
<th>£ms</th>
<th>2009 vs 2003 Share Index</th>
<th>2009 vs 2003 Volume Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>TV</td>
<td>25.1</td>
<td>3722</td>
<td>24.3</td>
<td>3525</td>
<td>97.9</td>
<td>2009</td>
</tr>
<tr>
<td>National Press</td>
<td>12.8</td>
<td>1902</td>
<td>10.6</td>
<td>1532</td>
<td>82.8</td>
<td>82.8</td>
</tr>
<tr>
<td>Regional Press</td>
<td>20.0</td>
<td>2962</td>
<td>11.8</td>
<td>1708</td>
<td>59.0</td>
<td>57.7</td>
</tr>
<tr>
<td>Consumer Mags</td>
<td>5.3</td>
<td>784</td>
<td>4.1</td>
<td>595</td>
<td>77.4</td>
<td>75.9</td>
</tr>
<tr>
<td>Business and Professional Mags</td>
<td>7.1</td>
<td>1048</td>
<td>3.8</td>
<td>553</td>
<td>53.5</td>
<td>52.8</td>
</tr>
<tr>
<td>Radio</td>
<td>3.6</td>
<td>526</td>
<td>2.8</td>
<td>404</td>
<td>77.8</td>
<td>76.8</td>
</tr>
<tr>
<td>Outdoor</td>
<td>5.3</td>
<td>786</td>
<td>5.4</td>
<td>782</td>
<td>101.9</td>
<td>99.5</td>
</tr>
<tr>
<td>Cinema</td>
<td>1.0</td>
<td>149</td>
<td>1.2</td>
<td>180</td>
<td>120.0</td>
<td>120.8</td>
</tr>
<tr>
<td>Online</td>
<td>3.1</td>
<td>465</td>
<td>24.4</td>
<td>3541</td>
<td>787.1</td>
<td>761.5</td>
</tr>
<tr>
<td>Direct Mail</td>
<td>16.7</td>
<td>2467</td>
<td>11.6</td>
<td>1686</td>
<td>69.5</td>
<td>68.3</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>14811</td>
<td>100</td>
<td>14506</td>
<td>97.9</td>
<td></td>
</tr>
</tbody>
</table>

(Source: Advertising Association)

Moreover, it is important to note that while advertising on the Internet has grown massively, the role it fulfils for both the advertiser and the public is very different to television.

It is estimated that over 80% of the money spent online by advertisers is on “Search”.

The importance of traditional media in building brands—which consumers subsequently search for on the Internet—currently remains largely unchanged.

(ii) TV revenues have not been constrained by the growth of the Internet

There is no evidence to suggest that the growth of online (or added supply in any other media) has constrained the price of television.

Television represented 57.5% of total media spend for the top 20 advertisers on TV in 2009—only slightly less than the share for the top 20 advertisers on television in 2003 at 64.9%. (Source: NMR)

Over this period, the cost of television fell to mirror the financial climate:

<table>
<thead>
<tr>
<th>2003 All Adult CPT*</th>
<th>2009 All Adult CPT*</th>
</tr>
</thead>
<tbody>
<tr>
<td>ITV1</td>
<td>£6.86</td>
</tr>
<tr>
<td>Broadcast</td>
<td>£5.76</td>
</tr>
</tbody>
</table>

(Source: Industry estimates)

Whereas, according to industry estimates, the price of online media fell by 20%.

(iii) While the TV sector has expanded dramatically since 2003, power still rests with the big players

It has been variously suggested that the growth in the number of digital channels since 2003 has reduced the importance of ITV1.

Analysis, however, indicates that while the number of digital channels available to viewers has increased from 300 to around 500, the impact of this growth has, in fact, been considerably less than might have been supposed—with a significant proportion of the viewing population having access to only 45 channels (ie DTT homes, which accounted for 47.7% of homes in the UK in March 2010)
Moreover, within the digital and terrestrial channels, the big players (ITV1 + Digital, Channel 4 + Digital, Five and Sky) continue to dominate, with ITV1 actually strengthening its “must have” status for major advertisers:

<table>
<thead>
<tr>
<th>% Top 1000 Advertisers in the UK</th>
<th>Spending on ITV1</th>
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<tbody>
<tr>
<td>2003</td>
<td>87.6%</td>
</tr>
<tr>
<td>2009</td>
<td>95.6%</td>
</tr>
</tbody>
</table>

(Source: NMR)

Likewise, within the TV sector, ITV’s importance remains undiminished. Given the arrival of the digital channels, ITV1 has inevitably lost revenue share in the last seven years (from 51.7% in 2003 to 37.0% in 2009).

Having said this, by trading its “family of channels” in terms of pricing/value and access to audiences, ITV, as a whole, has retained its position of market dominance (52.7% in 2003 vs. 45.3% in 2009).

Significantly, this means that ITV plc is still almost double the size of its next largest competitor (Channel 4 Family at 23.8%)—and by exploiting the combined strengths of its analogue and digital offering whenever and wherever possible, has continued to be by far the most powerful advertising-funded commercial TV player in the sector.
THE PATTERN OF TV ADVERTISING SPEND ON DIFFERENT TV CHANNELS
BROADCAST TELEVISION REVENUES

<table>
<thead>
<tr>
<th>Channel</th>
<th>% share of revenues</th>
<th>£m</th>
<th>% share adult impacts</th>
<th>Index share of revenue on share of impacts</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ITV1</td>
<td>51.7</td>
<td>1628.5</td>
<td>42.7</td>
<td>121</td>
</tr>
<tr>
<td>C4</td>
<td>19.9</td>
<td>626.7</td>
<td>16.5</td>
<td>121</td>
</tr>
<tr>
<td>Five</td>
<td>8.0</td>
<td>251.4</td>
<td>11.1</td>
<td>72</td>
</tr>
<tr>
<td>GMTV</td>
<td>1.9</td>
<td>59.1</td>
<td>2.9</td>
<td>65</td>
</tr>
<tr>
<td>Sky</td>
<td>11.3</td>
<td>356.0</td>
<td>11.9</td>
<td>95</td>
</tr>
<tr>
<td>IDS</td>
<td>4.0</td>
<td>125.0</td>
<td>6.7</td>
<td>59</td>
</tr>
<tr>
<td>ITV Dig</td>
<td>1.0</td>
<td>33.0</td>
<td>2.8</td>
<td>37</td>
</tr>
<tr>
<td>C4 Dig</td>
<td>1.4</td>
<td>44.0</td>
<td>1.3</td>
<td>107</td>
</tr>
<tr>
<td>Five Dig</td>
<td>0.0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Others</td>
<td>0.9</td>
<td>28.0</td>
<td>4.1</td>
<td>22</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>3151.7</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ITV Family</td>
<td>52.7</td>
<td>1661.5</td>
<td>45.5</td>
<td>116</td>
</tr>
<tr>
<td>C4 Family</td>
<td>21.3</td>
<td>670.7</td>
<td>17.8</td>
<td>120</td>
</tr>
<tr>
<td>Five Family</td>
<td>8.0</td>
<td>251.4</td>
<td>11.1</td>
<td>72</td>
</tr>
<tr>
<td>2009</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ITV1</td>
<td>37</td>
<td>1101.9</td>
<td>28.4</td>
<td>130</td>
</tr>
<tr>
<td>C4</td>
<td>18</td>
<td>535.6</td>
<td>12.1</td>
<td>149</td>
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<td>Five</td>
<td>6.9</td>
<td>206.5</td>
<td>8.1</td>
<td>85</td>
</tr>
<tr>
<td>GMTV</td>
<td>1.8</td>
<td>52.7</td>
<td>2</td>
<td>72</td>
</tr>
<tr>
<td>Sky</td>
<td>11.6</td>
<td>345.5</td>
<td>17</td>
<td>90</td>
</tr>
<tr>
<td>IDS</td>
<td>6.7</td>
<td>200.1</td>
<td>11.5</td>
<td>58</td>
</tr>
<tr>
<td>ITV Dig</td>
<td>8.3</td>
<td>245</td>
<td>9.5</td>
<td>87</td>
</tr>
<tr>
<td>C4 Dig</td>
<td>5.8</td>
<td>172</td>
<td>7</td>
<td>83</td>
</tr>
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<td>1</td>
<td>30.7</td>
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<td>Others</td>
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<td>37.9</td>
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</tr>
<tr>
<td>C4 Family</td>
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<td>19.1</td>
<td>125</td>
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<tr>
<td>Five Family</td>
<td>7.9</td>
<td>237.2</td>
<td>10.5</td>
<td>75</td>
</tr>
</tbody>
</table>

(Source: OMD)

(v) ITV1 continues to be un-substitutable

As Select Committee Members will be aware, in 2003 the Competition Commission concluded that ITV1 was non-substitutable for major advertisers. This was based on:

— The ability of the channel to deliver mass market audiences rapidly. (Key for advertisers seeking to communicate their messages quickly to large numbers of people);

— Its programming environment (big, “famous” programmes capable of generating “watercooler” discussion);

— Its size and status (which granted status to new brands and reinforced the status of established products).
While it is technically possible to run most campaigns in non-mass market programming, the vast majority of advertisers believes—with good reason—that to be successful, it needs large audiences and is prepared to pay significant price premiums to achieve this.

The attached Nielsen spreadsheet reveals that only 1.7% of TV revenues in 2009 was spent behind campaigns which used no ITV 1 at all.

The reason for this lies in the importance attached not simply to the reach levels achieved at the end of a campaign, but the speed with which that reach is attained. Put simply, almost all advertisers will want to see their advertising investment having as much impact as possible, as early as possible, in their activity.

This highlights a fundamental flaw in the substitutability analysis historically put forward by ITV in that it ignored the importance of rapid cover build.

Of course, there will be certain categories of campaign for which generating such reach quickly and in shorter periods of time will be critical (eg most retail accounts, promotional activity, seasonal advertisers and new product launches).

However, leaving these aside, there are powerful reasons why all advertisers would want large programmes on their schedule, including:

— Prestige (both for external reasons eg, status with the consumer—and internal reasons, eg status within the retail trade and the advertisers’ own sales force, staff etc);
— Rapid sales generation (advertisers like to know that a campaign is working);
— The driving of trade distribution (retailers expect significant support to underwrite their stocking of products and allocating them appropriate shelf facings and favoured locations in their premises)

ITV has always been proud of its ability to build brands and to achieve both business and media deliverables quicker than anyone else, and it has attributed this to the mass audiences that it consistently delivers over and above its competitors.

ITV “Fame Rating” research published in May 2005 concluded that TV advertising made brands “famous” and the more famous a brand, the higher the consumer’s intent to purchase. Behind this research was the implicit assertion that ITV built this “fame” faster than all other channels through its ability to deliver mass audiences larger and more frequently than its rivals.

By contrast, comparatively few types of advertiser can operate without mass audience programming and will largely comprise DRTV operators (who will generally use in the daytime) and advertisers targeting children.

(For further information on ITV Fame research and the importance of rapid cover build—see the Appendices A and B.)

To what extent has any of the above changed?

In 2008, in a submission to the OFT, we wrote “to illustrate how (ITV’s strength) has remained largely unchanged over the last five years, it is worth considering the top 500 programmes by volume of audience in 2007. Of these 328 (or 66%) were ITV1 programmes, with 171 being broadcast by the BBC and the remaining one by Channel 4. Even if we were to exclude Coronation Street and the other “soaps “ from the calculation, ITV1 is still responsible for 196 of the 500 (39%), with only six (1%) being broadcast by other commercial channels”.

As a point of comparison, we have checked the data for 2010, looking at the week ending 31st May. Of the top 500 rating programmes, ITV1 accounted 326, while BBC1 accounted for 174.

Clearly there has been no change in the dominance of ITV1 and BBC1 in delivering large audiences, and the balance of power between ITV1 and BBC1 in this respect also remains unchanged.

(vi) **ITV1 remains vital for a range of key advertisers**

As stated elsewhere, we believe that most advertisers are dependent on ITV1.

Having said this, the mass reach and rapid cover build that this channel can deliver, will be particularly vital for advertisers in the following categories:

— Mass appeal advertisers (eg FMCG brands, with regular product turnover).
— Major spending advertisers restricted from moving money away from ITV (eg Unilever, COI, Procter & Gamble)
— Regional advertisers
— Short-term “sale”/news-based advertisers (eg retailers/newspapers/new product launches)
— Seasonal advertisers, including the gift market (eg Christmas/ Easter/ Mother’s Day, weather related products (eg gardening) and the fixed event related promotions.

ITV would certainly discriminate against these advertisers in the absence of CRR, by demanding price increases, higher shares of expenditure and/or volume increases and other measures.

(vii) The creation of media agency “buying groups” has not countered ITV’s strength

In 2008 there were six major trading groups, sharing the investment responsibility for over 81% of commercial television expenditure.

However, while concentration of “buyer power” has increased since 2003, it is still limited/weak in comparison with ITV’s position.

Not only has no single agency group gained a monopolistic advantage (the largest, GroupM, accounts for only 29% of total television expenditure)—such operations are severely restricted in their freedom of action by the fact that they are only representatives of their advertiser clients, and as such will be:
— Restricted from using overall agency expenditure to counter ITV strength by clients who have their own direct deals with the broadcaster;
— Required to recommend the most effective” channel mix for individual clients/campaigns, and in many instances ITV1 will be regarded as essential for effective campaign delivery from both objective and subjective reasons.

(In this context, Select Committee Members may like to note the power of agency group buying operations is constrained more generally by the consolidation which has taken place on the sales side. In 2003 there were eight TV airtime sales points of note (Carlton, Granada, Channel 4, Five, Sky, IDS (Flextech), Viacom and GMTV); today there are just five, and most likely this will fall to four (ITV, Channel 4, Five, Sky), if the sale of Virgin TV to Sky is cleared by the Irish regulatory authorities and IDS VMTV channels are absorbed into Sky Sales. In 2003, four sales points controlled c81% of TV ad revenues; at the end of 2009 c83% of revenues were controlled by three sales points.)

VI. THE REMOVAL OF CRR WOULD OPEN THE GATES TO MARKET ABUSE

As I hope we have shown via this paper, while ITV1’s market position may have declined in terms of its share of commercial revenue and commercial viewing, in real terms, the power of the broadcaster remains intact.

This is based on three factors:
(a) ITV’s policy of selling its analogue and digital channels together on a conditional basis
(b) The fact that ITV1 still dominates the delivery of large audiences
(c) The increased value of large audiences as a result of fragmentation. Although ITV 1’s top rating programmes have declined in absolute levels of delivery, they are just as valuable now/more valuable because of the overall decline in peak time programme audiences across all channels.

On this basis, if ITV were released from its CRR obligations on ITV1, we believe it would leverage the combination of its overall market trading power and its unique ITV1 audience characteristics in order to increase its revenues through:
(a) Additional share demands;
(b) And/or additional volume demands;
(c) Price rises on ITV1 and its other channels.

Which, in turn, would mean that agencies/advertisers would have available to them one of three options:
(a) To accept arbitrary ITV price increases;
(b) To move some monies out of ITV (ITV1 and ITV’s overall family of channels) and then be subject to very substantial and punitive price increases on the monies remaining with ITV); or
(c) To move all the monies into other non-ITV owned channels
The last of these options would be extremely difficult for large advertisers—indeed certain channels (Channel 4/Sky Sports1) already put a limit on expenditure at deal rates for bigger players for inventory management/income optimisation reasons.

On a campaign by campaign basis, it would simply be impossible for many campaigns to be delivered (regardless of campaign reach performance) without ITV1. Many campaigns that run at a high weekly weight or require weights on specific days would not be able to get those weights away whilst substituting ITV1. Likewise products in categories that are heavily advertised would often find it impossible to substitute ITV1 as most appropriate breaks on non-ITV1 Channels will already feature clashing products. (eg retailers at holiday times, perfumes at Christmas and cars at registration times).

Moreover, even if any of the above were achievable, agencies would be placed in an impossible position since it would be commercial suicide either to inform their client base that they could not secure ITV1 airtime, or to say that this could be achieved, but only at a significant cost premium across all the ITV family of channels.

This inability to move large sums of money away without attracting inevitable punitive action would mean that advertisers and agencies would simply be forced into paying whatever ITV wished to charge—precisely the anti-competitive situation which CRR was set up to avoid.

VII. Finally, has CRR really limited ITV’s ability to compete in the production of quality programming?

Having put forward our reasons why we believe it is vital that the Contract Rights Renewal Mechanism should be retained—we should perhaps state that the IPA has as much interest in ensuring that ITV1 remains healthy, vibrant and attractive to audiences as broadcasters—since without it, our members’ clients, the advertisers, would lose perhaps the most important single vehicle for delivering their commercial messages.

Programming is not an area over which the IPA would claim any special expertise, although clearly we would like to see the broadcaster producing the best and highest quality output that is able to afford.

Having said this, we do feel it is possible to make a few observations.

While we are aware that Michael Grade has stated historically that CRR has acted as a brake on experimentation—whether under the ownership of ITV, Carlton or Granada, ITV1 has not—in recent years—been a risk taker, particularly with regard to peak programming.

The trend towards more episodes of soaps, etc., exploiting strong programmes and programme franchises to maximize audiences—and quickly removing underperforming programmes from schedules—had begun pre-merger.

CRR takes into account audiences traded—and so it is to ITV’s benefit to produce more programming designed to appeal to audiences that advertisers are targeting more over time—and less programmes designed to appeal to audiences that advertisers are targeting less over time.

If ITV’s objective in removing CRR were to be able to charge the same (or more) for airtime in programming, irrespective of the audience it delivers, then Select Committee Members will understand the advertising industry’s lack of sympathy with this goal.

APPENDICES

A. ITV Fame Research

ITV produced research entitled “ITV Fame Ratings” in May 2005 to promote the TV sector and combat what it perceived as “Historical complacency” within the TV market place and the “Demand for evidence based ROI”. It also hoped that its research would provide some reassurance about TV advertising and safeguard revenues in the face of the successful growth and proliferation of both the multichannel TV world and other media, notably online.

ITV1 looked across 16 different sectors from a cross section of advertisers’ with different media strategies.

The conclusion of the study found that TV advertising made brands famous and the more famous a brand, the higher a consumer’s intent to purchase was. Behind this research was the implicit assertion that ITV built this “Fame” quicker than all other channels through its ability to deliver mass audiences larger and more frequently, than all its rivals.
Indeed Jeremy Bullmore, former chairman of both JWT and the Advertising Association is quoted to that effect in the research, stating:

"A brand, if it is to enjoy genuine celebrity, must be known to a circle of people that far exceeds what we in the business so chillingly call its target group ", or to paraphrase Jeremy Bullmore, the most important thing is being seen by the largest group of people as possible.

In 2008, ITV1 delivered 92 out of the top 100 rating programmes on commercial TV and it should be remembered that this only includes the top incidence of each programme occurring. If we look at absolute numbers, ie every episode of Coronation Street rather than just the top episode, ITV1 are responsible for delivering the top 540 rating programmes before we get to a non ITV programme (Peter Kay’s “Britain’s Got The Pop Factor”, appeared on Channel 4 delivering 6.3 million adult viewers).

B. Why Building Coverage Quickly is Important

There are two key reasons for fast coverage build being linked to business performance:

1. A key objective of advertising (esp. FMCG advertising) is to influence as many purchasing occasions as possible (known as recency). So each rolling 2-3 day period is like a mini-campaign. The higher the coverage in each rolling period, the higher the likelihood of strong sales performance. Hence, coverage across longer periods of time is almost irrelevant, what is relevant is catching a consumer when they are in the mindset of buying a product.

2. For longer term branding campaigns, even if 1+ coverage is not the objective, building 1+ coverage quickly is very important, as 1+ build affects the frequency distribution across your campaign. eg. If your effective frequency is 3 exposures, building fast 1+ will do two things: 1) enable you to build the quickest 3+ coverage 2) reduce the length of your frequency tail. If 1+ doesn’t build quickly, your campaign will end up delivering an amount of 3+ but optimising at a much higher frequency of 6–7+.

In both cases (ie for hard and fast FMCG campaigns and for longer term branding campaigns) building quick 1+ coverage has a direct effect on sales and cost efficiency. Some of the theory and the research studies that have reached these conclusions is detailed here:

The effect of advertising on sales

Most recent studies on the relationship between advertising and sales have sought to measure the effect of frequency on purchasing, the best of these using single source data, where the purchasing behaviour of a panel is measured (these days generally by scanning all purchases) and the television advertising exposure is also measured (generally via a TV set top box)

We have picked out a few of the key studies, some of which analyses the effect of frequency on sales and some which use other measures of effectiveness (most often advertising awareness).

John Philip Jones 1990 & 2000’s

A significant step was taken in the early 1990’s when John Philip Jones released the results of a large-scale analysis of ACNielsen panel data. He developed the research technique of STAS (Short Term Advertising Strength), which compared a brand’s share of purchase occasions in those households where there had been at least one exposure to the brand’s TV ad in the last seven days, with those households not exposed to recent advertising.
The analysis confirmed earlier findings from single source research that advertising was capable of generating immediate sales. It also came to the surprising conclusion that just one exposure generated the highest proportion of sales with additional exposures having relatively little effect (Chart 1).

Among the 78 brands in 12 categories, Jones found a considerable variation in STAS score (Chart 2). For the top 10% of brands, the average STAS differential was 136%, meaning that the share of purchase occasions in households who had been exposed to the advertising was more than double the share in “unexposed” households.

Erwin Ephron—1990’s

Erwin Ephron took up the results of this work. He concentrated on the issue of time rather than frequency and created the concept of “Recency Planning”. This says that all that is needed is one exposure in the period immediately prior to purchase. This may not be the first exposure, it may be just one in a long series of exposures. However, because purchases, and purchasing decisions, are being made all the time, the ideal plan is a continuous one maximising both the number of weeks on air and weekly cover. What counts is whether the consumer is ready to buy, not how many times he or she has been exposed to the advertising.
In the UK in the early 1990s, research company AGB fused viewing data from the BARB peoplemeter system on to their grocery purchasing panel “Superpanel”. The data was analysed to compare the number of brand purchases made by housewives who had been exposed to the advertising with the number of brand purchases by those not exposed to it. Allowance was made for “purchase viewing bias” by examining different weight-of-viewing groups separately.

### RESPONSE CURVES—ESTABLISHED BRANDS

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<tr>
<th>Brand</th>
<th>Response Curve</th>
<th>Saturation level (4 wks)</th>
</tr>
</thead>
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<td>H</td>
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<td>5</td>
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<tr>
<td>I</td>
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<td>2</td>
</tr>
<tr>
<td>A</td>
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</tr>
<tr>
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<td>B</td>
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Source: TNS

Among the first 24 brands to be analysed, 17 were established ones and the remainder new or re-launched brands. 15 of the 17 established brands exhibited convex response functions with the first exposure having a greater incremental effect on purchasing than any subsequent exposure (Chart 3 & 4).

### RESPONSE CURVES—NEW/RELAUNCHED BRANDS

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<tr>
<td>G</td>
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</tbody>
</table>

Source: TNS

chart 3

chart 4
Effect of frequency and recency of exposure
(normalised by weight-of-viewing)

In most cases there was little additional effect after 4 or 5 exposures. One brand had a linear response, and the other a threshold at 3 exposures. Among the 7 new or re-launched brands, 5 showed a linear response.

More recent analysis by the same company (now re-named Taylor Nelson Sofres) of true single source data has highlighted the relatively greater impact generated by concentrating exposures in the period immediately prior to purchasing (Chart 5).

While diminishing returns are seen to exist over a longer period, they show a benefit of multiple exposures across a 3-day period immediately prior to purchasing. In these circumstances, 3 exposures will produce an effect many times greater than that produced by a single exposure (Chart 6).

**Summary**

Over the last 30 years the advertising industry has moved from away from an almost universal belief in the S-shaped response curve with effective frequency levels at around 2 or 3. It is clear from the more recent research that the first exposure can, and frequently does, have a greater effect than later exposures. This is particularly true for the larger and more established brands, suggesting that they can be effectively supported at relatively low weights of advertising. For newer brands, higher frequencies may be more appropriate. Here an element of learning is involved rather than a mere reminder of a brand’s presence and its qualities.

In the same way that the response curve of a brand may vary over time (possibly S-shaped at launch, then increasingly convex as it matures) it will vary between different consumer groups. To persuade someone to switch brands may well require more exposures than just encouraging them to stick with their existing brand.
As important as the number of exposures is their timing—particularly in relation to the time of purchase or purchase decision. Advertising seen in the days before a purchase will have a greater effect than that seen several weeks before. The issues of timing and frequency need to be considered together. An “effective frequency” does not really make sense unless it’s related to a specific time period.

The first edition of “Effective Frequency” published in 1979 by the Association of National Advertisers (of the USA) concluded “One exposure of an advertisement to a target group within a purchase cycle has little or no effect in all but a minority of circumstances”. Over twenty years later we can say, with some certainty, that this is not the case.

September 2010

Examination of Witnesses

Witnesses: Mr Steve Williams, CEO, OMD Group Ltd, Mr Tom George, CEO, Mediaedge: CIA, Mr Geoffrey Russell, Secretary and Director for Media Affairs, Institute of Practitioners in Advertising, and Mr Andy Jones, CEO, Universal McCann London.

Q460 The Chairman: Good afternoon. Thank you very much for coming along. I am delighted to see that you have brought your own name tags, as well as those provided. We’re double banked now, so there is absolutely no chance that we will misidentify you in the course of the proceedings. I wonder if you could introduce yourselves and just explain your area of expertise, because obviously it will be very helpful when we are addressing the questions to know where the thrust of them should go.

Could I also apologise? I am really sorry that we were delayed but, as ever, we have internal deliberations to get through as well. So I am sorry for that.

Mr Russell: If I could possibly kick off then. My name is Geoffrey Russell and I’m the Secretary and Director for Media Affairs at a body called the IPA. For those of you who have not come across the body before, the Institute of Practitioners in Advertising is the trade association and professional institute for UK advertising agencies. We have 263 corporate members who are primarily concerned with providing strategic advice on marketing communications, including the creation and the placing of advertising. These members are based throughout the country. They are responsible for over 85% of the UK’s advertising agency business and they play, we like to think, a key role in advising the nation’s companies on how they should deploy their total marketing communications. While the IPA membership comprises all forms of advertising agency, given the nature of the subject today we have representatives from our media policy committee, which is called the Media Futures Group. IPA media agency members will be responsible for planning and buying their clients’ media budgets across all the different media in the UK, and the Media Futures Group represents their interests from large to small on matters of common concern.

I’m a generalist and I will defer to my expert colleagues who work, as it were, at the coalface of media. So, I will start with Steve Williams at the end there.

Mr Williams: Hello there. I’m Steve Williams. I’m the Chief Executive of OMD, which is part of the Omnicom Group in the UK. I sit as Chair of the Media Futures Group with the guys here. Through history, I’m a TV trader by background, and I now run the agency in a more general sense.

Q461 The Chairman: Could you just explain what Omnicom does?

Mr Williams: Omnicom is a global marketing services group.

Q462 The Chairman: You are media buyers and so on?

Mr Williams: Absolutely. A full range of marketing services—all the guys around the table work within that, but I work specifically within OMD, which is the media division.

Mr George: Good afternoon. I’m Tom George. I’m the CEO of MEC UK, part of the WPP Group, which is also a global marketing services group. Again, in an earlier part of my career I headed up trading for a media agency, so was responsible for directly dealing with all the broadcasters.

Mr Jones: Hello. I’m Andy Jones. I’m CEO of UM, which, like the other two guys at the end there, is a media communications planning and buying agency. Again, it’s owned by one of the large advertising groups, Interpublic. And again, like Tom and Steve, my background originated in the TV trading side of the business. In fact, I worked at ITV on the sales side trading with agencies before I came over to the agency side, although that was many years ago I must admit.

The Chairman: So I do not know whether you are a poacher turned gamekeeper or a gamekeeper turned poacher.

Mr Jones: You decide.

The Chairman: Very good. Geoffrey, will you help us direct the traffic? That might be necessary. I think.

Mr Russell: Yes, indeed. It will be my pleasure.

The Chairman: I think that to some degree there may be competition in answering the questions. We have a very competitive group here.

Mr Russell: We did spend a little time divvying up responsibilities this morning.
Q463 The Chairman: Good. That is very helpful. Thank you. Perhaps I could introduce the first question. Since the introduction of CRR the number of commercial impacts has increased by about a third. At the same time, the price per impact that advertisers are paying has fallen significantly in real terms, even after the recent recovery and even for ITV1 and Channel 4. Do you agree that advertisers are now able to buy many more impacts and are also paying much less for each impact?

Mr Jones: Yes, that’s true. Over the last six, seven years or so commercial impacts have increased by something like 35%, due to the extra channels that have come on board primarily. So, the price of airtime has deflated overall by about 16%, although interestingly ITV has only deflated by 6% so it’s managed to stem the tide in many ways. There are a number of reasons why the price of airtime has come down. You have mentioned commercial impacts, but it’s not just that and we believe that the UK digital economy is one of the biggest factors in this as well. A lot of money has gone out of television. There is a big e-commerce business in the UK. A lot of money has gone online or it has gone to search, so that has been a factor as well, but I guess increased supply of commercial minutage is significant.

Q464 The Chairman: Is this post hoc or propter hoc? Is it just simply the result of the digital age or is it because of CRR being instituted in 2003?

Mr Jones: No. I think since 2003 we have seen broadband penetration increase significantly in this country and, as I say, we lead the world in many ways in the online e-commerce economy. So a huge amount of money is being spent online by advertisers and that has had an effect on all other media, not just television.

Q465 Earl Onslow: I am extremely confused by the system of discounts. Can you tell me if anybody ever pays the full market price?

Mr Jones: Do you mean on television specifically?

Earl Onslow: On television.

Mr Jones: There are lots of advertisers who would pay, depending on what kind of airtime they want to reach, what kind of audiences.

Q466 Earl Onslow: If somebody quotes £10 an hour, or whatever the figure is, media companies go round and negotiate a discount, but somebody will actually pay that £10, will they?

Mr Jones: Or more. It depends, as I say, in which programmes you’re advertising, on your selection of channels, when you book, if you commit late, what you commit to the TV stations in advance, whether you’re prepared to guarantee them X or Y of your budget. There are a number of factors. Then quite often after campaigns have been booked, advertisers need to make amendments to those in the short term, for a variety of reasons, and that tends to get quite heavily penalised, particularly if you get close to the date of transmission. So there are a number of ways in which premia are paid, yes.

Mr Williams: Without wishing to get too technical, there are a number of different target audiences that are bought within the TV market. So, a price for a spot in “Coronation Street” against target audience A, let’s call it housewives, will be a very different discount to a target audience if you were buying ABC1 adults. There’s a balancing act that goes on in terms of that whole mathematical equation, so you’re right to ask the question.

Q467 Lord Gordon of Strathblane: Just to supplement the question. My understanding is that the ratio of the top rate to the bottom rate for the same sort of spot is about 10 to one. Is that correct?

Mr Jones: Do you mean some people pay 10 times more than others?

Lord Gordon of Strathblane: Well, depending on when you buy it and this, that and the other thing. Mr Jones: I would imagine that if you book a late spot in the “X Factor” this weekend on Friday, compared to committing to a very cheap spot on a low-rating channel months in advance, yes, that is probably true.

Q468 Lord Gordon of Strathblane: Just to pick you up on an earlier point you made, I rather got the impression that you thought there had been a transfer of business from TV to the internet.

Mr Jones: Yes.

Lord Gordon of Strathblane: I think a lot of evidence put forward by the advertising industry has suggested that TV is immune from the internet, and that therefore nothing has changed that would warrant changing CRR.

Mr Jones: I don’t think any media is immune to the internet at all. I don’t think that’s true.

Mr Russell: I think it would be true to say, however, that certain media have been more vulnerable and if you were to look at, say, the regional press you would have seen that that had been very severely hit by the arrival of the internet, most notably in the loss of things like its classified advertising. Similarly, if you were to look at one or two—I’m just trying to remember the other areas; radio in particular—they have suffered very badly. Alongside that, television has probably suffered less.

Q469 Lord Gordon of Strathblane: There is a general feeling that if CRR were removed the cost of airtime would go up. Is that your impression?
Mr Williams: Yes. There’s no doubt, in our view, that the costs would go up. As a generalisation, I think it’s fair to say that if interested parties are looking to remove a control that would be for reasons of making more money. Our point is, there’s no question that if control was taken away—in this instance CRR or whatever now may be put in its place, without getting on to a further question no doubt—that would have the effect of prices uncontrollably going up potentially, yes.

Q470 Lord Gordon of Strathblane: So it’s not a zero-sum game? It is not as though the removal of CRR would hit the other commercial channels? ITV would win over the other commercial channels, all boats would rise and the price of all airtime would go up, you would argue?
Mr Williams: There is no doubt that with ITV’s power it would stand to gain above other stations in that regard.

Q471 Lord Gordon of Strathblane: But do you think the others would gain as well?
Mr Williams: I think that would be a tough one for them, unless the general economy lifted to such an extent that that gave a greater opportunity for all, but if all things were equal, then I think that would put much more control back into ITV’s hands to increase its prices over others.

Q472 The Chairman: One of the issues for us is whether there is this idea of a kind of fixed pot for advertising budgets, and that is why Lord Gordon used the phrase “zero-sum game”. But the issue is, as he said, whether it does make all boats rise in those circumstances, whether additional money could come into advertising, or whether all that would happen would be that ITV would benefit at the expense of other broadcasters.
Mr Williams: Our view would be that there is a good chance that ITV would benefit over and above other broadcasters, in that scenario.
Mr Russell: Basically, it would suck the money away from Channel 4 and Channel Five if CRR were removed.
Bishop Liverpool: I think question 3 has been dealt with so I am going to pass on to question 4.
The Chairman: Yes, okay. Move on to question 4, absolutely.

Q473 Lord St John of Bletso: Many would argue that CRR should be scrapped because the whole TV market has moved on substantially since the days in 2003. Surely the preservation of CRR protects the status quo of the main three to four media agencies. As a supplementary to Lord Gordon’s question, to what extent would the cost of advertising rise, or consumers suffer an increase in retail prices if CRR were to be removed?
Mr Williams: Putting a number on exactly what would happen with CRR is a tough one because I think there are many plays here. There is the economy in general, obviously, if we look at what is going on. There is what is going on with the rise of procurement in our business in terms of driving prices down, which is a very real factor. It’s not a moan but it’s just a market reality for us there. There are the other options for our clients to take their marketing budgets on to other channels. Digitally, it is a big opportunity that kind of resets the frame, if you will, on the cost of marketing full stop at the moment. Putting a number on exactly what that would do to the TV market in terms of its cost is a tough one to say but—a personal point of view here—I would say within a range of 5% to 10% could be the number that we would look at.
The Chairman: Sorry, could you say that again?
Mr Williams: I would say that if we were to put a number on exactly what would happen with the price of television, with regard to ITV, that could be in the region of 5% to 10%. That’s not a formula I’m playing back at you there, that is a sense, and it’s very difficult for us to put a finite number on that.

Q474 Lord St John of Bletso: What about the first comment that I made about those who would argue that CRR should be scrapped because the whole television world has changed substantially since 2003?
Mr George: We sat before the Competition Commission in 2003 when the Carlton-Granada merger was proposed. Our view is that fundamentally the conditions haven’t changed since 2003; and that is that ITV1 is still a very important channel.

Q475 The Chairman: Despite what Lord St John said about the internet?
Mr George: It’s still a very, very important channel within TV. It has the unique property of being the only channel able to build mass coverage very rapidly, and that hasn’t changed to any great extent since 2003.

Q476 Earl Onslow: I have a problem when you say “our clients”. It seems to me that you get paid both by the advertisers—or the media companies do—and those who place the adverts, because you get a discount if you use X% of your budget on somebody, which means you get paid to distort your own internal market for an individual client. We had a very intelligent—at least I thought it was very intelligent—description of how media companies work and this was a thing that jumped off the page. If you took X% of the broadcast time of your budget,
you got a bigger discount from the company than you would if you got slightly less. That must mean it is saying to you, “Bring us the budget from your clients at the other end”. That seems to me striking two ends against the middle.

Mr George: Just to clarify, we make our income from the fees and the commissions that our clients pay us for planning and placing their advertising space. We negotiate discounts with media owners but those discounts are passed on in the form of discounts to our advertisers.

Q477 Lord St John of Bletso: But is this necessarily in the interests of the advertisers? The point I am trying to make is that those who would argue that CRR should stay are surely the main three or four agencies. You almost have your own monopoly on prices.

Mr George: It’s true to say that there has been consolidation in media agency ownership over the last seven or eight years and I think the issue is, as it pertains to ITV in particular, that we represent hundreds of clients in our respective groups, and we respect their interests and their wishes. It’s more of an implied leverage than being actually deliverable, because we have hundreds of clients who all want different things. If there were a replicable broadcaster to ITV delivering the sort of qualities that ITV delivers, then I would say that that would put us in an advantageous position. At the moment, there is nowhere that is a realistic alternative for ITV on advertising.

Q478 The Chairman: Just following up Lord St John’s point: are you not using the power of your clients to negotiate better terms with ITV?

Mr George: We are trying to use the power of our clients’ combined spend to negotiate better terms with all media owners, and we do leverage that with other broadcast channels and other media owners. The point is that with ITV there really isn’t very much of an alternative for the majority of the moneys that it spends on ITV1.

Q479 Lord Gordon of Strathblane: Just to be clear, the discount deals are between you, as media buyers, and ITV.

Mr George: Generally, although there are exceptions where you do a deal with a single advertiser on behalf of that advertiser.

Q480 Lord Gordon of Strathblane: That to some extent pre-empts my next question. I was going to say, is there not a tendency for that—which is no bad thing from your point of view—to lock in your clients to you, because it is through you they get those deals, whereas if they move to another agency they are starting from scratch?

Mr George: It is part of the position—in a competitive position in the marketplace.

Q481 Lord Gordon of Strathblane: No, but if I have a good deal, based on something you did for me in 2003, and I move to another agency, I might not get as good a deal. So I am kind of locked into you, am I not?

Mr Jones: I think any advertiser that moves agency would ensure that it gets that covered off before it moves.

Q482 Lord Gordon of Strathblane: And who do it negotiate that with then?

Mr Jones: With the other agency.

Q483 Lord Stevenson of Balmacara: I am going to change the line of questioning a little bit. This is more from the viewers’ point of view. I think, and the consumers’ side. Ofcom have given us an estimate that about £700 million of investment in original UK programming has been lost to free-to-air television as result of the fall in public service broadcasters’ advertising revenue. You have said, and we would agree, that some of that is because of the recession, but ITV specifically attributes some of that lost investment to CRR. Channel 4 and Channel Five have a slightly different take on this. They argue that without CRR, total television advertising income could rise. I assume that is broadly not in contention but I wouldn’t mind your comments on it.

The specific question is, you presumably have a trade-off that you must think through, and I would like your thoughts on it: is it in the public interest to have slightly cheaper products as a result of all that or is it a better public interest case to have fewer higher quality television programmes?

Mr Jones: I think that’s something you can argue either way for both those questions.

Q484 Lord Stevenson of Balmacara: I think there is a public interest question. If you can get away from that, is that possible?

Mr Jones: I think everybody would have a different point of view. Do they want worse television or cheaper products? I don’t know. I don’t think anyone could answer that objectively.

Q485 Lord Stevenson of Balmacara: Just to follow that through: you say in the postscript in your evidence on page 5 that you are not convinced that CRR is the break in creative programming that ITV has claimed. Could you give us a bit more on that?
Mr Russell: Yes. I think the fact that CRR is, maybe, present during a time of reduced public service content or original content doesn’t necessarily mean it’s responsible for that trend. We’ve certainly seen no evidence to suggest that CRR is responsible for a reduction in public service content. If this were the result of constrained budgets, then we would suggest that the economic recession and the driving down of rates through the increased supply of impacts was far more important than CRR could ever have been.

Q486 The Chairman: Can I just stop you there, Geoffrey? Are you saying that those reduced budgets, or whatever they may be, for programmes are purely in the last few years, during the recession; they don’t date back to 2003?
Mr Russell: No. We spent a little bit of time looking at this and we think that the attitude towards public service broadcasting could be broken down into what are called four phases. The first phase is from the establishment of ITV back in 1955-56 and will last through until the mid-1990s. This, if you like, is the golden age of public service broadcasting in the commercial sector. The reason for that is very simple: there is no other commercial competition. If ITV wishes to produce public service programming and it doesn’t attract a large audience it doesn’t matter because ITV has complete control over the prices that it charges. If it has a declining audience it can in fact increase the price of the airtime that it has available to it. There were, in fact, examples during the period from the 1950s to the 1990s where ITV was withdrawing airtime, reducing minutage, and as a result of that the ITCA introduced the selling-up rules that have recently been withdrawn.

In the mid-1990s the world changed. It changed with the arrival of effective competition from Channel 4, from Channel Five, from the arrival of Sky, and from the arrival of the satellite stations. What that meant was that if your audience didn’t want to watch programming, or—

Mr Russell: I would suggest that that would be a requirement, yes. You would lay that down as a requirement. I thought it was a very interesting statement that Adam Crozier made; that if CRR were abandoned, the moneys would go into programming. It was only in mid-2007, when Michael Grade starting looking at refocusing, if you like, the output of ITV on quality of programming, that the concept of CRR being responsible for the diminution of original programming was first floated. We would cite that this trend started far earlier and was in fact the result of increased competition in the marketplace that caused ITV to begin to compete more strongly for its audiences.

Then we come to the third phase, which was probably from 2004 onwards; it was the arrival of the merged ITV and Charles Allen cutting costs. He cut headcount, and he looked very severely at his programming budgets, and you began to get pressure on regional programming, pressure to try and release ITV from public service broadcasting. At the same time you got pressure on original children’s programming. This was really as a result of the unintended consequence of the ban on high fat/sugar/salt foods that meant that there wasn’t advertising going around the children’s area. As a result of that it didn’t wash its face. As a result of that there was a cutting down of original production in the children’s sector.

It was only in mid-2007, when Michael Grade starting looking at refocusing, if you like, the output of ITV on quality of programming, that the concept of CRR being responsible for the diminution of original programming was first floated. We would cite that this trend started far earlier and was in fact the result of increased competition in the marketplace that caused ITV to begin to compete more strongly for its audiences.

Q487 Lord Stevenson of Balmacara: That is very interesting. My final point on it, just to tie it up: if ITV was in a situation where perhaps it was free from CRR, we would still be faced with the problem of how to ensure for the public interest the quality of programming that was provided. Obviously as a commercial interest you want a range of diverse and interesting programmes, high value, low value, everything you can get in order to sell them, but in the public interest there is obviously interest about UK content and diversity within the programming. How would you approach a suggestion that might be made that ITV should be regulated by, say, Ofcom to achieve those better outputs?

Mr Russell: Are we talking about the abandonment of CRR in that context?

Lord Stevenson of Balmacara: I am saying you could move away from CRR to give you that freedom, but the quid pro quo the Committee is exploring is whether or not we would want to still impose slightly higher thresholds in such things as regional programming, or—

Mr Russell: I would suggest that that would be a requirement, yes. You would lay that down as a requirement. I thought it was a very interesting statement that Adam Crozier made; that if CRR were abandoned, the moneys would go into programming. I suggest that the shareholders of ITV would be equally clamouring for some sort of reward, not having received dividends for some months or years.
The Chairman: I don’t think they were quite as explicit as that, strangely enough, but we had better look back at the transcript.

Q488 Baroness Deech: Can I ask a supplementary? Why is it the case that UK content is always deemed to be synonymous with quality, or are we just talking about keeping our own industry going?
Mr Jones: I don’t think we’ve claimed that.
Baroness Deech: No, you have not but it is generally accepted that UK content must be a good thing.
Mr Jones: I don’t necessarily think it is. You look at Channel 4, for example, and its track record of importing US comedies. They’re not for everybody but I would argue the content has been of a high standard—they wouldn’t succeed here otherwise—compared to some of the programmes that ITV, or in fact BBC, puts out that get bigger audiences. So I think, again, it’s a subjective area. As advertisers, we would generally look at the quality, if you like, of the audience profile, and depending on which brand you’re advertising, you’re going to have a preference as to which target demographic, which people you want to reach. They will tend to normally have a high disposable income or maybe a younger profile, depending on the brand. So, I don’t think necessarily mass ratings are the be all and end all.

Q489 The Chairman: Do you define quality by the quality of audience rather than some sort of indefinable quality of programme?
Mr Jones: Yes. To us, as advertisers, it’s the quality of the audience that the programme reaches, rather than a pronouncement on the quality of the actual show.

Q490 Lord Skelmersdale: But that said, you, as I understand it, place bookings for advertisements very many months ahead.
Mr Jones: Two months ahead normally.
Lord Skelmersdale: So, although you have a good idea of what the actual programmes are, you have no idea what the audience reaction to those programmes will be. There is an historical basis—for example “Britain’s Got Talent”, which we mentioned earlier—but there are other things where I suspect you have very little idea indeed.
Mr Jones: Yes, you’re right. There are some shows that will come on that are new that you can’t predict. You can never predict exactly what a show is going to do tonight until tomorrow, until you know the result. It’s not a prediction then.
Mr Williams: That’s why the trading mechanism is based around keeping an audience as opposed to buying the show, generally speaking. There are some differences at the very top end. Let’s use “X Factor” as an example where ITV, for example, will sell that at what it calls a special rate. Completely understandably, arguably a quasi auction piece that goes on there too. But fundamentally the job of an agency is to achieve the right quality of audience for its particular advertiser, and that’s what we buy and trade against as opposed to saying, “We’d like three X Factors and a Coronation Street, please”.

Q491 The Chairman: If you are not careful you will get us very excited because we want to talk about auctions later for special events and so on. That is very interesting that you are equating those very highly rated programmes to an auction process.
Mr Williams: A different sort of demand, yes.
Mr George: We generally buy audience rather than specific spots, but we will have a viewpoint on which are the most relevant spots for our brands.

Q492 Lord Dixon-Smith: I am still trying to work out whether, in my mind, I see you as grit or grease. I suspect your advertising agency clients might see you as grease, but that the television companies might see you as grit. Is that a valid description, and if it is not why not?
Mr Jones: You’re probably right. I’m sure they do. We’re there to negotiate on behalf of our clients, as Tom said earlier. We’re paid by our clients to do a job and that job is to get them the best value we can for whatever their objectives are. That may not always coincide, or quite often doesn’t coincide, with the objectives of a media owner, not just ITV but any media owner.

Q493 Lord Dixon-Smith: What would be the effect if you were not there?
Mr Jones: If there were no media agencies, I suspect that clients would pay a lot more for their media.

Q494 Lord Dixon-Smith: That would, therefore, free up money for the television channels to spend on programming.
Mr Jones: You could argue that but I’m not sure you can un-invent media agencies now.
Mr Russell: Also I’m not sure that the inefficient use of advertising moneys would be of great benefit to those advertisers. They will be spending money unnecessarily, and as a result of that I suppose you’ll get a filter through to the cost of products to the consumer at the end of the day.
Mr Williams: If agencies weren’t there, just to be clear, in my humble opinion, the clients that we’re talking about representing here, would have to represent all that expertise inside their own organisations, which simply moves the cost, because it doesn’t just happen.

Q495 The Chairman: Well, Procter & Gamble for example.
Mr Williams: For example, yes.
Mr George: I think it's interesting that there are practically no clients in the UK who take responsibility for planning and buying their own airtime.
Mr Williams: Not the whole piece, no. Procter & Gamble have a negotiation piece, absolutely, but the agency facilitates the remainder of the implementation.

Q496 Earl Onslow: I still do not follow this. If I want to buy an insurance policy, which is in some ways just as complicated, I go to an insurance broker and he is my servant and my servant only. He is not the servant of Lloyd's or whoever it may be. He gets his commission, admittedly from a discount, from the broker. Why does this not happen in advertising? If I want to advertise Pepsodent, say, I go to advertising agency A and say, "Please, you know how to advertise Pepsodent. That is why I am employing you". What is the point of you, as somebody said of Lord Quickwood years ago? Why do you have to come in the middle? Why can't an advertising agency do it itself?
Mr Jones: As a client, as an advertiser, you probably could book some TV. You can; no one is stopping an advertiser from booking its own media. I think we have a number of roles. One is that we will advise clients on how those different media work together and what is the best combination for a client, and we use our own research and the industry research that we buy into, that we pay for, to help us with that. Another is we have experts that are in the markets we buy into, that we pay for, to help us with that. We have a number of ways in which we work for clients. We don't just book media; we do quite a bit more than that.

Q497 Earl Onslow: But is that not what the advertising agency is supposed to do?
Mr Jones: They make the adverts. We will advise them on—

Q498 Earl Onslow: The advertising agency is the chap who reaches a million housewives every day.
Mr Jones: The creative agencies. What a media agency will do is advise a client on who they should be trying to reach, when to reach them, how to reach them, by which medium, how much they should spend, what is the optimal level of spend and so forth. Mr George: I think very simply any client could do it. I think it would be absolutely cost prohibitive for them to achieve the same sort of value that can be delivered by media agencies.
status by being on ITV. If you are an established brand, you retain status by being on ITV. In addition to the straight numbers that we’ve been talking about in terms of the reach, in terms of speed of acquiring cover, ITV also has a whole load of what I’ll call soft reasons why an advertiser would want to be there. Prestige I’ve mentioned and there is rapid sales. The fact that you’ll get your message out there quickly means that advertisers can see that their campaign is beginning to work.

It’s also extremely important for trade distribution. If you are a manufacturer, you need to have your products out there in the marketplace. A retailer will want to know that if he takes your products into his shop they’re going to go back out through the door. And they will go back out through the door if you advertise on ITV. They know that from history and they require that in order to take the stock in. On the back of that, the retailers will also grant you an appropriate number of facings in the store; they may give you a better position in the store. All those things you’ll get through being on ITV that you would not get if you went on to a basket of satellite stations.

Q504 Bishop Liverpool: Since the introduction of CRR, the monopoly, or the oligopoly, of the media buyers has gone up from about 50% to 75%. What is it about the CRR that has led you to increase your market share, or is there no connection at all between those two facts?

Mr George: It’s totally unrelated. It’s nothing to do with the CRR. It’s about the continuing consolidation of media owners and media sales force. It’s a reaction to that so we can try to meet might with might.

Q505 Bishop Liverpool: And has CRR not driven that at all?

Mr George: No.

Mr Williams: In our view, the 2003—when you talk about top buying points, I believe from previous video that we’ve seen, it’s the top four that you tend to view. So, on my record 58% of the billings were through the top four agencies in 2003, and that has crept up to 66% this year to date.

The Chairman: Is it 66%? We thought it was rather higher than that.

Mr Williams: With the top four buying points. This is published information from Nielsen, by the way, so it’s not real numbers, but it’s as accurate as it can be in our market. So we have a 58% top four buying points to a 66%. So, yes, it has gone up for sure. Has CRR driven that? No, absolutely not. Has the need to deliver competitive advertising full stop for customers done that? Yes, it has. But it’s not a CRR impact—

Mr Russell: It’s a general market force of supply and demand.

The Chairman: What, the consolidation?

Mr Williams: Yes, and the need for clients to get stuff cheaper, whether that’s through the economies of big agents being able to do some work, or indeed prices.

Q506 Baroness Fookes: Could we say a little more about the online auction, which was mentioned a little earlier on? Do you think it would affect ITV’s revenues if that were to be introduced: up, down, the same?

The Chairman: Can I just, by way of background, say that we do find as a committee the trading system incredibly arcane. It has probably existed for 50 years and got quite a lot of barnacles on it, but one of the areas that I think we are attracted by is this idea of auction that Lady Fookes has mentioned.

Mr Jones: We would agree it’s an interesting idea. To your point about the trading system, we’ve been saying this system has to change for 20-plus years and nobody has yet come up with a better system. And I don’t think that’s for lack of trying. There have been attempts to trade in different ways, fixed price, volume deals, and we end up with this system because—

Q507 The Chairman: How have you tried?

Mr Jones: There was a sales house in ITV, probably 15 years ago, that sold airtime for Yorkshire and Tyne Tees. It came out and said that it only going to trade on volume. The sales house went under within 18 months because it had overtraded, it had promised too much and couldn’t deliver it. Channel 4 came into the market with a slightly different take on trading. It was fixed prices but with an impact adjustment. It has been out there. Anyone can trade in any way they like but, generally speaking, this is the most straightforward way to trade that we have against a sort of station price or something along those lines.

Q508 The Chairman: You are all part of global groups; WPP, Omnicom. None of your colleagues in continental Europe, for instance, operates on the same trading system, does it?

Mr Williams: There are different trading mechanics but nobody operates on an online auction model.

The Chairman: That is not the answer to the question. The question, or rather the observation, was that none of your colleagues operates on the same trading system as we have in the UK.

Mr Williams: Some of them do, yes. There are parts of eastern Europe that have taken on, ironically, the UK trading mechanism over the last five years.

The Chairman: You probably taught them everything they know about an advertising trading mechanism.
Mr Williams: They believed it was better than what they had before, and who are we to judge. I’m not an expert on Hungary.

Lord Razzall: Fiji probably does as well.

Mr Russell: It has many pros and cons but, as Andy has said, nobody has come up with a better system and that isn’t for the want of trying.

Q509 Baroness Fookes: May we assume then that the idea of the online auction does not appeal to you individually or as a group?

Mr Jones: It has an appeal in a way. As Steve said earlier, there is almost an online auction with certain highly demanded programmes at the moment, specials as ITV would call them. I wonder whether, if I were a media owner, I would want an online auction, because that would take the control of my inventory away from me. I definitely wouldn’t want it if I was a media owner.

Mr George: Let’s not forget that there used to be an auction system in place in the UK for airtime and, again, that stopped.

Baroness Fookes: It stopped?

Mr George: Yes. It was the pre-emption system, where there was a price for a spot, and if somebody was prepared to pay a higher price you lost that spot.

Mr Williams: And advertisers felt that was a very inappropriate way to be able to control their advertising message going out, because of the coming and going, of spots in and out.

Mr George: If I was a media owner I would be very reticent. I think it’s an interesting idea. I’d be very reticent about taking control of my inventory to a free market, particularly across the last few years where we’ve seen heavy recession. Don’t forget that media owners also conditionally sell their inventory as well. So one could argue there might be a marketplace for the very, very best spots; one could argue that the market price for the less highly demanded spots would fall off a cliff as well.

Q510 The Chairman: But on the other hand, if you have a virtuous circle of more investment in programming, and therefore more impacts and so on and so forth, then if you are a media owner you have, maybe, an incentive to introduce a different system.

Mr George: I think theoretically it has some interest. I think the practicality is the fact that, when you start delving into the difficulties of selling individual spots on an auction system, you can’t have competing advertisers in the same break, and the fact that you are leaving it open to market forces. I’m not so sure that media owners would vote with their feet for that system either.

Mr Jones: I think if we go back to the pre-emption system that we discussed you can see the same issues arising from an online auction now. Advertisers spend a lot of time building other marketing activity around their TV campaign. So if you’ve done a lot of marketing work and you find out that on Friday you don’t have the spot on “X Factor” that you thought you did, and you can’t get back in there, then you’ve got a bigger problem to contend with. So, it’s impractical.

Q511 Lord Skelmersdale: You could stop that overnight by banning resale.

Mr Jones: Well, if it’s an auction then—

Lord Skelmersdale: No, if it is an auction, an auction comes to a full stop when the gavel goes down. What you are suggesting is that once it has come down, the company could resell that particular spot if it was suddenly offered more money.

Mr Jones: That’s how the pre-emption system worked and I—

Mr Williams: Every advertiser would want that gavel to come down at a very different time as well. So, if you were an advertiser that needed to get late into the market for whatever reason, maybe the day before, then the gavel is down and you can’t get in.

The Chairman: Sadly, I do not think we can go further into this great new world of auctioning but your reaction is extremely interesting. Thank you.

Q512 Lord Razzall: I want to change the subject to two other areas really: the Airtime Sales Rules, and the Code on the Scheduling of Television Advertising. As regards the Airtime Sales Rules, I won’t rehearse what they were because you would be more expert than us, but they were dropped. The first question is: have you noticed any difference in the way advertising is sold as a result of the dropping of those rules? Secondly, were we minded to recommend that CRR should go; one option would be to restore some of the Airtime Sales Rules. Do you think that would be a good thing and if so which rule? Then, thirdly, as regards the Code on the Scheduling of Television Advertising, we have had an awful lot of views regarding the seven minutes and the nine minutes. Assuming they go, do you think everybody should go to nine minutes or do you think the nine-minutes people should come down to seven, without getting tautological about whether that is up or down? Three questions.

Mr George: On the first point, you’re talking about the removal of the need for broadcasters to sell all their minutage, aren’t you? And then you’re talking about conditional selling. The honest answer is that we’ve seen absolutely no difference in the way that airtime is sold with the removal of those rules. On the first point, the reason for that is in a CRR environment there is no incentive for any broadcaster to depress the amount of commercial impacts by reducing minutage. We would have a different point
of view under a non-CRR environment. Before CRR was in place and before there was a requirement for broadcasters to sell their advertising minutage we did see manipulation of minutage that artificially forced the price up.

Q513 Lord Razzall: So, were we minded to recommend the abolition of CRR you would want restoration of at least the minutage?
Mr George: We would probably want restoration of that, yes. On conditional selling, the honest answer is of course that we support the principle that airtieme should not be conditionally sold. On a practicality, it is just the thrust of trading. It’s the ebb and flow of trading that airt ime is conditionally sold. We conditionally buy as well. We’re sort of grown-ups on this. So, the theory we support; on the practicality, we know it really doesn’t operate that way in the marketplace.
Mr Williams: On your last point with regard to up and down—

Q514 Lord Razzall: That is the question: are you up or down? Are you seven-minutes people or nine-minutes people?

Mr Williams: We’ll go the middle, thanks. I think it’s a well trodden path. The bottom line is that it’s a legacy position now in terms of the minutes per hour, per advertiser. In the first place it’s anomalous. It was a leg-up for the multi-channel environment that came into the market many years ago. That’s not the case now. There’s much more equilibrium in the marketplace, there’s no question. Would we want everything to come down and artificially suppress the market to make it more expensive again, one of the points here? No, of course we wouldn’t. Do we think there’s a happy medium in there? In other words, are the general public really going to be very concerned at possibly another minute on their terrestrial channels and thereby making, if there’s a difference between nine and seven, eight the mid-ground, from a sensible point of view? No, I don’t think we would have a problem with that.

The Chairman: That’s great. Thank you very much. I will take away that phrase “the leg-up for the multi-channel environment”.

Mr Williams: A long time ago.

The Chairman: Definitely we will have to consider that very carefully. Thank you very much indeed for giving evidence today.

Examination of Witnesses

Witnesses: Mr John Billett, Advertising and Media Consultant, Mr Steve Hewlett, Broadcaster and Media Commentator, and Mr Ray Snoddy, Media Commentator.

Q515 The Chairman: Can I welcome you very warmly to the Committee. We have, in a sense, three for the price of two, I think, today. I have the biographies of two of our witnesses but not the third. I am going to ask you to introduce yourselves anyway, so no bones broken. We have roughly 50 minutes, I think, to go of evidence. I do not know anyway, so no bones broken. We have roughly 50

Mr Snoddy: I’ve been a journalist mainly specialising in the media for many years: 20 years on the Financial Times, eight years as media editor of the Times, now freelance and writing about issues surrounding the media, and also presenting the BBC’s viewer access programme NewsWatch.

Q516 The Chairman: Okay, let’s crack on. First of all, since the introduction of CRR the number of commercial impacts has increased by about a third. At the same time the price per impact, which the advertisers are paying, has fallen significantly in real terms, even after the recent recovery and even for ITV1 and Channel 4. Do you agree that advertisers are now able to buy many more impacts and are also paying much less for each impact?

Mr Billett: Yes. You’ve summarised it exactly.

Q517 The Chairman: Do you think that is relative to 2003 when CRR was introduced and, if so, do you think that is because of CRR or entirely independently?

Mr Billett: I think it’s independent of CRR, and the reason for that is that advertising money is spent for reasons separate from the value. Advertising in television is a relative rather than an absolute price
mechanism. Advertisers decide to buy a certain quantity of advertising, and if they can buy it more cheaply they will do so and then divert other resources into other activity. Unfortunately, the relationship between advertising expenditure and effectiveness is not an exact science and, therefore, there will always be enormous room for variability in the relationship between advertising effect and price.

Q518 The Chairman: So it is all a bit hit and miss really, is it?
Mr Billett: I wouldn’t say that it’s hit and miss. I would say that the metrics for measuring it are about relative efficiency rather than effectiveness.

Q519 The Chairman: How, therefore, do you know that it is not because of CRR?
Mr Billett: The relationship between advertising expenditure and value for money has been tracked for some 40 years to my certain knowledge. The work we did to look at the effectiveness of introducing advertising on to the BBC, and what that would do to advertising price, proves quite conclusively that advertising pricing moves in relationship to audience and economic factors such as company profitability, such as consumer expenditure, and those dominate the agenda far beyond the effects of any restrictions or creations such as CRR.

Mr Hewlett: The other thing is that from 2003, but before that, we’ve entered the world of multi-channel television. Multi-channel penetration is now at 90% but it was a lot less than that then. We’ve just been through a period where the number of channels and the amount of viewing has continued to rise, and understandably the number of commercial channels has risen very significantly. Understandably, therefore, the amount of commercial impacts available, the amount of commercial hours available to watch, has gone up and the number of commercial impacts has, therefore, gone up with it. So, the market is being inflated or diluted by the emergence of lots of new channels and more viewing of new channels. So, once upon a time ITV was the only one, then there was Channel 4, then there was Channel Five, then there were all the Sky channels.

Of course, I’m sure you’ve heard this many times before and, having read what your previous discussants have had to say, I’m not sure there is very much I can personally add. But it strikes me that one of the more bizarre aspects of the CRR mechanism is that ITV should offer it up at a point when—there are few certainties in this world but one of them was this—ITV’s share of commercial impacts would drop like a stone as digital penetration increased. The one certainty was that ITV’s share of viewing would drop. It was almost the only certainty, but it was a certainty. And offering CRR with an automatic ratchet mechanism that reduces your revenue in proportion to that when you know it is the only thing you could be certain of happening is, frankly, bizarre.

Q520 The Chairman: But you do not think, as such, it has had an impact on pricing?
Mr Hewlett: There is a consensus, as far as I can tell. I’m a journalist, I don’t work in it anymore, but I think there’s a consensus among the people I speak to in agencies—I speak to people across the business on all sides—that CRR has had a deflationary effect. The reason for that is that in so far as it reduces ITV’s effective price, although by a complex mechanism, everybody else will jack up prices. If they jack up their prices, you would expect the market to deflate. So everyone else’s pricing is discounted in the business as being up or down on ITV’s price. ITV’s is the base price. So, if ITV’s price drops, which because of CRR it has done, other prices will come to reflect that. It’s not an absolute relationship but the likelihood is—the consensus would be I think it’s fair to say—that overall CRR has deflated the market. It’s not the principal cause of deflation, however, because that’s about there being more impacts, more viewing and more—

Q521 The Chairman: You see I am sure Jimmy’s expression was all boats floating, in a sense. The reverse could, therefore, be true that if CRR is taken off—and I think, Ray, you are looking as though you want to say something on this—then effectively that would raise everybody’s boat.
Mr Hewlett: Well, if all you did was take off CRR, that’s right. If, however, there were to be a more fundamental change in the way that advertising was sold, then in the end prices would come to reflect more accurately the value that advertisers could get specifically from the places that they advertised in. I’m conscious I’m speaking to the converted already. If you maintain the share of broadcast—

The Chairman: Well, you probably heard what we said about the trading system, yes.
Mr Hewlett: If you maintain the trading system, the share of broadcast in exchange for share of ratings system, then take off CRR, expect ITV to increase prices. That’s what they’ll do. They’re a commercial business. Of course they will. It’s the only reason they will do it. They will jack up their prices. If they jack up their prices, you would expect the market to inflate. However, one wrinkle here is that one of the impacts of CRR, of the share of broadcast system, should I say, is that while it prevents ITV in the short term from premium pricing its premium products, it can’t spot sell. For all the press you read about the price of “X Factor”, “X Factor” was sold last year. It can’t spot sell in the context of the deals it has with
the agencies which consume nearly all its airtime. So, those deals are already done. There is probably an impact of the share of broadcast system of maintaining an artificially high value for off-peak airtime.

**The Chairman:** Jimmy, you can pick your choice, basically, because we have had an amalgam of two and three.

**Q522 Lord Gordon of Strathblane:** Well, it’s very interesting the debate as to whether it is a zero-sum game or all boats would rise, and we have had conflicting evidence, as you can imagine, from a lot of people in the advertising industry. But if we assume for the moment that all boats rise, do you think ITV would rise disproportionately and would it be at the expense of other commercial broadcasters?

**Mr Billett:** Since CRR, ITV has gone from scarcity to almost ubiquity and you’ve now got a situation in which ITV is fully substitutional. With the exception of a few large housewife-focused advertisers, it is now perfectly possible to launch major brands without using ITV. And we now have the situation in which ITV’s premium pricing is sustained because of the emergence of a new phenomenon, and that is that there are now five major media buyers and they are almost now acting as media owners. This is the biggest change since CRR was introduced.

And remember that the CRR does not protect the advertisers, because very few advertisers have media buying contracts. It protects the agencies because they are the people who hold the pot and create the media deal. So we now have a situation in which the price of television is being determined by the agencies which are then allocating internally among their various clients who gets what part of it.

**Q523 The Chairman:** And they are keeping up the prices, are they, that way?

**Mr Billett:** Yes.

**Q524 Earl Onslow:** Can I come in on this because this is the bee that I have got in my bonnet? It strikes me the media companies are not acting in the interests of their own clients. If I want to sell Pepsodent, say, I go to an advertising agency. The advertising agency goes to the media company, who has actually got more than one interest. He wants to support a high price from the media thing, so he does that, and he wants to get the best deal for his advertising agency clients. It seems to me that they are not being as direct clear in their line of responsibility.

**Mr Billett:** So when you say “media company” do you mean the media owner or the media agency?

**Earl Onslow:** I do not mean ITV and I do not mean Sky. I mean the media buyer. Until about 10 days ago I knew absolutely nothing about this and it may be very apparent that I still do, so I apologise, but these are the things that have struck somebody who has come in literally from the outside to look at it. We had an extraordinarily good paper explaining to us how it worked and that was what jumped out of the paper at me: the media buyers were not acting for the person who I would assume they should do, which is the person who wants to advertise Pepsodent or whatever it may be.

**Mr Billett:** It would be incorrect to say that they are acting against the best interests of their clients. I would not support that comment. What I would say is that their principal objective is to satisfy themselves before they satisfy their clients.

**Earl Onslow:** Yes, that is how I would interpret it.

**Mr Billett:** And the evidence for that is that the amount of commission that they are paid or fees paid by their advertiser clients has reduced and the amount of performance-related fee that they are paid has increased significantly. That performance-related fee is not based on the cheaper absolute price, which we talked about earlier, but on the discount from the relative price that is being charged.

**Q525 The Chairman:** And the share of budget that their clients are putting forward? I do not know whether that—

**Mr Billett:** That could be true. So we have a situation in which an advertising media agency can get paid because it increases its discount to 10% from 5%, but if the base price has gone up, it is not in any way limited by that. So it is being remunerated on discount from a variable norm rather than absolute price and change year over year.

**Earl Onslow:** I thought that was what I understood and I now understand it. Thank you very much indeed.

**Q526 Lord Gordon of Strathblane:** Would it also be true to say that the impression is given to clients that everyone is getting airtime at a discount better than the average, which mathematically must be an impossibility?

**Mr Billett:** Correct, and the way that works is because you set prices for different target audiences. So, a discount for reaching upscale men is a far higher price than the discount for reaching low income families. The internal machinations of the agency allow them to move the airtime around, which is why you see different sorts of advertisers at different times of day.

**Mr Hewlett:** I was going to say the concept of a discount on the share of broadcasting sale system is not an obvious one. It’s not like I’m selling potatoes and if you buy 10 bags I’ll give them to you cheaper than if you buy one bag. That seems obvious, but it isn’t like that. Discounts in the share of broadcasting system have to balance, and that’s because I’ve only got 100% of ratings and if I give them to you I can’t give them to him. So, discounts in the first place in
this system are not based on price at all. They're based upon the ratio of the share of broadcast spend by the agency to the share of ratings. So, it doesn't turn into a price until after it's all happened. Only then do you know how much cash there was and how many—

The Chairman: That is why we find it somewhat arcane.

Mr Hewlett: It is bizarre. Can I just say one other thing? I think it's just for the record. It wouldn't be accepted by lots of people in the advertising industry that ITV is fully substitutable. A lot of people still say, and they must have said to you, no one else gives you 10 million quite like that, no one else gives you the “X Factor”; no one else gives you that sense of occasion. ITV, of course, has argued both things and I would commend—

The Chairman: Yes, we noticed that.

Lord Razzall: It is argued that that is only about 1.65%.

Mr Hewlett: If you go to the Competition Commission's report, appendix D called—well, it's about quality of impacts, there's a great story in there about what ITV told its investors about how it was not substitutable. When questioned by the CC, ITV went on to say that its “research was only undertaken for marketing purposes. It had significant methodological flaws. ITV used the results that are most favourable to ITV. ITV submitted that most results of its research in fact showed that, when compared to other commercial channels, ITV did not have a more engaged audience”. I won't bore you with it, but essentially you will find on the record ITV saying both things very definitely. On one hand it is entirely unsubstitutable—that is what it says to its clients—and on the other hand it is entirely substitutable, which is what it will want to say to you.

The Chairman: Thank you and we will come on to ask you about whether or not it is conceivable to have a different trading system when we have just heard a rather different answer from that one as well. With apologies, Bishop, I am going to go this way round the table.

Q528 The Chairman: So you are a bit of a CRR fan, are you?

Mr Snoddy: No, that's not entirely true, but there are a few basic truths, which you're all very well aware of, so I will not belabour them. There would have been no Granada/Carlton merger without it. It's not nearly as bad as ITV implies it is. Some people argue it actually helps to keep ITV prices fairly high, actually, in the relationships with the media buyers. I absolutely believe it needs to be reformed and made more flexible.

This may not be the appropriate time, but what I wanted to argue before your Lordships today was that one of the useful things you can recommend, I believe, is that what is needed is a voluntary system of reform. No one in my experience in the industry wants a complete three to four-year study of the entire advertising market. Everybody would run a mile. While ITV is 49% of the commercial advertising market, in any market that has to be a dominant position. And that's why the advertisers do not want to let it go.

Secondly, I would agree with not John Billett but Steve Hewlett. Indeed, I would argue more forcefully that ITV is in an extraordinarily strong position for now going into the future, and much of what it does is not substitutable by any other broadcaster.

Q527 Earl Onslow: Do you believe that ITV airtime will become significantly more expensive if CRR were removed? By what sort of figure would you expect prices to increase if you do? Would this be for airtime across the channel or just around specific programme and times? And to what extent would the cost of advertising rise or consumers suffer an increase in retail prices if CRR were to be removed?

The Chairman: Whoever would like to answer that?

Mr Snoddy: Well, I will make a beginning. It would almost certainly rise and, not just that, everyone in the industry believes it will rise. There was a straw poll, a show of hands, at a conference I chaired on Thursday of 150 people from the industry, and the overwhelming majority, like only two or three against, said they believed it would rise. While it's not a zero-sum game, I think money would flow from other broadcasters like Channel 4.

The Chairman: It would flow from?

Mr Snoddy: Yes. They've been doing, I believe, rather well on the basis of the rigidity in public on the CRR system.

Q529 The Chairman: So, with CRR, it is still in an extraordinarily strong position.

Mr Snoddy: Yes, indeed, but I think that the system is unnecessarily rigid. The world has changed and I think what is necessary is—the ideal solution for me would be for all sides of the industry to get together and hammer out a voluntary agreement, possibly monitored by Ofcom. I like the idea of Lord Bragg before your Lordships that some sort of deal could be done, relax CRR for more public service. The problem is monitoring it and how you actually get them to do that, not just take the money and run. However, I'm absolutely convinced that CRR should be relaxed, but the best way forward is a voluntary agreement between all the parties because they have a common interest in making this more flexible.

Q530 The Chairman: There is the power, of course, to take undertakings. You could do better than that in terms of taking undertakings, but nevertheless, even in the face of the ability to take legally binding
undertakings, you would say it would be better to have a voluntary agreement.

Mr Snoddy: Yes, indeed, and again at this conference last week people were starting to say that. I interviewed Adam Crozier for half an hour and even he was starting to say, “Well, look, there might be a way forward. There are talks going on between ISBA and ITV”. There are quite a few things going on in the undergrowth. Nobody, nobody, nobody wants a huge inquiry. They know the Competition Commission is not a viable route, but people do want change.

Q531 Earl Onslow: What did Adam Smith say? When two or three people of the same trade or profession—

Mr Snoddy: Of course.

Earl Onslow:—nothing but the public interest do suffer.

Mr Snoddy: That is the danger.

Q532 Earl Onslow: It strikes me that that is called a monopoly, is it not?

Mr Snoddy: Yes.

Q533 Earl Onslow: Not only our own Monopolies Commission, but also the European Commission people would be coming down on their necks like a tonne of bricks, wouldn’t they, or not?

Mr Snoddy: Well, except, very briefly, there are clearly different interests served, from advertisers to media buyers to ITV. Of course, they can’t go and have some sort of cartel. Each side should hurt and the ultimate result should be something that benefits the public, which is what Lord Bragg was hinting at.

The Chairman: Yes. At least we do not have vertical integration yet in quite that way.

Mr Billett: Could I pursue this substitution issue? The discussion so far takes substitution without introducing the critical element of price. Of course, parts of the ITV audience are not substitutional, but if you are buying ITV currently at a premium of 26% to the norm of television and you can buy other channels at an index of 50, nearly a third of the price, you get to the point where you can now reach more people without ITV1 than you could with ITV1 at the time that CRR started for the same cost. Every time you do an analysis of audience, you have to introduce cost in order to be able to say, as I do, that for most circumstances ITV is fully substitutable. Of course, it’s not on an “X Factor” night. Of course, it’s not with “Downton Abbey”. But as your colleagues observed, that is under 2% of the schedule.

Mr Hewlett: Forgive me, then you’d have to explain why more money hadn’t gone out of ITV to Channel 4, Channel Five and elsewhere.

Mr Billett: Because the media agencies—

Mr Hewlett: Because the buyers don’t think it’s substitutional.

Mr Billett: No, because the media agencies like the status quo. They have a vested interest in retaining CRR because it’s a vehicle which guarantees their value, which insures them against default and which is easy to administer.

The Chairman: And they are in their comfort zone in this trading area.

Mr Billett: You’re in a comfort zone, and Steve Hewlett said a few moments ago that the deals were done a year ago. Precisely. The deals for 2011 have been done.

Q534 The Chairman: So, unlike Ray, you do not think that abolishing CRR—give or take other forms of regulation or undertaking or whatever, but just all things being equal—would make a great deal of difference?

Mr Billett: That is correct and that is a completely different view than I held when I was a consultant to Ofcom in 2003 at the time that the CRR was invented.

Q535 Earl Onslow: Having charged it a large sum of money for giving it the wrong advice?

Mr Billett: The advice was the right advice, sir, at that time. The world has changed since 2003.

Earl Onslow: I am only teasing.

Lord Gordon of Strathblane: You are going to get fewer Christmas cards this year.

Mr Hewlett: Having worked at ITV and knowing a fair bit about the way that that company functions, and still knowing people involved in it, I have no doubt at all, however it’s settled out in the market in the longer term, the first consequence you would see of lifting CRR but leaving the share of broadcast system in place would be that advertising agencies would have their arms put up their back and would be told, as historically they always were, “Give me X% of what you spend on broadcasting or you’re not coming on ITV”. So, ITV will use it to put up its prices, unquestionably. Now, whether in the end—partly the discussion we’ve just had about substitutability—that market is sustainable or whether the market might settle out so that they jack their prices up so other things become more attractive—

Q536 The Chairman: Do you agree with this substitutability?

Mr Hewlett: I think it’s a multi-faceted question because it depends which way you look at it from. Strictly speaking, of course you can generate similar numbers of impacts and so on and so on and so on by moving your money around through cheaper channels to get to the same effect, but you can’t do it as efficiently; you can’t do it at the same time. There are reasons why advertisers believe that ITV is
unsubstitutable and I think on balance they’re probably right.

Q537 The Chairman: They are slightly creatures of habit, though, aren’t they not, in that sense? Mr Hewlett: Well, but it’s not just the agencies that think this, it’s the advertisers that think this. Mr Snoddy: I would just simply emphasise my view at least of the larger market developments that have happened since 2003. Yes, there have been all these hundreds of channels, but there are some people who treat all channels equally. They’re not. Some of these channels have tiny, tiny audiences. They may amount to businesses for those who are actually broadcasting them, but they’re of very little interest to advertisers. Also, you shouldn’t neglect the ease with which an advertiser can reach a huge audience and—Steve Hewlett’s point—at the same time. If you’re launching a new brand, you want impact; you want word of mouth throughout society. Yes, you could ignore ITV and over a period of months maybe reach the same proportion of society, but it would not have the same impact and, therefore, I believe there’s no easy substitution.

The Chairman: Well, we have a very interesting tension between the members of the panel, do we not? Tim, it is probably five and six, I suspect.

Q538 Lord Razzall: I think yes, quite. I am going to merge two questions together, really, and I suspect I know what you are going to say so you do not need to go into a great long answer, but it would be good to have your response on the record. As you know, the management of ITV when they came before us got into trouble externally by telling us that the CRR had led them into a rat race of dumbing down programming, which of course was slightly unfortunate just as they were getting maximum ratings on “Downton Abbey”. I suspect their editorial and production staff were not happy with them. First of all, I assume you do not agree that CRR has had that impact on ITV to the extent there has been dumbing down—it has come from other factors, but disagree with me if you want. Secondly, if we do get slightly cheaper products as a result of CRR, as a result of some element of dumbing down, is that actually in the public interest to have slightly cheaper products even if there is less high quality programming? I suspect you do not think there is less high quality programming, so the second question may be irrelevant.

Mr Hewlett: Those are theoretical. I think ITV overstated its case, and I wrote a Guardian column about just this, because someone in the advertising business said, “They’ve just hit their—”

Q539 The Chairman: Can we have a copy?

Mr Hewlett: You can. But ITV overstates its case. While there is a theoretical possibility that at some point the requirement to maximise share to avoid the ratchet-reduction mechanism might lead it to commission this sort of programme rather than that sort of programme. There’s a theoretical risk of that. However, look at it this way, the Competition Commission looked at this in considerable detail, including one of ITV’s own consultant’s reports by my reading of what it said, and it could find no evidence that CRR per se had impacted directly on ITV’s programming decisions. In other words, there’s a theoretical possibility it could have happened, but no evidence that it actually has. As you point out, to come up with “Downton Abbey” at the same time as saying, “We’ve been forced down; the rat race has forced us down” is slightly perverse.

Lord Dixon-Smith: Can I just pursue—

Q540 The Chairman: Sorry, just one point, Bill, actually CRR has benefited ITV quite a lot actually as a result of programmes like “Downton Abbey”, has it not? The ratchet effect—

Mr Hewlett: No, because the thing is CRR is irrelevant. ITV exists primarily, remember, to deliver profits to its shareholders. Nothing wrong with that; perfectly proper. Actually, its shareholders have been squeaking because of the lack of such delivery for an awful long time. They’re long-suffering, ITV shareholders. So, ITV exists to deliver profits to its shareholders and it does that by making programmes for people to watch whose eyeballs, if you like, it can then sell to advertisers.

So, ITV remains incentivised to invest in programmes that people want to watch. The suggestion that it left that impact on ITV to the extent there has been dumbing down—it has come from other factors, but disagree with me if you want. Secondly, if we do get slightly cheaper products as a result of CRR, as a result of some element of dumbing down, is that actually in the public interest to have slightly cheaper products even if there is less high quality programming? I suspect you do not think there is less high quality programming, so the second question may be irrelevant.

Mr Hewlett: Those are theoretical. I think ITV overstated its case, and I wrote a Guardian column about just this, because someone in the advertising business said, “They’ve just hit their—”

Q541 The Chairman: Exactly. The one thing we have discovered during this inquiry is how elastic the term “quality” is.

Mr Hewlett: But you know a bad one when you see it.

The Chairman: Exactly.

Q542 Lord Dixon-Smith: I must try to understand the process. Because if I have understood the way advertising is being sold, all the advertising space in “Downton Abbey” would have been sold well before anybody realised that “Downton Abbey” was a hit.
Mr Hewlett: Yes, because—
Lord Dixon-Smith: So how does the market affect that?
Mr Hewlett: Here is what happens. In year one, let’s say, ITV delivers all its programmes and generates ratings and so on. So at the end of year one, we sit down to talk about the deal we might do for year two. So I say, “In return for X% of what you, the agent, are going to spend in broadcasting, I’ll give you X% of my ratings”. Now, it’s a more complex discussion than that because you don’t just want any old ratings, you want 16-34s, you want housewives and children, you want over-75s. That is because you’ve got your clients, Coca-Cola, BMW, whoever else you’ve got, and you know what they want. So you’re negotiating with me for the best package of ratings I can give you. That’s what we agree. We don’t agree about programmes; we agree about delivery of ratings. Now, when I have a number of really top programmes like “X Factor”, which have run for a number of years, you might say, “And as part of my package, in addition to these, I want to be in these three slots”, for the World Cup Final, for this, that and the other. So, it’s not sold separate from this; it’s part of our discussion. Now, what I’m not doing is selling you individual programmes primarily, I’m selling you packages of ratings. The programmes deliver the ratings and I then optimise my schedule by putting your adverts wherever I can, subject to our agreement, in order that at the end of the year I have delivered to you the package of ratings that you bought.

Q543 Lord Dixon-Smith: So it is nothing to do with the programme, you are actually selling the time.
Mr Hewlett: No, if I turn out a set of rubbish programmes, in the end there will be a thing called “deal debt”, which is this: I have sold to you; you’ve given me your money in the expectation that you’ll get a certain amount of ratings; I won’t have delivered them; and then we’ll have a big row about how we resolve that. So, it’s slightly complicated because in principle I’m selling you ratings, not programmes, but of course it’s more complex than that because there will be particular programmes that some of your clients really want. They won’t have known about “Downton Abbey” primarily because it hadn’t happened when it was sold.

Q544 Lord Dixon-Smith: Well, I am very grateful for having it explained, because I could not get a connection between what the viewer actually sees and what the advertiser purchases by way of times.
Mr Hewlett: It all comes down to the share of broadcast, selling a share of ratings, a percentage of ratings, for a percentage of spend on broadcasting. That’s the essence of the deal.

Q545 Baroness Fookes: Would I be right in assuming from what you have already said that you do not think that the abolition of CRR, were that to happen, would have any effect on the amount of UK-produced programmes or quality programmes? I do not know whether those two terms are synonymous.
Mr Snoddy: I think it would have an effect, but not an absolutely huge one. I think the two drivers of ITV’s relative lack of success over the last three or four years has been the subjective losing their way creatively and, secondly, the impact of advertising recession. A lot of people argued that television advertising was dead, channels were dead, the advertising would never return. We now know that a very high percentage of it has returned. But in a curious way they don’t seem to be able to predict from one year to the next. The CRR should be a rational system, but Channel 4’s advertising head, for instance, predicted that it would be down 6% this year. It is actually up 16%. He just sort of joked, “Yes, no, I don’t actually know”, so that would imply to me that whatever is happening is not all down to a single mechanism like CRR.
But on the lack of creativity side, ITV throughout the recession managed to stay very close to spending £1 billion a year in programmes. I think part of the problems came from how it spent that money, and advertisers were not best pleased. They, of course, want the big “X Factor” mass market programmes, but in my experience they also want to reach the light television viewers, the people who are more affluent in society, the ABC1s, and until “Downton Abbey” reversed that trend they just hadn’t done that. For instance—I’m sorry Lord Bragg. I’m rather glad Lord Bragg is not here, actually, because I want to say it was a complete outrage that ITV closed down his programme. It was completely unnecessary and it narrowed the range of ITV programmes in a completely unnecessary way. It had the money; it could have kept on doing that. So there’s been a lack of ambition, which I think might be—there are some signs of it—being put right now.

Q546 Baroness Fookes: There is no way in which one could nudge it. I think, in the right direction, is there?
Mr Snoddy: Well, Baroness Fookes, I’m sure you could nudge it very well indeed, but history shows it does more or less what it wants. But certainly I think there is a public element. It could be shameless, I’d say. Well, it certainly was when I was there. But can I just say about lifting CRR and investment in UK programming, it is
complicated and it’s complicated because you don’t just have to consider what happens to ITV; you have to consider what happens elsewhere. Now, it is a fact that Channel 4 in particular but also Channel Five have benefited from CRR because advertisers have been able to get their ITV airtime for less of their total spend. So they’ve had more money to spend and that has no doubt spread out. It’s particularly spread out within television to other broadcasters.

So, if you lift CRR and the reverse were to happen—supposing the TV advertising market, for argument’s sake, stayed about the same size roughly, the reverse happened and money was sucked back into ITV because advertisers were forced to pay higher prices, they might spend less on Channel 4, less on Channel Five, and that would then concomitantly have an effect on the commissioning of UK content by those other broadcasters. So it’s not just a question of what ITV would do with the money. Whether or not you think it could be shamed, persuaded, engaged in some way to spend more of its own money or the money it would get on UK broadcasting rather than give it to the shareholders—

Q548 The Chairman: Although there is a difference of view on the panel, I think, probably, even on—
Mr Hewlett: I think the key factor in terms of ITV’s programme investment actually has not been CRR at all, it’s been the recession.

Q549 The Chairman: John, you would probably have a slightly different view?
Mr Billett: Yes, I do. I have no view on the quality of programmes. I think my colleagues are in a far better position to comment on that. I want to put it to you, sir, that the CRR has had unintended consequences and it’s now delivering distortions that are of a deeper significance than was the threat from ITV dominance when in 2003 CRR came about. On this notion of ITV forcing price increases, there is now an audit system well established in the marketplace. There is no way that ITV could force price increases into this market given what has happened since 2003.

I would put it to your Lordships that what has happened is that CRR has made it easy for the very large media buying companies, which you’ve recently seen, to become even larger. It’s now a barrier to entry for smaller media companies. Very few contracts, as I said earlier, are in the name of advertisers; they are in the name of agencies. And you now have a situation in which it is becoming quite common for media owners to be paying media buying companies commissions and additional discounts in order for them to make the right sort of investment.

If you didn’t have CRR, we would have a much more open trading situation. It would be far harder. People would have to work harder. It wouldn’t have this insurance policy around it. But my judgment is that advertisers would benefit because the art of media planning, the art of creativity, would come back into the advertising process in a way that it now is quite impossible to do in a situation dominated by CRR where media buying has become commodity trading rather than advertising effectiveness.

The Chairman: Thank you.

Q550 Lord Dixon-Smith: I was going to say I have heard what we have got to do away with. I am not quite sure whether I am clear about the issue of whether there should be some other form of protective mechanism that you could suggest, which would perhaps alleviate to a degree the absolutely open market situation and regulate it so that there was an element of stability without the flaws, if you like, of CRR, which clearly exist.

The Chairman: Is there a halfway house from total deregulation?
Mr Billett: I think Steve Hewlett and I would perhaps agree on the next stage, which is that if you abandon CRR you have to change the share of broadcast within the whole process. You cannot retain share of broadcast deals without something like CRR. Is that correct?
Mr Hewlett: I agree with that. If you had an open trading system of some sort such as you would find in the US and other places where people bought slots either in an auction or in some upfront process or whatever, then the broadcaster can say, “Unless you pay this price for this programme, you’re not getting that slot”. But they can’t say to you, “If you don’t buy this programme, you’re not having that programme”. So at the moment, because of the share of broadcast, that’s where their leverage comes from. There’s a lot of bad feeling about this—you’ll no doubt have picked it up—going right back to the beginning of ITV. The sales houses inside ITV, when it was the only broadcaster, were all incentivised about taking a share off each other.

Q551 The Chairman: So rules for the protection of advertisers, taking into account that very point.
Mr Hewlett: Yes. So, if one was able to have a more open market, then one would need fewer rules to protect anybody. It would be my take on it. I’m an amateur, but that’s my guess. If you have a system such as the one that exists now—the advertisers I’m sure will have told you this—there is a real risk that advertisers will end up being worse off if ITV is allowed to operate its existing system without some form of protection.

Q552 The Chairman: But then the media houses, we have heard, essentially are part of that same system. Mr Hewlett: They are, although there is an interesting twist. Again, if you go back to ITV, and I was in the company at the time, when the Competition
Commission accepted CRR as the price of the merger, ITV was cock-a-hoop. Apart from—leaving aside the lack of foresight as to what would happen to its own ratings, it had a certain amount of hubris about what would happen in a merged company. But the other thing that it was so excited about was that share of broadcast was traditionally the way that ITV had held advertisers’ or agencies’ arms up their backs. That’s how ITV had played the bully—when it was the only player in it. That’s the mechanism by which it did it. That’s how the big companies overhauled the small companies. That’s how the system worked. So it was thrilled to have got the CC to agree to let it keep the share of broadcast system. In the back of ITV’s mind was the prospect that it might have to forfeit that share.

Spool forward to the most recent Competition Commission and OFT review and you find that ITV is now saying it wants to be free of share of broadcast in order to premium sell its premium programming; in other words, to spot sell “X Factor”, “Downton Abbey” and so on. It would like to get away from share of broadcast. Paradoxically, it’s the regulator that says, “No, no, no, share of broadcast is now protecting otherwise vulnerable advertisers who without share of broadcast wouldn’t be able to get access to your premium slots”. So, look, they’ll all have their own reasons for saying this, but consideration of CRR as distinct, separate from, the trading system that it’s meant to regulate, I would suggest respectfully, is not the right way of going about it.

The Chairman: You have to view the two together.
Mr Hewlett: Correct.

Q553 Earl Onslow: With modern technology, there is no reason why ITV should maintain that particular share of broadcasting. Is there no reason why another group of investors might not come along and say, “We could produce basically a generalist high quality channel”? After all, Sky News did it against BBC 24-hour news. Is there any theoretical reason why another totally free, private ITV should not be put on channel”? After all, Sky News did it against BBC 24-hour news. Is there any theoretical reason why another channel shouldn’t be put on? Mr Hewlett: Theoretically, no. Theoretically, we could start a channel together and if we were very lucky and had enough money to spend, we could have a major hit on our hands.

Q554 Earl Onslow: 6 million?
Mr Hewlett: But also they’re very, very expensive. You need a business generating very significant revenues before you can even contemplate—

Q555 Earl Onslow: I absolutely understand that, but there is no theoretical reason why it should not.

Mr Hewlett: Theoretically, no. Theoretically, we could start a channel together and if we were very lucky and had enough money to spend, we could have a major hit on our hands.

Q556 Baroness Deech: On the number of minutes of advertising, do you think that the rules about this should be harmonised and, if so, should it be upwards or downwards? Mr Billett: Well, we have done research that demonstrates that the higher the volume of advertising transmitted the lower the effectiveness of the advertising. Advertising clutter is an issue. That’s why being first or last in a commercial break is seen as valuable and a premium is charged. Higher ad minute generates higher levels of exposure among the heavier viewer and the higher channel loyalist. The problem we have is that the pricing mechanism works on the basis of them selling all of their airtime. And one of my real concerns is that, even if you have harmonisation of minutage, unless there is the recent decision by Ofcom to relax the necessity to sell all of that minutage, you will then destroy the pricing mechanisms that exist.

So, my answer is in two parts: I think there should be harmonisation, but there should also be a requirement for the media owners to sell all of their minutage and allow market forces to determine the price, rather than what has happened in the past, which is ITV forcing price increases by closing down breaks.

Q557 Baroness Deech: From what you have said, I take it that you would favour harmonisation downwards. Mr Billett: Yes.
Baroness Deech: Fewer minutes. Thank you.
Mr Snoddy: Very briefly, I agree with that. I’ve just come back from a stint in New York where television—I’m sure all of you who’ve been there will know—is almost unwatchable because everything is routinely interrupted by advertising. If it takes regulation to make sure that that doesn’t happen in the UK, I’d very happily have that regulation. But John has just given you the economic argument why it’s not even a very good idea.

Q558 Lord Stevenson of Balmacara: I think most of it has been covered, particularly the economic argument, but what is the consumer argument? Do we have any evidence of that? Mr Billett: The consumer argument seems to be that, if you leave aside facility breaks, they actually like fewer breaks. Let me correct that. They actually like shorter breaks rather than longer breaks, and there is very good evidence that that keeps the audience; that the audience is then less likely to channel switch. So from a broadcaster’s perspective, it can be very valuable to have shorter breaks.
Mr Hewlett: Anecdotaly, one knows, because it happens in my own living room, that excessively lengthy ad breaks, especially on ITV1, drive you a bit nuts. So I’m sure if you ask the people the question, and I read what Diana Guy—

Baroness Deech: You get up and make a cup of tea, don’t you?

Mr Hewlett: If you ask people what they want, they’ll say they want fewer adverts. If you look at what they do, I think it’s a bit less clear, to be honest.

Q559 Lord Stevenson of Balmacara: Our household tends to watch everything time shifted by half an hour so we can skip through the breaks. Does that matter?

Mr Hewlett: If it catches on, it doesn’t half matter, yes. Because you don’t count as a commercial impact if you’ve gone through at times 16.

Mr Billett: But the current evidence is that not too many people do.

Mr Hewlett: Well, generally speaking, people don’t, but when people have Sky Plus, V Plus, PVR content, they zip through quite a lot.

Q560 Lord St John of Bletso: We have covered this already, but a fair market price for airtime on ITV could be determined through an online auction. Do you think it would be possible to introduce a so-called system?

Mr Billett: Let me share with you that I’m fortunate enough to be consultant to Rupert Murdoch’s newspaper organisation and we’ve had a look at that. The worst possible thing we could do is to auction the newspaper space in the Sun and the News of the World and the Sunday Times. Because they are in demand, they can get a far higher price than would ever be available through that sort of thing. Applying that to television, I’m pretty sure that an auction system would work extremely well for those myriad small channels which Ray Snoddy referred to. I think it would be an unmitigated disaster as a trading mechanism for ITV, Channel 4 and the major channels and major media generally.

The Chairman: Thank you for putting your views in such a moderate way, if I may say so, John. Excellent.

Q561 Lord Gordon of Strathblane: I recognise that we are out of time, Chairman, but I was hoping that perhaps our witnesses might be prepared to submit something in writing to us. All the advertising industry people we saw this afternoon were saying, “We don’t like CRR either. We think the present trading system is hopeless, but we’ve been trying and we can’t find a better one”. Can you help them to find a better system, either collectively or individually? Is there a system you would suggest, and could you write to us?

Mr Hewlett: The Competition Commission has been saying since 2000—it’s said it three times now to my knowledge and probably more often than that if ever it’s been asked—that there needs to be a proper review of the television advertising system. It’s so complicated. It has so much history built into it, so much established practice and, as a result, so many vested interests. It seems to me, in my own personal view again—I stand outside of this—I wave a flag for no one—it’s very difficult to disentangle the bits of this without a thoroughgoing inquiry.

Now, does everybody want to wait three years for it? No, because we’ll all have dropped off the perch in the process. But if somebody could come up with a shortcut, using all the work that’s already been done in various places to produce a workable review of the system in a reasonable timeframe, that would be a very good starting point.

Q562 The Chairman: I am going to give the final word to Ray.

Mr Snoddy: I simply want to follow on from that, which is an exposition of where I was heading. I think the way forward is to have a very small, informal, specialist committee chaired perhaps by Lord Bragg or Professor Barwise, and with no more than five people from different sides of the industry, to explore within a timeframe of no more than three months whether there is a more flexible way that everyone would accept which does not—taking your Lordships’ point—amount to a breach of creating a new monopoly. There has to be a way but I do feel, in my very final word—you’ve already realised this, I think—that this is a bit like the Schleswig-Holstein Question and just when you think you’ve grasped it, it disappears into the fog again.

Q563 The Chairman: That is a very good note on which to end. I think we will live with Schleswig-Holstein for a little bit.

Baroness Fookes: One’s dead and one’s forgotten.

The Chairman: Exactly. Thank you very much indeed. Thank you for handling your differences in such a civilised way as well and for helping us think the unthinkable. Thank you.
WEDNESDAY 8 DECEMBER 2010

Present

Lord Clement-Jones
(Acting Chairman)
Lord Dixon-Smith
Baroness Fookes
Lord Barnett
The Lord Bishop of Liverpool
Lord Bragg
The Earl of Onslow
Baroness Deech
Lord Razzall
Lord Stevenson of Balmacara

Examination of Witnesses

Witnesses: MS DINAH CAINE, Chief Executive, Skillset, and PROFESSOR SYLVIA HARVEY, Chair, Citizens’ Coalition for Public Service Broadcasting.

Q564 The Chairman: I welcome you both very much. Thank you very much for coming. I am afraid, in a sense, the questions will be divided between you because John McVay, unfortunately, is ill and hasn’t been able to come. But you’re both extremely welcome and we’re hoping you’re going to be able to answer all our questions. We normally go round the table; it will be fairly obvious as we travel round who’s going to be asking the question and, between you, no doubt some sort of telepathy will occur where you decide which question you prefer to answer. Would you like to introduce yourself to us to start with and then we’ll start the questions?

Professor Harvey: I’m Sylvia Harvey. I’m a Visiting Professor at the University of Leeds in the Institute of Communications Studies. I’ve taught in British higher education for about 35 years. Currently, I’m also a Visiting Senior Fellow at the London School of Economics and I’m the Chair of a very small organisation, the Citizens’ Coalition for Public Service Broadcasting. I think that’s why I’ve had the honour of being invited here.

The Chairman: Wonderful; thank you very much. I’m sure that’s the case.

Ms Caine: I’m Dinah Caine. I’m Chief Executive of Skillset, which is the Sector Skills Council for the creative media and fashion and textiles industries.

Q565 The Chairman: Great, thank you. Let’s kick off then. ITV have told us that their schedules have become less diverse since the introduction of CRR because they’re driven towards predictable mass audience programming. Do you agree with ITV’s assessment of its schedule? Do you think that, for whatever reason, its programming has indeed become less diverse and less adventurous over the last five to 10 years?

Professor Harvey: There’s a disagreement about this, is there not? Some think that the ITV leadership has been unfair to itself. That is to say, they’ve underestimated the quality and range of their existing programming. There’s another view, of course: that there has been a diminution in the quality of their output and, from a citizen’s perspective, I want to mention two areas specifically. One is children’s, where I think I’m right in saying that ITV is almost entirely withdrawn from the field, although I look to people who know more than myself. I think they might have just said they’re coming back in a bit to children’s broadcasting. The other area, which I care about a great deal because I live in Sheffield, is regional programming. Quite a few years ago—three or four, is it?—ITV very significantly cut back on its investment in regional news and current affairs and this has been a great loss in the English regions and probably also in the nations.

Q566 The Chairman: Can I follow that up with a couple of points? When you say being unfair to themselves, are you referring to Archie Norman’s comments when he appeared about chasing ratings?

Professor Harvey: Yes. No; about his own programmes.

Q567 The Chairman: About his own; right, yes. The sort of programmes they made were chasing ratings I think; I forget quite what it was but there was quite a lot of press coverage about what he said when he came here.

Professor Harvey: If I might say so, it should not be assumed that to have large ratings means that you’re producing poor work. On the contrary, if we have respect for the British public, as I do—and I’m sure you all do—higher ratings can mean very good work.

The Earl of Onslow: There’s absolutely no point in producing programmes if nobody watches, is there; which is a counterargument to high ratings.

Q568 The Chairman: To what extent do you think any changes, those kinds of changes that you have mentioned, can be attributed to the effect of CRR? Professor Harvey: I’m not an economist and I’ve struggled to understand the finer points of CRR. The field of the sale of advertising airtime is fraught with or bogged down by the dead bodies of unintended consequences. One thing we do know is that the less
airtime you have, the higher the price; so scarcity obviously keeps the prices up. So there’s been quite a debate, hasn’t there, about whether or not one should increase the amount of airtime? On balance, Ofcom and the industry has decided, as I understand it, up to this point in time, that they don’t wish to see a great increase in the amount of airtime because the price will go down. So whether or not the CRR has had an adverse impact on ITV investment in original—that is, new—programming is quite difficult to say, I believe.

**Q569 The Chairman:** So you don’t want to come down on either side on that one? I don’t blame you. It’s a $64,000 question.

**Professor Harvey:** No. From a citizen or user or viewer perspective, clearly a very high priority is to wish to see increased investment in original production or even just retaining existing levels because, in fact, as I’m sure you’re aware, since 2004 the amount of money that’s been lost from investment in original production is £700 million; that is, £0.7 billion. In that five-year period we’ve lost, in the United Kingdom, £0.7 billion.

**Q570 The Chairman:** That’s not just ITV; that’s across the piece!

**Professor Harvey:** No; that’s all five public service broadcasters; the five PSBs.

**The Chairman:** I think your question follows on very nicely.

**Q571 The Earl of Onslow:** My question follows on extremely well but, first of all, I would like to ask—I’ve only come back to the Committee, after a period of absence, fairly late; so I’m probably in a minority—do you understand CRR yourselves?

**Ms Caine:** No.

**Q572 The Earl of Onslow:** I rather wish I’d been able to ask that of everybody who has given us evidence. What a lovely, honest answer.

**Professor Harvey:** As I said, I’m not an economist but I do know that the consequences of changing airtime prices are very difficult to predict. So, in that sense, I cannot claim to understand CRR.

**Q573 The Earl of Onslow:** Okay. My question is simply what has the investment effect of CRR had on original UK content? I think you’ve more or less answered that—you can’t tell; you don’t know except it has gone down. Is that a fair summary?

**Professor Harvey:** I think it is, yes.

**Q574 The Chairman:** So, because you don’t know whether it went down because of CRR, you don’t know whether, if CRR was taken away, it would go up?

**Professor Harvey:** If I might say so, we have to look at a broader contextual factor, namely the growth of Internet advertising, and I think we know that this year, for the first time, the value of Internet advertising—we’re the first country in the world where this has happened—has overtaken the value of television advertising. I think that happened this year for the first time. That’s a bigger negative factor for ITV than CRR, probably.

**Q575 The Earl of Onslow:** So from that conclusion, the slight fall from 2003 to 2009, or 2010 or whatever it is, in the revenues from television advertising is surprisingly low if you consider that you have an advertising budget the size of or bigger than ITV that’s come into the market? Am I drawing the right conclusions from that? I’m not an economist either.

**Professor Harvey:** Please forgive me; I’m not sure exactly what aspect of that you’re—

**Q576 The Earl of Onslow:** What I think I’m trying to get at is this. You’ve just said to us, and I believe you to be correct, that there is now more spent on Internet advertising than there is on ITV advertising. Is that what you said? Did I get you right on that?

**Professor Harvey:** The totality of television advertising, not only on ITV.

**Q577 The Earl of Onslow:** Right, the totality is less than on internet.

**Professor Harvey:** Just less; just gone under, yes.

**Q578 The Earl of Onslow:** Just under. To me, it says this fall in television advertising has been remarkably little, considering that chunk of stuff going into it, looking to the same market. Am I right in that, do you think?

**Professor Harvey:** I suppose you could see it like that but, I have to say, I’m not an expert in the value of advertising.

**Q579 The Chairman:** Dinah, just chip in if there is any point but I’m assuming you’re going to be mainly interested, if there’s any extra money, in where it would go. Obviously we’ll talk about the training side and so on, but I’m assuming that’s where you will be coming from mainly.

**Ms Caine:** Absolutely, but I would just make the point, going back to my honest answer on CRR, no, I don’t understand the detail of it. What I do understand is the importance of original content creation for ITV’s business plan and for its profitability going forward under Adam Crozier, the desire to invest more and the desire to do that across multi-platforms. Whether or not CRR relates to that, I’m not an expert; I can’t answer. But what I can say is that there is an intrinsic link between the desire to create original content and the desire to remove
mechanisms that apparently get in the way of that and the importance of ensuring that the investment is there in the skills and talent of the people required to produce that original content. So there is a triangulation.

Q580 The Chairman: So you welcome their new strategy, basically?

Ms Caine: I welcome their overall strategy and obviously I’ll comment later, I’m sure, if you ask me questions on their current approach and investment in training.

Q581 Lord Dixon-Smith: I’m sorry to come back to CRR but unfortunately, like you, I’m not sure that I understand it either. But it is also the hare that we are, so to speak, hunting. So we do need to think about it; it’s clearly a factor in the whole system, but it’s only a factor in the whole system and personally, I doubt whether it’s a keystone, if I can put it that way. We’ve had conflicting views on the impact that the removal of CRR might have on other channels from minimal, which is some people’s opinion, to huge, which is other people’s opinion.

Two questions flow from that. How concerned would you be if the removal of CRR had a significant impact on Channel 4 or Channel 5 revenue and would this lead to a significant loss to programme makers and to choice available to viewers? Then, flowing on from that, what about cable and satellite channels? Would it have a significant impact on those and perhaps even force one or other—or more—to close down as a possibility, as an outcome?

Ms Caine: I’m sorry; I don’t feel able to comment on that in detail. I feel the loss of John McVay here, I must say.

Q582 Lord Dixon-Smith: I’m not responsible for composing the questions.

Ms Caine: No, but I am aware of the ability of witnesses to answer.

Lord Dixon-Smith: We’re mining a difficult seam of ore and we have to get what we can from every possible source.

Ms Caine: Absolutely, yes. Sylvia, again, you’re probably a bit more able to answer on that.

Professor Harvey: No, I think it’s an extremely difficult question.

Q583 The Chairman: I don’t think we’re asking you to say that you think that the removal of CRR would lead to a particular conclusion. We’re just saying, “What would you think if CRR did have that effect and, therefore, have an impact on Channel 4 and Channel 5?” Obviously, from your point of view, particularly in terms of UK production, they are an important source of—certainly Channel 4 is—

Ms Caine: I beg your pardon. Absolutely. I think, clearly, from my perspective—which is the importance of nurturing talent and skills in a variety of settings—that polarity of programme making and investment in programme making is key to producing the kinds of ranges of people that we need to take forward the industry in this country. So, from that point of view and that interpretation of the question, that would my answer.

Q584 The Chairman: Yes. What we’re getting at is the concern that you would have if there was an impact on either of those two channels as a result and your answer is that they form a significant part of UK content.

Ms Caine: Yes. They’re a significant part of the ecology. If there was an impact, it would impact on employment and I would say it would impact on the skills and talent base and the polarity of that base and the types of programmes that we potentially can make.

Q585 Baroness Deech: Can I just follow up on that before I get to my own question, Lord Clement-Jones? From a public point of view—and Professor Harvey, you’re an expert on that as Voice of the Listener and so on—would it make any difference to the viewer if one or two satellite or cable channels went because there wasn’t enough advertising to go round? Don’t we have enough choice already?

Professor Harvey: Surely the most successful element of the most successful satellite businesses is not advertising but subscription. But there are three main forms of finance for British television: subscription, advertising and public funds or, mainly, the licence fee. Of those three areas, the two that are going down are advertising and public. The one that has been going up is subscription, so there are more—I’m slightly avoiding your question but do you see what I mean?

Q586 Baroness Deech: No, that’s very interesting. So other channels could keep going on subscription, if people want them, never mind advertising?

Professor Harvey: Yes. Subscription has proved to be an extremely successful business model in the UK, which is arguably why we could now breathe a deep sigh of relief and call for coexistence.

Q587 The Chairman: That’s very interesting. But does subscription operate, for instance, if you wanted a drama channel or something of that sort? Is that the model? Subscription is largely brought in by people who are attracted to pay a subscription by things like major sporting events, aren’t they?

Professor Harvey: You mentioned drama. People in Britain sometimes talk about the brilliance of the HBO channel in the United States—that it produces
brilliant drama—and we, in the United Kingdom, see some of the best of what HBO produces. But, in my opinion, we have our own HBO in the United Kingdom and it’s called the BBC. That’s the organisation that, since the 1920s, has been producing high quality original work. I beg your pardon; I’ve lost the thread now. You mentioned drama; that was what it was.

Q588 The Chairman: The satellite people have told us that some of their channels might be forced to close if CRR were removed. Would that have any impact at all, in your view, on the things that you hold dear and that Dinah does, in terms of skill and in terms of UK production and so on? There isn’t a huge amount of UK production.

Professor Harvey: I’m sorry; I don’t know. But one should inject into the issue of not just size of audience but also nature of audience. I think perhaps in the recent debate, as developed by the leadership of ITV, there’s been a little bit too much emphasis on the size of the audience but, of course, you can sell airtime and subscriptions on the nature of the audience. We know that in terms of sports fans, for example. I think we know it in terms of the demographic of the audience—whether it’s very young or very rich will affect your ability to sell airtime. So ratings are not the only consideration when it comes to the value of airtime.

Q589 Baroness Deech: It’s been suggested that if CRR were relaxed or removed then, in return, one might ask for an appropriate level of investment in UK content on the part of ITV. What would you consider to be an appropriate level of investment by ITV in UK content? Perhaps that’s one for Ms Caine.

Ms Caine: I can certainly answer that, I think, in part. if CRR were relaxed or removed then, in return, one might consider to be an appropriate level of investment in skills to support greater content in production. My briefing, in terms of coming to this Committee, was to update you following the recent debate, as developed by the leadership of ITV, there’s been a little bit too much emphasis on the size of the audience but, of course, you can sell airtime and subscriptions on the nature of the audience. We know that in terms of sports fans, for example. I think we know it in terms of the demographic of the audience—whether it’s very young or very rich will affect your ability to sell airtime. So ratings are not the only consideration when it comes to the value of airtime.

Q590 The Chairman: Yes but the appropriate level of investment, you would say, includes training and also investment and content?

Ms Caine: Yes. Also, if one is making an argument that a certain regulation is getting in the way of increasing investment in original content, then I would see that as being an argument, as a package, that if the increase in original content is being argued for the removal of the regulatory mechanism, then also, in line with that investment, needs to go greater investment in the training and skills base to support it. So I see the two having to go hand-in-hand as a weight against CRR.

Q591 The Chairman: Just to go a little bit further on the appropriate level of investment, Sylvia, what we’re trying to struggle with to some degree is if you did say, “Right, we would want certain undertakings or set up a fund or whatever to invest in original UK content”, the question is how long is a piece of string? Do we say, “You must spend more in certain categories; you must have a balance between the types of programming”, or is it a figure that you pluck out of the air, in that sense? So what are your thoughts on that? That was the thrust of Ruth’s question.

Professor Harvey: I think we can begin to work out the length of the piece of string. It’s in the Ofcom Communications Market Report, on the page on which they give the key metrics for the industry and that’s the page that I’ve been using in referring to the missing £700 million of investment in original production; new programmes made in the United Kingdom. What I don’t know, and what I think we don’t know, is what proportion of that missing £700 million is, as it were, ITV’s share. I’d have thought it would be possible for somebody somewhere to work that out.

Q592 The Chairman: So, in your mind, there’s a kind of baseline period, in a sense?

Professor Harvey: We can never go back, can we? We can only ever go forward.

Q593 The Earl of Onslow: I have a question I’d like to ask Ms Caine. What would you think the best thing to do to increase UK production was? If you were given carte blanche to increase UK production, how would you do it?

Ms Caine: It’s a very difficult question for me to answer. I’m afraid. Again, I can answer part of that question—to increase UK production you have to have the skills, the talent, the management, the leadership, the entrepreneurship and the flair to lead and grow an industry. That means that you have to have those kinds of skillsets available within the industry to take it forward in a way that will help it grow, be that exploiting global markets, be it...
_capability to produce content across multi platforms and to exploit that, be it to do with IP I'm sure that's a big issue for the industry at the moment in terms of its protection and exploitation. There's a whole range of factors. Inevitably, because of the role I'm in and the reason I've been called to this Committee, my slant is always to come from the skills and training aspects of that particular question. So, for me, an absolutely integral part of that mix is this industry taking its responsibilities and recognising that investing in training skills, education, new talent and existing talent is critical to growing production going forward. I can't speak about the more detailed mechanisms of finance and levels of intended production.

The Chairman: Great; I'm going to stop you there because Melvyn's question is very apposite to this as well. You can develop that in response.

Ms Caine: Okay, thank you.

Q594 Lord Bragg: We're still feeding at the same trough I'm afraid, the CRR business. If CRR were lifted from ITV in exchange for a commitment to invest more in UK content, how do you think that could be enforced?

Ms Caine: That is a very good question—and certainly if I'm allowed to include in Melvyn's package of content, content and the means to produce it and the training and skills to support it—then, looking back, for example, to the recommendations from the last Committee, there was both a strong request that the industry took its responsibilities more seriously and also, in relation to PSB, that there should be greater emphasis placed in relation to a tie-in between PSB responsibilities and investment in skills and training.

While this Committee recommended that and while the Government welcomed it and took on board that recommendation and said it would pursue it, there has been no obvious mechanism for doing that. It's interesting that, in the recent discussions around the Communications Act, Ofcom's responsibilities for training and equality have now been put into the area of one of the powers that's going to be removed.

So in a sense, that avenue for potential enforcement is not there, although I would say that the existing legislation and the level of powers was, as I think we discussed the last time we came to give evidence, not sufficient and not clear. So to remove that power at the moment, I don't think, makes that much difference. The Committee may want to consider whether or not it needs to be replaced with something stronger and/or whether or not you tie in to PSB requirements and responsibilities—as the new amendments to the Communications Act go through—some sort of clear tie-in. I assume one would make, if John McVay were here and others, similar links to the production of content, Melvyn.

Q595 The Chairman: Right, okay. Sylvia, do you have any thoughts on this point Melvyn has made?

Professor Harvey: If I may, yes. Our chief regulation body, Ofcom—notwithstanding the role of the BBC Trust as well of course—hasn't got itself very much experience over the last few years of monitoring where the investment goes.

Q596 Lord Bragg: Why not do you think? A few years is quite a long time. It isn't all that big a company, ITV. Why can't they monitor it?

Professor Harvey: Because the Communications Act 2003, it would argue, didn't give it the tools it needed to bite. That would be its answer, I imagine.

Q597 Lord Bragg: I'm not trying to trick you. I just want information. Did it give it the tools to investigate?

Professor Harvey: No, it certainly didn't.

Q598 Lord Bragg: That's crazy, isn't it? They're supposed to be in charge of stuff and they don't have the tools to investigate. That seems a bit of an omission, wouldn't you say?

Professor Harvey: Absolutely, but there are elements in the Communications Act 2003 that have been party to this whole process unfolding. What I wanted to say from a citizen's perspective is that there is a minimum of six genres: drama, documentary, current affairs, news, children's and comedy. Those six genres are arguably critical from a citizen's perspective and there's very little work been done, I think, including by the regulator, to track—that's a bit unfair; they have done some work on this, but perhaps not enough—how much of each genre is being invested in. We could do with a lot more monitoring work there.

But the bigger philosophical problem that is making it difficult for the regulator to bite in the user interest or the citizen interest—I won't say the public interest because that's defined in such different ways—it's been difficult to keep tabs on the relationship between inputs and outputs because, as I understand it, it's become fashionable to say, "We can focus on outputs without thinking about inputs". I disagree with that.

Q599 Lord Bragg: Can I just come back to something? I find this puzzling and quite alarming. When ITV came, they made a very good case but they wouldn't give us the key figures as to what they would do with the money or some of the money they would get back were we to recommend or were CRR to be lifted. Without those figures, it's difficult to know where to move. Now we're being told—and this isn't challenging you for one second—that it's difficult to monitor it.
It isn’t difficult to monitor. You could do it in an afternoon. You just look down the programme list, see the budget set against them and do it. It’s a simple thing. If I was licensed to do it, I could bring you a report back tomorrow lunchtime and it would be reasonably accurate within about 10%. So all this “difficult to monitor” is, in my earnest opinion—let’s choose a polite word—nonsense. Why are we, as a Committee, and you in the position that you have, being blocked by this hot air about “difficult to monitor”? Why is Ofcom, which I voted for and work for in the House as do other people in this room, allowing itself to just linger away in the shadows, not coming on the stage and saying, “We’ve got to know these things or we can’t do our job properly”?
The Chairman: Can I just stop you there, Melvyn? I’m sure Sylvia and Dinah would like to answer the question, because that’s the purpose of the exercise. Professor Harvey: I must say I very much agree with that point. But if it’s in the public interest for a regulatory body to perform a piece of work, it must be given the specific permission to do that work and, arguably, that permission has been, in part, lacking.

Q600 Lord Stevenson of Balmacara: You’ll be relieved to hear we’re now going to focus a little more on training. You can switch hats if you wish or maintain them as you feel. The next three are drilling down into ITV and your relationship with them. As a general proposition, we’ve heard about the reduction in the overall amount of funding available. We’ve thought about the way in which ITV has told us what its attitude is and I think there’ll be questions later to ask a bit more about that. But as a general scene setter, could you tell us, roughly, what is the proportion of people undertaking training in the television industry at the moment?
Ms Caine: I can make available to the Committee our very comprehensive strategic skills analysis for the media industries that we’re just about to publish in December and it’s something we produce on a yearly basis. At the moment, according to our latest workforce survey, we are in a position to report that, in broadcast TV, 46% of people have accessed training and development and in independent production that’s slightly reduced to 48%.

Q601 The Chairman: Say that again. Slightly—
Ms Caine: Sorry; it’s 64% in broadcast TV. Sorry; let me start again. Over half the TV workforce, about 55%, has received some learning and development and that’s about 64% in broadcast TV and about 48% in independent production. That’s from our workforce survey basically. Demand for learning and development in TV remains very, very high. So about 50% of respondents say that they do have current needs and, obviously, that’s more pronounced amongst the freelance population who have much greater difficulty in terms of accessing provision. Interestingly, in terms of our employer survey this year, 21% of employers in TV said that they do not open up training opportunities to the freelancers they use.

There’s an interesting point here that relates to tax status, because the freelancers are Schedule D for tax purposes and I think strictly by the letter of the tax law, if employers offer them training opportunities it can change the nature of the employment relationship. So that seems to me to be one of the blockages that we’re certainly going to be asking the current Government to look into in their review of the creative industries. So that gives you a picture.

I think the other stats I would just mention are there’s still a very high reliance on recruitment of graduates; that the proportion of people who have been recruited for media degrees is going up significantly; that women are important in the industry but the age profile is very marked. Over a certain age, women tend to disappear. Finally, the freelance statistics obviously are much higher in the independent production sector but obviously there is an absolutely intrinsic link between that sector and the broadcasters in that they commission significant amounts of programming.

Q602 Lord Stevenson of Balmacara: That’s very helpful and, indeed, if we can get access to your report in due course, I’m sure that would be very useful.
Ms Caine: Certainly, we’ll submit that. Yes.

Q603 Lord Stevenson of Balmacara: Could you just give us a sense of how that’s been changing over the last couple of years? Are the figures roughly the same?
Ms Caine: The figures in terms of those needs being met are roughly the same but, of course, the issue is about drilling down because whether or not a person has had a learning and training engagement can vary between whether they’ve been accessed to a health and safety course that they have to be accessed to and rather more profound issues about whether, as a sector looking forward, we have the right kinds of skill mixes at the moment to take advantage of and to manage the great technological changes that are impacting on the business at every level.

Q604 The Earl of Onslow: Presumably employment law applies the same as tax law, does it not? That is another counterweight. Would I be right on that?
Ms Caine: Employment law—
The Earl of Onslow: The construction of unfair dismissal; all these things that go with employment law must encourage the increase of the use of subcontractors or independent—
Ms Caine: Yes. It’s swings and roundabouts, I think, but clearly the industry sees some benefit in terms of using contracted talents. The other thing that would be worth drawing to your attention—and it goes back to the very first question about diversity of production, which is where you started your questioning—is that it is very interesting to note in TV that 47% of people have worked for nothing at some point in their career and one can make a safe assumption that that is obviously at the start of their career. Now, that has significant implications for the diversity of people who enter this industry and have the opportunity to enter this industry.

I think there is an intrinsic link between that and the point about CRR diversity of production because, again, if you are going to be reaching out to audiences on many different platforms, which quite often are specific and niched, then it makes good business sense to be doing that in relation to the kinds of different people in our population. There has to be a link between the creating of programmes and the kinds of people who make them and a good business link to those audiences. So, again, I’d like you to think about that in terms of your bag of issues around original content creation, diversity and the link to training and education.

Q605 The Lord Bishop of Liverpool: Staying with the training profile, over the last two years Skillset has lost nearly 40% of its funding from ITV. Can you tell us what impact that’s had on people working in the broadcast sector?

Ms Caine: Yes. In fact, as we sit here now, we’ve lost all our funding from ITV; although I’ll come back to that in relation to the next financial year.

Q606 The Chairman: Is the figure 40% of your funding, full stop, or 40% of our overall funding1.

Ms Caine: It’s 40% of our overall funding1.

The Chairman: Yes, that’s right.

Ms Caine: The difficulty about this is that obviously we are only one mark of investment in training and education, although a significant one within the industry, because clearly the companies invest themselves. The difficulty is there is no way of tracking that. Going back to the point about Ofcom, another area when it was dealing with regulation of training was that there were no individual figures on investment from individual companies. So it’s very difficult to monitor that, as it is very difficult to monitor levels of investment in the independent production sector.

Having said that, if you take us as a kind of bellwether, then clearly we have seen that reduction and, certainly with both Channel 4 and ITV, those reductions were linked to a loss in advertising revenue. Now, clearly ITV said at the time that if advertising revenues started to increase, which they have, then it would come back to the table to start to discuss that with us. But I think it’s interesting because—going back to my overhead point—it seems to very much see that investment as part of its corporate social responsibility portfolio, rather than a commitment to investing in the creative industries.

Effectively its investment to us comes in two ways. One is to the core of what we do and deliver as a sector skill council and that covers everything from careers information, advice and guidance, the development of standards and qualifications, the very important work we’ve been doing with higher education—probably very appropriate as we sit here today with various students in the House—and the issues that the Browne review has thrown up. So significant amounts of work there, but also we hold specific funds that are there to invest in the training of freelancers in the industry. As of next year, ITV’s contribution was going down to nothing. Now, having said that, I think Adam Crozier reported, when he came to this Committee, that we were in positive discussions with ITV and that continues to be the case. My understanding—

Q607 The Lord Bishop of Liverpool: Could I ask you to say something about the regional dimensions of training, because, in the past, the regional companies were quite often an access to working within television? How does it stand today?

Ms Caine: Yes. I think that’s a very important point and a very important question because clearly, as you know, the critical mass of the industry is in London and the south-east and I think one of the really important jobs that we do is to work very closely and on the ground in both the nations and the regions to seek to use the investment we have; our ability to broker that with public investment to make sure there is the skills and talent base capable of delivering. For example, in the north at the moment we’re working very closely with the BBC to develop action plans to nurture the base there and elsewhere. But clearly, in order to do that, we have to have the investment and, going back to my oft repeated points, if you don’t have the skills and talent within those geographical areas then all the targets in the world aren’t going to be delivered.

Q608 The Lord Bishop of Liverpool: You mentioned higher education, too. With the Government’s intention to withdraw funding from the arts and humanities, could you imagine a new scenario in which ITV and Skillset entered into partnerships with universities for funding courses?

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1 The witness has since clarified that it is an overall cut of 75% of Skillset’s overall funding from ITV for the financial year 2009–10 and 100% cut for the financial year 2010–11.
Ms Caine: Absolutely. That has been one of the big areas that we've been working on at Skillset, and for the core industries, we are a catalyst for the creative economy. We've been looking at specific areas such as computer graphics, animation and video games, but also at the creative industries, where we see a significant impact on the UK economy.

The Chairman: Well, the Browne review, it is of concern to us all that although creative industries have been identified as a growth area, there is a need for some undertakings and investments to be made. We will come back to that in terms of what ITV can do to support and drive forward training, which obviously would be one of the key areas.

Ms Caine: Yes. Yes, absolutely they do. They obviously invest in that, do they, the kind of undertakings that might be appropriate. We'll ask you a direct question about the ITV situation. You yourself mentioned about the risks of the ITV situation. You yourself mentioned that although there is a need for some undertakings and investments to be made, there are many ways in which training and support and drive forward training, which obviously would one of the key areas.

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sector and although there are really important high-level skills needs in terms of supporting the growth of that sector, most of the courses, some of which are excellent, fall within the areas that will receive significant cuts. In fact, we would very much like to position our recognised courses as being ones that should be worthy of investment, along with and aligning to the STEM emphasis at the moment.

Q613 Baroness Fookes: May I come back to regulation? Do you think what you have outlined is sufficient on its own or would you see a role for any regulatory body to oversee this?
Ms Caine: Well, you ask me that question at an interesting time because obviously we have had co-regulation on this issue up until now. When we came to give evidence to this committee previously, one of the recommendations was the need to relook at that because it was opaque and it wasn’t very well co-ordinated and the powers that underpinned it weren’t strong enough to apparently allow Ofcom to intervene in a meaningful way. So let us look at the situation with ITV. ITV cuts its investment; Ofcom says it has no powers to raise or deal with that.

Q614 Baroness Fookes: May I assume then that you would like them to have those powers or some body, if not them?
Ms Caine: Well, either one way or the other. Either the powers are sufficient and the will is there to look at it effectively or that it is seen as a responsibility on businesses and the relationship, therefore, with Skillset is one that would be managed through a series of MOUs.
The Chairman: Thank you. That is our last training question. We just have two more and I’m going to direct these pretty much at you, Sylvia, if you’re happy with that.

Q615 The Earl of Onslow: Professor Harvey, in your opinion, is it in the viewer’s interest for the amount of television advertising to be increased, decreased or stay the same? The background to this is that Channel 4 told this committee that it has research that shows 65% of viewers oppose an increase in the advertising on commercial channels and 55% supported a decrease in the amount of advertising on non-public service broadcasting channels. What’s your view on that?
Professor Harvey: Well, generally speaking, if we look at the research conducted by Ofcom on the views of the users, of the public—both in relationship to non-PSB channels and PSB channels—I think it’s fair to say that people would certainly not want to see any more advertising. I’m referring to Ofcom’s review of television advertising, the stage 2 2008 document; there’s some wonderful bar charts. The percentage of people who say, “There’s already more than I am happy with”, that’s 41%. In addition, 37% say, “Present levels don’t bother me but I would not want any more”, and it seems to me to be fair to add those two together and that makes 78%.

Q616 The Earl of Onslow: So perhaps you would agree with the fact that they should all go down to, whatever it is, seven minutes rather than up to nine; the amount allowed?
Professor Harvey: Well, isn’t that a more specific point about what’s allowed in peak time?
The Chairman: It’s a broad harmonisation question.

Q617 The Earl of Onslow: I’m pretty certain—is it the average? I mean harmonisation downwards rather than harmonisation upwards, That hides my ignorance on the actual amount that it should be; I apologise.
Professor Harvey: I think the general feeling is that people would not want to see a lot more advertising. However, if it went up from eight minutes to nine minutes, maybe that wouldn’t be noticed.

Q618 Lord Dixon-Smith: Both satellite and cable channels gave evidence that the current disparity in permissible levels of advertising between public sector and non-public sector broadcasting channels should be retained, whereas ITV and commercial public sector broadcasters tend to disagree. Now, the question is: should this disparity be retained or not? It’s really a follow-on from the previous question, I suppose.
Professor Harvey: Difficult questions. Yes, if the PSBs are allowed to increase their advertising airtime that would arguably damage the non-PSBs. I think that’s what they argue, is it not?

Q619 Lord Dixon-Smith: I think we’re asking you whether you agree with that or not?
Professor Harvey: Well, there could be a beneficial kind of co-existence there but it would be better for the PSBs and better for PSBs’ audience for there not to be a whole lot more advertising time. So there’s no reason, from a viewer perspective, to be aggressively seeking to increase the PSB airtime, except for reasons of additional income.

Q620 Lord Dixon-Smith: Being devil’s advocate for a moment, presumably additional advertising time would imply additional revenue, which would imply perhaps additional programme quality, which might then, of course, come back to the fact that you might ultimately attract more viewers; or am I just being ridiculously idealistic?
Professor Harvey: I think that’s absolutely correct. That’s where, if I might say so, I think it’s a question of scale and that’s why I said before perhaps the difference between eight minutes and nine minutes
might not be so objectionable to audiences but it might make a significant difference to the levels of investment within original production. So there could be a good scenario there.

The Chairman: Thank you very much indeed, both of you, and especially for answering some of the questions slightly outside your comfort zone. That’s splendid, thank you very much indeed.

Memorandum by the Department for Culture, Media and Sport and the Department for Business, Innovation and Skills (RTA 4)

The following memorandum provides written evidence from the Department for Culture, Media and Sport (DCMS) and the Department for Business, Innovation and Skills (BIS) on the Government’s position with respect to the regulation of television advertising.

1. The television advertising market and how it should be regulated is the subject of much debate in the sector. The media sector as a whole is changing so dramatically, through new innovations and changing audience demands, that future trends are very difficult to predict.

2. This inquiry, therefore, offers a very timely and welcome opportunity to reflect on current regulation in the advertising market and to draw out the many and varied views about where change is required. The Government has been clear about the need to look at the market and determine where de-regulation would be appropriate. Our aim is to secure a strong UK broadcasting sector that not only provides high quality content for the UK public but is able to compete in a global content market.

3. This memorandum considers the current TV advertising market and then sets out the current regulation relating to television advertising.

TV Advertising Market

4. Recent figures released by Ofcom show that the TV advertising market in the UK was worth £3,136m in 2009, down by nearly 10% on 2008. This was against a backdrop of a shrinking UK advertising market—down by 12.5% on 2008. The main commercial Public Service Broadcasting channels felt the brunt of the TV market advertising decline with a 14% drop. This decline is likely to be a combination of cyclical and structural factors, the latter including the increased supply of advertising impacts from multichannel TV and their growth. Figures show that internet advertising has grown from £1.4 billion in 2005, to £3.5 billion by 2009.

5. Figures from Ofcom show that TV industry revenue rose from £9.2 billion in 2003 to £11.1 billion by 2009 while the number of channels increased from 295 to 490. In that period, the breakdown in the proportion of revenue from advertising, public funds and subscriptions changed with the 6% increase in the proportion of revenue generated by subscriptions being offset by a drop in the proportion of revenue generated from advertising. Despite the drop in advertising revenue, at 28% of total television revenue, income from advertising remains a crucial source of funding to commercial broadcasters.

6. Enders Analysis (EA) predict that the upturn in television Net Advertising Revenue (NAR) looks set to continue into Q4, resulting in full year-on-year growth of about 12.5%. EA say that the growth in 2010 has more than reversed the −11% fall during 2009, although it still leaves NAR in 2010 about −5% below 2007 levels and even further behind 2005 levels, which may never be matched again in real terms. EA are estimating no growth for 2011. As explained above, revenue from TV advertising remains a crucial source of funding, however, with advertising revenue having to stretch over more channels, broadcasters are having to examine their funding models. Indeed Adam Crozier recently launched a change of direction for ITV plc with a push into pay-TV with plans to launch high-definition versions of channels including ITV2, ITV3 and ITV4.

Regulation of Television Advertising

7. Television advertising in the UK is subject to regulation in its content, scheduling and sales arrangements. This helps to ensure a balance between protecting consumers, maintaining high quality programming and ensuring a competitive and healthy commercial broadcasting sector.
UK/European framework for advertising regulation

8. Under the Communications Act 2003 (CA), Ofcom has statutory responsibility for the regulation of broadcast advertising in the UK. The Act requires Ofcom to set, and from time to time review and revise, codes to secure the standards objectives for the content of television and radio services licensed under the Broadcasting Acts 1990 and 1996. This includes the international obligations the UK must comply with set out in EU Audio Visual Media Services Directive (AVMS).

Ofcom/ASA co-regulation

9. Ofcom has a co-regulatory partnership with the Advertising Standards Authority (ASA). Under this system, complaints about broadcast advertising are considered and determined by the ASA. The key exceptions to this partnership are political advertising, programme sponsorship/product placement and investigation of complaints in relation to “participation TV”, which remain with Ofcom given the strong links between sponsorship and programming and editorial issues.

10. Ofcom’s functions in respect of the setting, reviewing and revising of advertising standards codes are undertaken by the Broadcasting Committee of Advertising Practice (BCAP) in consultation with, and with the agreement of, Ofcom. The BCAP Code is designed to inform advertisers and broadcasters of the standards expected in the content and scheduling of broadcast advertisements and to protect consumers. One other significant piece of legislation that prohibits unfair advertising to consumers is the Consumer Protection from Unfair Trading Regulations 2008.

Recent introduction of content/scheduling restrictions

11. Further regulatory restrictions on the content and scheduling of specific categories of television advertising have been recently introduced to ensure appropriate levels of consumer protection have been maintained. As example, the rules on broadcast promotion of food were significantly strengthened in 2007 with the introduction of restrictions on the advertising of high fat, salt and sugar (HFSS) foods to children (this included a total ban on HFSS food advertising in and around all children’s programming, on dedicated children’s channels, and in programmes of particular appeal to children under the age of 16). The controls on broadcast alcohol advertising have also been tightened recently. In particular, the rules concerning appeal to young people, sexual content, and irresponsible or antisocial behaviour were strengthened in 2005.

Product placement

12. Section 319 of the CA requires Ofcom to draw up and, from time to time, revise a code for television and radio services, covering standards in programmes, sponsorship and fairness and privacy. Ofcom’s Broadcasting Code came into effect in July 2005. Previously, this Code has prohibited television broadcasters from showing programmes which contain product placement, other than in cinema films and in programmes acquired from outside the UK. This prohibition was based on the requirements of European legislation.

13. However, changes to EU law through the introduction of the Audio Visual Media Services Directive, and resulting amendments to UK legislation, now allow for the placing of references to products, services or trademarks in television programmes in return for payment. The Audiovisual Media Services (Product Placement) Regulations 2010 amends the CA to enable such product placement on television and to require Ofcom to set standards in respect of product placement. Subject to Ofcom’s consultation and if accepted, publication of the revised Code later this year, it will be possible for broadcasters to show programmes that contain product placement.

Financial impact of the introduction of Product Placement

14. Product placement has the potential to give programme makers and broadcasters an important new revenue stream. The Government’s 2009 consultation indicated that allowing product placement would most likely deliver economic benefits to broadcasters in the region of £25-30m p.a. once established. Although revenue from product placement is likely to be modest initially it has the potential to grow over time. For example Ofcom’s 2005 product placement consultation concluded that if the US experience were replicated in the UK, product placement revenues might reach £100 million per annum. Respondents to Ofcom’s consultation noted that this rule relaxation may lead to advertisers retaining or spending more of their advertising budget on television.
15. Ofcom’s previous assessment of competition issues suggested that, with the introduction of product placement, channels using more UK production would be able to capture a new source of revenues whereas channels importing foreign productions would not see much difference—as the product placement revenues relating to foreign productions are captured abroad.

16. Product placement will also provide a new source of revenue for domestic productions, this will lead to additional income for the providers of original content.

Regulation relating to Minutage of TV advertising

17. The CA allows Ofcom to include conditions in broadcast licenses which set the rules surrounding the scheduling of advertisements on television. The rules are set out in their Code and give effect to relevant provisions of the AVMS Directive.

18. PSB channels are subject to shorter advertising breaks per hour than non PSB channels. There is a debate about whether these conditions should be changed by Ofcom, subject to the AVMS Directive.

19. There are also rules about the number of permitted internal breaks in programmes. Again these apply differently to public service channels than they do to other channels. Additionally, other rules relate to live programme feeds, and subject matter such as schools programmes, royal ceremonies, Parliamentary proceedings, films and news broadcasts.

20. Finally, there are rules relating to the sale of airtime which Ofcom consulted on, and subsequently removed from 1 September. There were two distinct rules relating to how broadcasters sell TV airtime. The “withholding rule” meant that all airtime available on ITV1, C4 and Five must be sold. The “conditional selling rule” applied to all broadcasters and prohibited them from forcing advertisers and media buyers who wanted to buy airtime on one channel to purchase airtime on additional channels. Ofcom hopes that the removal of these two rules will have a positive impact on innovation and investment, with benefits for consumers.

Competition regulation—merger remedies

21. This inquiry has called for evidence specifically in relation to the Contract Rights Renewal (CRR) undertakings. The CRR undertakings are part of a remedy imposed under merger control law to address specific anti-competitive effects that arose as a result of the merger between Carlton Communications plc and Granada plc to form ITV plc. The remedy applies specifically to ITV rather than being a feature of the regime of regulation applicable to TV advertising more generally. These undertakings were designed to benefit the market as a whole.

22. Questions as to whether the CRR undertakings remain necessary or should be amended or released have been examined in detail in the formal review of those undertakings carried out initially by the Office of Fair Trading (OFT) in partnership with Ofcom and subsequently, in greater detail, by the Competition Commission (CC). The CC’s Final Report of this review, published on 12 May 2010, considers in depth whether developments in the market since the undertakings were provided mean they are no longer required. It assesses the merits of ITV’s arguments as to possible alternative remedies and amendments to the CRR undertakings.

23. The Government notes the CC’s recognition that the scope of its review was limited to the ongoing need for the CRR undertakings within the current TV advertising market. Paragraph 9.8 of the CC’s report says that this did not enable it to address the ways the market as a whole trades television airtime despite identifying certain concerns about this, and states “we continue to believe it appropriate for there to be a wider review of the market for selling television airtime”.

24. In its evidence to the CC review, Ofcom set out its reasons for not believing a market investigation was appropriate at that time suggesting it was more appropriate to proceed with the review of the CRR remedy and Ofcom’s work to update the television advertising sales rules. They said, “We have examined a number of indicators of competition—market shares, pricing metrics, profitability, barriers to entry and expansion, buyer power and substitutability. Overall they support the proposition that ITV’s market position has weakened since 2003. There is a strong case to suggest that there have been sufficient changes in ITV market position which means that the status quo is no longer appropriate”.

25. Ofcom pointed to the market facing a period of potential upheaval and a lack of clarity about what problems might be likely to persist and what remedies might be appropriate. On 28 July, in a press release Ofcom announced its plan to remove certain television advertising rules and launch a consultation on options for amending ITV’s networking arrangements. The Press Release also said that Ofcom considered that a wider market study was not justified at this time.
26. The Government recognises that the media market has changed since the CRR Undertakings were set in 2003; some parts of the sector argue that they deflate the whole market and should be changed or reviewed. The Government has some sympathy with the concerns underlying this view although it is worth noting that the other commercial broadcasters and advertisers are against the lifting or alteration of the Undertakings. ITV have 44.7% of the advertising market, so any increase in the cost of advertising due to the lifting or lessening of the restrictions is likely to mean that their dominance in the market could mean less advertising revenue for other commercial broadcasters.

27. It has been suggested that responsibility for taking final decision on future enforcement of the CRR undertakings might be transferred from the CC to the Secretary of State for Business. Whilst the Government is keen to avoid ruling anything out we also note the practical difficulties included and the importance of maintaining the integrity of the wider competition regime operated by independent bodies applying competition based tests. There would therefore need to be a strong case to justify the amendment of the applicable law and give powers back to Ministers in this way.

28. The Government is committed to a wider review of media regulation during this parliament. In that context, the Government looks forward to hearing the committee’s views on this complex issue.

MEETING THE PUBLIC INTEREST

29. It is the Government’s aim to produce and maintain a regulatory framework to secure the interests of the public. It is essential to ensure that this system is free from unnecessary burdens, allowing broadcasters to be able to flourish and invest in good quality and varied programming, whilst maintaining plurality. Our broadcasters must also be able to compete globally and as part of the rapidly shifting media market, which has seen internet advertising revenue grow substantially.

30. Much of the regulatory system that affects broadcast advertising has been in place for some time. The Government has made it clear it plans to review the regulatory framework for media over the life of this Parliament. As part of that we intend to look afresh at the issues so we are not closed to any suggestions for changes to the legislative framework which will allow broadcasters to continue to meet public expectations and produce strong programming in the future, whilst protecting the interests of the advertising houses as necessary. The market is complex. Changing the rules in one area has knock-on effects elsewhere and so there is a need to look holistically at the issue. We therefore look forward to considering any recommendations from this Inquiry in our future policy developments.

22 September 2010

Examination of Witnesses

Witnesses: Ed Vaizey MP, Minister for Culture, Communication and Creative Industries, Department for Business, Innovation and Skills and Culture, Media and Sport and Edward Davey MP, Minister for Employment Relations, Consumer and Postal Affairs, Department for Business, Innovation and Skills

Q621 The Chairman: Good afternoon, we’re delighted to see you. We’ve had a few weeks on this and you’re, in a sense, the final course of our inquiry, subject to a little bit of further evidence next week. So we’ve delved into the innards of the topic quite a lot and what is interesting is, of course, that this concerns both your departments. It’s rather unusually for a single policy matter like this to see it split between the two of you. We’ve no doubt that you’ll be singing in harmony today. The only confusing thing is that we have two Ministers called Ed—

The Earl of Onslow: Sorry, can you move to the right?

The Chairman: Sorry, Ed, could you move—

Ed Vaizey: Earl Onslow, I moved here because I couldn’t see Lord Clement-Jones.

The Earl of Onslow: And I can’t see you because you’re—

Ed Vaizey: Yes, but if I move there I can’t see Lord Clement-Jones.

The Earl of Onslow: I don’t mean to be difficult; it’s nothing personal, I promise you. If you sit there we can see you.

Ed Vaizey: I might just move between both seats because it’s—

The Chairman: Earl Onslow wants to look at your full profile.

Ed Vaizey: Yes, but I can’t see you, Lord Clement-Jones.

The Chairman: I was just going to say that rather than direct individual questions at you, because we have two Ministers called Ed, the easiest thing is to throw out the question and then see which of you wishes to answer it. That’s probably the least confusing way of dealing with it.
Ed Vaizey: Okay.
The Chairman: Great. So can we just start off, for the record, in having both of you introduce yourselves?
Ed Vaizey: My name is Ed Vaizey and I’m a Minister in both BIS and DCMS. I’m often confused with my colleague Ed Davey. This has some advantages in that last week I was delivered a bottle of champagne that I still haven’t given to Ed Davey. My responsibility is culture, communications and the creative industries and it’s the communications part that takes me into BIS and that’s dealing with issues like mobile phone spectrum. But the DCMS Secretary of State tends to take a lead on communications issues and that would include, for example, broadcasting policy such as the recent licence fee negotiation, as well as broadband policy.
The Chairman: Thank you, Ed?
Edward Davey: I’m Edward Davey, not Ed Vaizey. I just don’t tell Ed Vaizey when I get sent things by accident. I’m a Minister in BIS solely and I’m responsible for employment relations, postal affairs, consumer affairs but also competition policy, which is why I think you’ve invited me here today.

Q622 The Chairman: Great, thank you very much. So we’ll kick off and we’re just going around the table in the usual fashion. Of course you gave joint BIS/DCMS evidence. You say in your evidence that the media market has changed since the CRR undertakings were introduced. What particular changes do you think are relevant to advertising regulation? Why do you now feel that CRR might deflate the whole market?
Ed Vaizey: Well, we’re keeping an open mind on CRR because obviously we’ve had the Competition Commission report, which was very extensive and published only in May, which in the scheme of these things is actually quite recent. Obviously, in terms of factual changes since 2003, the biggest driver for change has been digital switchover and the increased use of the internet. That means, obviously, in terms of digital switchover, people have more access to many more channels than they would have done previously—I think the number of channels has broadly doubled—and in terms of the internet, clearly, advertisers have access to effectively a new medium in which to communicate with their customers.

What I would say on both those points is that ITV, across its digital channels, has maintained a relatively robust market share. Obviously, as you’ve discussed with a number of your witnesses, the key issue in the Competition Commission report was, in terms of internet advertising, whether it was effectively cannibalising television advertising. The Competition Commission took quite a robust view that it wasn’t in the sense that the growth in internet advertising has mainly been in classified advertising as opposed to, say, brand and product advertising.

But if you were to say how the change has developed in the last seven years, I would say it was the explosion in the availability of channels and obviously the growth of the internet—not just in terms of advertising; it’s probably worth adding, in terms of face time for consumers. More and more consumers, as Ofcom reports are showing, spend more of their time online than they do watching television.

Q623 The Chairman: But there’s no settled view as to what particular impact CRR is having on the market?
Ed Vaizey: There is no settled view. I’ve read the evidence that ITV gave with interest. Obviously in the Competition Commission report the specific figures that ITV put in front of the Competition Commission are redacted and I’m not privy to any confidential information that ITV have given. Their evidence seemed to indicate, if I could take a broad view, that they estimate that CRR is costing them £30 million to 40 million a year but they’ve never given me an estimate. Obviously, in terms of the impact on advertising for ITV, I think there would probably be a general consensus that the main impact has been because of the recession and it’s pleasing to note that ITV advertising revenue is now back to about 5% below what it was in 2007. So it hasn’t quite fully recovered but it is certainly back to growth.

Q624 The Earl of Onslow: Ministers, I have difficulty because I’ve only come back to this committee after a certain period of absence. I, myself, have considerable difficulty understanding what CRR is and how it works. I have even further difficulty in understanding how the actual advertising market works, which strikes me to be incestuous and byzantine at a minimum level. The first part of it is: do you both have greater understanding than I have or is yours a little bit higher but you think you understand the whole of the question?

Ed Vaizey: I wouldn’t say that I would have technical understanding such that if I left this room and left politics this afternoon I could be chief executive of a media buyer tomorrow morning. I understand the broad principles behind CRR in terms of the fact that the undertakings were put in place to maintain, effectively, the contracts that were in place with media-buying agencies at the time of the merger between Carlton and Granada in terms of maintaining a share of revenue but also complicated mechanisms to allow advertisers to adjust their spending, depending on audience figures, which is why ITV obviously gave you evidence that they were chasing the lowest common denominator in terms of getting maximum audiences.
I think it’s a very fair point that the market does seem byzantine and complex. It does remind one of the Schleswig-Holstein question in which one is mad and which one is dead is open to conjecture in terms of who understands the answer. But it does also appear that those who do work in that market, broadly speaking, feel that they do have a fair understanding of how the market works. Therefore, in a sense, one should perhaps be encouraged that the experts do know their way around the system and that, therefore, the fact that neither myself nor, I hesitate to suggest, Lord Onslow has a perfect understanding of the market is not necessarily a barrier to taking part in that debate.

Q625 The Earl of Onslow: It just strikes me that, in the media market itself, the media companies in effect are the regulator. I think that’s one of the interesting things. Thank you for your answer because it was a very good one. What is the public interest that CRR seeks to protect? Would you agree it prioritises the interests of advertisers over the interests of viewers and would you not prefer the term “the public interest test” to include the interests of viewers?
Ed Vaizey: Well, obviously CRR is there to protect in theory and in practice, perhaps. The reasons CRR came about was to protect mainly both advertisers and competitors, commercial competitors, to ITV at the time of the merger. It was felt in 2003 that the merger of Carlton and Granada would create a dominant player that could effectively dominate the advertising broadcast market and, therefore, CRR was put in place, in practice, to protect advertisers from—I hesitate to use emotive phrases like “being held to ransom”, I’m sure ITV would never do that—basically being beholden to a dominant player.

Proponents of CRR would argue that, in a sense, that protects consumers because it avoids higher advertising charges and, therefore, those costs being passed on to consumers. I would certainly agree with you, Lord Onslow, that the interests of consumers are important in this debate. But people who come before you to give evidence might argue that there is little evidence that CRR is acting to the detriment of consumers.

Q626 The Earl of Onslow: We’ve had evidence; some people said it is frightfully good, some people said it isn’t frightfully good and the evidence has been all over the place. That is how we see it anyway.
Ed Vaizey: I think that’s one of the interesting things. Both being a legislator or a Minister in terms of looking at this debate, it’s very hard to get a clear view. Having read the evidence given to your Select Committee and obviously having had meetings with the players, I think that there tends to be a consensus that CRR is liveable with. My own view is, on a matter of principle, I think that it is good where possible to deregulate and it is certainly good where possible to get rid of byzantine and incestuous rules.

But I think now, from my ministerial position, one also has to look in the round as to where CRR fits into this landscape and also in terms of how that leads on to policy making; make sure that the CRR debate is not seen in isolation to the wider policy issues that we want to address in a Communications Act that we hope we will start to begin to consult on next year.

Q627 The Chairman: Can I just follow that up, because something the DCMS Secretary of State, Jeremy Hunt, said really follows on from that. He suggested that some of the regulations affecting ITV are out-dated, very much your point. In particular CRR; he was more specific. He said he would like to find a way of relaxing some of those regulations; as, indeed, of course, we may recommend ourselves. Has the Government had any thoughts on how such relaxation might be achieved or what different mechanisms might now be appropriate?

Ed Vaizey: I’d like Ed Davey perhaps to comment after I’ve answered because I think the important thing from our perspective—and the Select Committee is quite right to have both myself and Mr Davey give evidence because, in effect, you force us to be joined up, if you like—is that it is one of those areas where you have to be joined up because, as a Minister responsible for broadcasting policy who wants to see a deregulated broadcasting sector, I would like to be able, as it were, to take a decision on CRR, whether it remains or not. There are obviously conflicting views about whether CRR could and should remain.

But I have to be mindful—and I think this is a very, very important point to get across—about the law of unintended consequences. So if I, as a Broadcasting Minister say, “I would like to wave a magic wand; I would like to have CRR on the table; I’d like to have a submission from my officials, A or B, take a decision, tick the box, get rid of it”, I could inadvertently, in pushing for that, completely upend competition policy. I think it’s pretty clear that Parliament took a decision to transfer competition policy to the regulators and we would have to have a pretty robust case to seek to take competition policy back to, in this case, the Secretary of State for Business. That’s why, in answer to my earlier question to Lord Onslow, I think it’s important that we debate the future of CRR in the round in terms of the other policy issues we need to look at for a forthcoming Communications Act. I don’t know, Ed, whether you want to—

Edward Davey: I think you’ve expressed it in the way I would have expected because there is this issue of, you deregulate here, whether you hit against competition policy issues. To give an analogy: I’m taking the Postal Services Bill through the House of Commons as the moment and it will come to your
Lordships’ House in the new year. The pressures to try to deregulate there are great from some parts in the industry but there is a danger that if you deregulate too much you will allow the universal service provider—in this case Royal Mail—that has a monopoly power in part of the market, to undermine competition.

I give that analogy because, while clearly it’s a Government that wants to deregulate—we are keen to look for deregulation in all markets—we have to make sure that in deregulating we would not undermine competition. Therefore, that is the approach that BIS takes to this. We want to make sure that our competition regime is robust. I am leading a review of our competition regime and the objective of that is to make it even more robust. We do have a world-class competition regime in this country.

I pay tribute to the previous Government and in the 2002 Enterprise Act they did improve the competition regime. It has come under some criticism—I would say in overall terms relatively mild criticism—but certainly it can be improved and we’re looking to do that, particularly in terms of speed and efficiency of the regime. But we will not want to take ministerial control back. I think ever since the Tebbit Doctrine in 1984 successive Ministers and successive Governments have wanted to make sure that decisions—be they related to mergers or analysis of a particular company’s monopoly power—were taken; not in a capricious way but in a very clear way with competition grounds being first and foremost and, since the 2002 Act, by independent bodies. We want to very much uphold that regime.

**The Chairman:** This is slightly anachronistic in a sense because this goes back to an earlier era where competition policy was rather different. One of the arguments that we’ve had before us as a Committee on the CRR was really directed towards a more limited form of public interest than was necessary or desirable. It should have been more broadly put. If you are looking at what the overall public interest was this is more—“What is in the competitive interest of advertisers and others?” This isn’t necessarily, “What is in the public interest in terms of public service broadcasting?”

**Q628 Lord Razzall:** Chairman, if I could just follow up on that. That is one of the problems we have as a Committee because we have had the regulators in front of us who have made it entirely clear that they only have the power to look at this issue in terms of strict competition law. Now, there are a number of issues that we’ll tease out a bit later, which go way beyond strict competition policy, and we’re struggling as a Committee to find a way that we can meld how to get those issues resolved—which we can come on to in a moment—with the view that the regulators are taking, which is, “Oh, we only looked at the competition issues”. Despite serious handbagging, indeed sandbagging, from Lord Bragg they maintained that position throughout their evidence; which is very difficult because we’re trying to look some wider issues.

**The Chairman:** So you could say that there were advantages in the old regime where public interest was more broadly defined.

**Edward Davey:** Let me respond to that. Obviously we’re very keen to receive your report and read it and I think we will want to pay attention to your recommendations and digest them, sandbags or no sandbags.

**Lord Razzall:** Well, it will be handbags and sandbags.

**Edward Davey:** But I do want to defend the competition regime. The reason I took it back to Lord Tebbit was, prior to the Tebbit Doctrine, public interest issues, in a very broad sense, were taken into account. But, then through the Tebbit Doctrine and thereafter—which I think includes the period when of course the CRR undertakings were required—competition policy has focused in on competition.

I think that’s right and I think the Competition Commission looked at this—you might consider it a narrow remit—in great depth. One thing that strikes you when you read the report is not that this was a cursory attempt to look at these markets. It was extremely thorough, extremely professional job and they, as in all markets, have had to consider not just the particular company that has some undertakings as a result of a previous merger, but they’ve had to look at the interests of the wider group, the consumers, the competitors of, in this case, ITV and the other players in the market, the media buyers. So I think it’s important when one is thinking about this area to make sure that, for all the people who are involved in a particular market and particularly the consumers, their interests are considered.

**The Chairman:** But there is a big query in this case as to whether or not that viewer/consumer was sufficiently taken into account. But let’s move.

**Q629 Baroness Fookes:** Ministers, you will know that there’s been a large drop in the amount spent on producing original programmes. ITV suggests that although part is due to the recession, part of it is due to the operation of CRR. They, therefore, suggest that if that were removed, they would spend more on programming. Now, do you accept that analysis?

**Ed Vaizey:** I would hesitate to say that I would accept that analysis. I would say that it’s a valid point for ITV to make on the basis that CRR, to a certain extent, is constructed in such a way that, because it allows advertisers to reduce their spend if audience share declines, it encourages maximum audience share. But, as I say, I think that as a Minister one has to take on board the Competition Commission’s very extensive report. I think one has to accept that that
report, although one may say it's narrowly drafted in legal and technical terms, a lot of ITV’s arguments were put forward and the fundamental argument with CRR is about competition in advertising. What the Competition Commission effectively rejected was the fact that the internet was a direct competitor or that there was another ITV out there that would allow advertisers to get the huge impact with audience figures that they get through ITV. So I think that’s where ITV’s problem came.

I'm not a broadcaster—there is a broadcaster on your Select Committee—but I would have thought that a company like ITV should be able to provide a range of different programming: programming that gets huge audiences but also programming that reinforces the brand. I think you can also, in terms of quality, have something that fits both bills. Those of us who obviously watch Downton Abbey would say, “There’s a high quality programme that managed to achieve mass audiences”.

Q630 Lord Razzall: But, of course, Downton Abbey was being shown at the same time as the Chairman of ITV and the Chief Executive of ITV sat where you’re sitting and told us that CRR forced them to dumb down.

Ed Vaizey: Yes.

Lord Razzall: Then Sunday, we watched Downton Abbey.

Ed Vaizey: Yes, and then they sent us all DVDs to reinforce the point.

Lord Razzall: You too?

Ed Vaizey: Absolutely. It’s under £140.

Q631 Baroness Fookes: But as you’re looking broadly at communications in terms of the new Act, would you consider the possibility that ITV might be asked to give more undertakings with regard to good programming, either as an exchange for a lessened or expulsion of CRR, or not?

Ed Vaizey: Well, we haven’t even really begun to even scope out how, in future communications, that would look but, in terms of my own view, the direction of travel, as I say, is to deregulate the media and broadcasters. I think that we are moving away from a period where Ministers and Parliament wanted to effectively direct a broadcaster into the types of programmes they should make. I think, personally speaking, that’s not a road I want to go down.

Q632 Baroness Fookes: But there is difference, isn’t there, between directing what they should make and asking that they spend a certain amount, which is not directing them but simply saying, “You should be spending X”?

Ed Vaizey: Yes. Well, we can all ask broadcasters to do things we want them to do and I’ve been asking Sky to invest in British film for the last six weeks and they’ve resolutely ignored me. So I think if one wanted them to make the programmes you want them to make you’d have to legislate for it.

Q633 The Chairman: So we know what we need in the next Ofcom Bill, basically.

Ed Vaizey: Yes, you’ve just given me an idea. Maybe I should put it in the next Communications Act.

Q634 Baroness Fookes: This is why I’m asking these broader questions. You say you’ve got a new Act coming along and perhaps wider thinking might be appropriate.

Ed Vaizey: Yes, wider thinking will be appropriate. What I was saying, Lady Fookes, is that my own perspective is a deregulatory perspective. So I think there will absolutely be that debate when we consult on the forthcoming Bill and there will almost certainly be that debate when it reaches Parliament about what obligations may or may not be put on broadcasters.

Q635 Baroness Fookes: So would you see a role for Ofcom?

Ed Vaizey: Yes. Ofcom already has a role in terms of policing content, if I can use that phrase; in terms of broadcast standards. I would see that role continuing.

Q636 The Earl of Onslow: Arising out of what you’re saying about deregulation, my instincts are exactly the same as yours on that. If you have a strong competition authority surely, if it sees ITV being monopolistic, it can deal with that itself—the anti-monopolistic thing can be dealt with by a competition authority—and, therefore, the CRR may not be necessary because it can be dealt with by another—in other words, if bad behaviour is seen it can be clobbered.

Edward Davey: Well, there’s a distinction, of course, between ex-ante competition regulation and ex-post regulation. If you deregulated in a market where a particular player clearly has monopoly powers, as has been found—I don’t even think that’s a matter for debate, given the strong findings of the Competition Commission—it would be quite difficult to deal with the potential problems of that monopoly power by ex-post regulation. So I think if you want competition in this market, if you read the Commission’s report, I think the case for ex-ante regulation—in this case the CRR undertakings—is there and that I think is what the Competition Commission is saying.

Q637 The Chairman: It’s partly a question of whether the market has changed and what the market is. We’ve had rather different evidence about what exactly is it that ITV has that people want to buy, so
to speak: is it the fast build, which is a very small part
of the market, or is it that much broader market
which the Competition Commission think that ITV
effectively has a monopoly on? So I think there’s a
differing view, in a sense, as to exactly what market
we’re talking about.

Ed Vaizey: Hopefully I’m still staying on the same
page as my ministerial colleague but, from the
perspective of media policy, I think there would be
concerns about the speed with which inquiries are
undertaken. That is literally almost a physical issue
in terms of how many people are available to undertake
a particular review. I think the OFT, when they gave
evidence to you, were pretty clear that basically
everybody was busy, which is why it took them a year
to even begin the consultation. But also whether
Ofcom in the future might have a greater role in terms
of media competition decisions is something, I think,
worth examining.

Q638 Lord Razzall: We have a number of problems
but one of them comes from ITV’s own submission.
Boiling it down, what they want us to do is
recommend the removal of CRR because they say if
we remove CRR they will invest more in original
programming—I think we’re now calling it
innovative programming—and that’s what they
want. Now, our problem here is that unless some
conditions or undertakings are imposed there would
be nothing to stop ITV simply spending it on paying
a dividend to their shareholders—they haven’t had a
dividend for a while—increased salaries, increased
bonuses, the whole range of alternatives. So we’re
trying to find a way under which, were we to
recommend CRR, we could impose some obligations
or recommend certain obligations to be imposed on
ITV to spend the money in the way they say they
want to.

Now, the evidence we’ve had is pretty consistent that
if CRR was removed, the price of advertising would
go up and ITV’s revenues would go up. I don’t think
we’ve had anybody—yes, the fellow from Enders said
he thought it would be marginal but I think everybody
else has said that they think that would increase ITV’s
revenues. Baroness Fookes has suggested one sort of
undertaking.

Other ideas have been put to us: that, were we to
recommend that, ITV should undertake to establish
an investment fund of a quantified amount that would
be spent on innovative programming and also
training; of course that’s the other thing that ITV has
rather abandoned in recent years. Do you think that
would be a runner and could that be monitored by
Ofcom, were that to be established? You see, ITV
could well give undertakings to this effect.

Ed Vaizey: I think there are two points I’d make
there. Again, part of the problem with the whole
outcome of the Competition Commission review and
indeed the evidence that ITV has given you is that
ITV has put forward different arguments at different
times about CRR.

Lord Razzall: Yes, quite.

The Chairman: With different management.

Ed Vaizey: Exactly. To come up with this new
proposal in terms of alternative undertakings at this
stage is slightly difficult. Let me reiterate that from a
purely policy point of view I think one would like to
live in a world, broadly speaking, without CRR
because it is highly complicated and byzantine and if
you want to deregulate and let broadcasters get on
with the job of doing what they want to do, just have
commercial arrangements with advertisers and
selling programme airtime, let them get on with it.

But we are where we are. The undertakings were
given. They are now part of the competition regime.
The Competition Commission has opined.

The second point I would make is when I hear that
proposal I think, “Out of the frying pan into the fire”.
You’ve come to the table saying we’ve got complex
rules that we’d like to get rid of in order to be freer to
behave as a broadcaster should but, in return, we’ll
hand over the additional revenue effectively to
politicians to tell them what programmes to make.

Q639 Lord Razzall: Well, only the amount. Only the
amount, not the content. Just the amount.

Ed Vaizey: Yes, but you can imagine what
bureaucracy might transpire if Ofcom had to monitor
whether ITV was making the appropriate
programmes.

Lord Razzall: Honouring their undertaking or not.

Ed Vaizey: It would be incredibly difficult to—
Edward Davey: If I may; creating some fund isn’t
taking into account the interests of everyone in this
market. You’ve got to take account, I think, as a
competition authority and as a Government, of all
the players in this market and you can’t simply say,
“Well, we’re going to allow one particular
organisation to use its monopoly powers to create
some fund that we, the politicians, think is a good
idea. By the way, that’s at the expense of all these
other players”. I wouldn’t expect the Competition
Commission, or any of the other competition
authorities who obviously have the locus here, to
come to that sort of—

Q640 The Chairman: That’s an interesting
perspective. So you’re saying it would have to be a
kind of contestable fund or something if you were
going to—

Edward Davey: I wasn’t saying that, that’s your
conclusion.

The Chairman: But—surprise, surprise—the other
TV companies are not in favour of the removal of
CRR.
Ed Vaizey: Yes, nor are the advertisers.

Q641 Lord Dixon-Smith: My heart lifted when I got to these questions because at last we have a question you can answer yes or no. But there are supplementaries, which of course immediately throw that statement into confusion. The question is: in general do you think that CRR has outlived its usefulness? That’s the yes or no bit. But we go on, of course: would it be possible to relax CRR without removing it? That’s the first thing. Might there be other options?

Ed Vaizey: Well, CRR was, in theory, relaxed or altered by the Competition Commission by its extension to ITV HD. I can’t give you a yes or no answer because as a politician I’m programmed not to. So I would say instead that contracts rights renewal does seem to be approaching the end of its sell by date but not quite yet; or rather we can live it for the time being.

Q642 Lord Bragg: I have been allocated a very simple question. What legislation would be required to remove CRR and do you think it’s possible to do it?

Ed Vaizey: Well, there’s a debate going on, as it were, between the Department and ITV about whether or not you could use the Interpretation Act to give CRR back to the Secretary of State. There is a dispute over that and Lord Davies, when he was a Minister, debated it with Lady Bonham-Carter and then wrote her a letter.

The Chairman: We have that.

Ed Vaizey: You have that letter, good. So that explains the detail of that. It also is important, even if, say, it was a clear argument that that could be done—not only the principle of whether or not, even if you do it, you are undermining the competition regime if you do it—because you are carving out one specific sector. But the second question is whether or not it in practice gets ITV to a better place, given that some kind of assessment would have to be undertaken. It couldn’t necessarily be removed on a whim of the Secretary of State. He would still have to consult and carry out research and all of that would be eminently litigable and traditionally reviewable. Those are the issues. As I say, I think that the most positive way forward is to put CRR within a wider context of looking at media policy in the round, as we start to frame a new Communications Act.

Q643 The Chairman: Is there a slightly different perspective from the competition point of view at all then?

Edward Davey: Not at all. It seems to me that if you were to try to take the suggestion that ITV have come up with, first of all you would have to ask yourself whether you did that, the Secretary of State, doing the sort of research the Competition Commission has done, would come up with another answer. I think it would be quite difficult to understand. I haven’t heard and seen evidence that would suggest that the Secretary of State, doing the sort of review that the Competition Commission has done, would come up with a different answer because the Secretary of State could not act capriciously; they would have to go through a process. So I question whether it would result in anything different.

But I think, more significantly, what sort of precedent would it set for the way we value our competition regime and the legislation that stands behind that and that creates it? You would use the 1978 Act in a rather odd way to decide that, because you didn’t like a particular decision of the Competition Commission, you were going to bring it back to the Secretary of State. There are a number of very important Competition Commission decisions that have affected very large businesses in a major way. The classic illustration of this is on BAA when the Competition Commission required it to sell off some of its airports. Would we then have a lot of lobbying pressure from BAA saying, “Let’s change the legislation, so that we can carve out BAA in airports; they don’t fit into the competition regime”? I think that’s quite a—

Q644 The Chairman: It is interesting you say that. There is a slightly different emphasis in that case between the two of you, because it sounds as though you are saying that even a new Communications Act wouldn’t be the way to do this and that you still have to stay within the competition regime. You still have to have another review, if you like, before you can do anything with CRR at all.

Edward Davey: I don’t think there is anything that is different between us, Chairman. I am not privy to the initial thinking on the Communications Act.

Ed Vaizey: Nor am I.

The Chairman: How very convenient.

Edward Davey: I can’t quite see how we can say that it is going to collide with a competition regime. But the competition regime, in the way it has been developed by successive Governments, is there to make sure that there is stability and predictability and not capriciousness. I think that is a very important part for investors, for private business, to understand that decisions on competition will be taken in a measured way with a proper process.

Q645 Lord Razzall: I think what the Chairman is saying—I must say that’s what I thought that you were both saying—was that even if it was decided by you in government that the Competition Act should deal with the issue of CRR in one form or another, that would still leave the requirement that the competition authorities still had to look at it.
The Chairman: We have a new Communications Act, do you mean?

Lord Razzall: Yes. I understood you to say that.

Ed Vaizey: Where I think Mr Davey and myself are at one is that we think that to, as it were, bring in a statutory instrument to take out CRR—effectively on a whim, if you like—as one part of the competition regime, as against all others, would be wrong. To take the BAA analogy, as it were, and not to get too tortured, if Parliament decided to have an Airports Act and decided, as a matter of policy, that the Secretary of State would be responsible for deciding whether airports were sold or not, that would be Parliament’s decision.

As for saying a Communications Bill, I was obviously being facetious when I said I didn’t know what was being discussed, but we are at the two or three-page scoping document stage. When we start to look at this in depth, given that 2011 will be a very open process in terms of people giving their views before having any kind of formal consultation, I have no doubt in my mind that people will want to discuss the competition regime as it applies to the media. I will want to ensure that my colleague Mr Davey is fully informed of the representations that both DCMS and BIS receive and there will have to be policy discussions about whether wrapping up a reform of CRR within a piece of primary legislation would or would not be appropriate.

Q647 Lord Stevenson of Balmacara: We are slightly tramping over this stuff in some detail here, but I am still on this general question about whether or not you have a predisposition one way or the other to allow a transfer between competition authorities and Secretary of State—BIS, presumably—on this particular narrow point?

Edward Davey: We don’t.

Ed Vaizey: No, we don’t.

Edward Davey: We are as one on that.

Q648 Lord Stevenson of Balmacara: You are as one. Well, I absolutely accept that and that you are also saying that you have not ruled anything in or out at this stage, in terms of whether it still can be discussed?

Ed Vaizey: No. What I am saying is that if the current regime stays exactly as it is, we would not support taking CRR out of the current competition regime and handing it to the Secretary of State. There will be a debate on communications policy leading up to a Communications Act 2013, more likely 2014, in which CRR and competition may form part of that debate. But I am not prejudging the outcome of that debate.

Q649 Lord Stevenson of Balmacara: I think I am with you. But in paragraph 27 of the note that your departments have jointly submitted to us for our consideration, you say, “The Government is keen to avoid ruling anything out”. I just play that back to you as it says. But then it goes on to say, “We also note the practical difficulties included”. We talked a lot about the sorts of issues and I understand these are more theoretical than real, but what are the practical difficulties? Could we have an answer to that, please?

Ed Vaizey: The practical difficulties—and, again, my colleague Mr Davey may want to come in on this point—are exactly what it says in this note, “included”, which is whether or not it is legal to do it. ITV has an opinion and the BIS legal team has a different opinion in terms of what Parliament’s intention was when it transferred those undertakings to the competition regime and that leads onto the point about maintaining the wider integrity of the competition regime. Again, in terms of practical difficulties, as Lord Davies’s letter to Lady Bonham-Carter spells out in great detail, even if it were possible to do it and take it back to the Secretary of State, there is a debate in Lord Davies’s letter about whether using the Interpretation Act simply takes it out of the competition regime but leaves it somewhat in limbo. So it is a highly technical and complicated area where there is a dispute on whether it is possible to go down the road that ITV is suggesting.

Q650 Lord Stevenson of Balmacara: I suppose the word is “practical”. It is not practical. It’s just trying to work out what the various regulatory and legislative hurdles might be if you were minded to do that.

Ed Vaizey: Practical can also go to the fact that I alluded to earlier, which is that, even if you were able to hand it back to the Secretary of State to consider, the practical difficulties might be, first of all, whether
or not other parties who were interested in CRR might take issue with that and litigate it and also the process the Secretary of State himself would have to go through in terms of reaching a decision on CRR.

Q651 Lord Stevenson of Balmacara: So it is not a Yes Minister cover up. It is a genuine assessment of the fact that there are real and present risks of any process that the Government might wish to take because it might lead you into areas—

Ed Vaizey: I think what is important, again, is having the opportunity to look at CRR in the wider context of competition. So you take it from the Broadcasting Minister’s perspective, which is, “One would like to deregulate; these are complicated rules”, to the fact that Parliament took a decision about how competition issues were to be dealt with and whether the issue was so important and so pressing that you would seek to do something that could fundamentally undermine the integrity of a competition regime. I think those are extremely powerful arguments.

Lord Stevenson of Balmacara: I think we would probably agree with that.

Q652 The Lord Bishop of Liverpool: Ministers, why do you think in the last two years there has been no formal complaint lodged with the CRR adjudicator by the advertisers against ITV? Do you have any view on that?

Ed Vaizey: No I don’t. I wasn’t expecting the question. One of the points I wanted to make was that, as far as I’m aware, I don’t think ITV has tried to renegotiate particular contracts. As you know, that would have to be done on fair and reasonable terms and the adjudicator would have to come into play, so that may be the reason.

Q653 Lord Stevenson of Balmacara: Can I follow up Lord Onslow’s point about how obscure and lacking in transparency the whole system seems to be? You talk about regulation being important to ensure competition. Have you reflected on the fact that, since the introduction of CRR, the share of the market by four media buyers has increased from about 50% to 75%? We have had evidence from the Competition Commission, in their review, did have some concerns about the opaqueness of the market and the workings of this market, the wider advertising market, and they reiterated their call for transparency the whole system seems to be? You obviously can’t answer for them whether they misunderstood it, I quite agree, because it is very byzantine. I think all of the Committee, to a certain extent, have sympathy with this view.

Edward Davey: I don’t know whether the Competition Commission backed off or not and I obviously can’t answer for them whether they thought this was a difficult issue or not. You, no doubt, will come to a judgement, reading their evidence, seeing their written submissions and taking into account what others have said. But I do note that the Competition Commission, in their review, did have some concerns about the opaqueness of the market and the workings of this market, the wider advertising market, and they reiterated their call for review as they had made in the 2003 inquiry.

The Chairman: The one thing that had struck us all the way through is that it is a very arcane market in many different ways.
channels are allowed seven minutes per hour and the others nine minutes per hour. There is pressure for this to be harmonised, but there is no agreement as to whether it should go up to nine or down to seven. I wondered what your views were about harmonisation and if you think they should be harmonised, up or down.

Ed Vaizey: I think it is a very important question, Lady Deech, and I would, first of all, take refuge in the fact that Ofcom is obviously conducting this inquiry and I think it is important not to prejudge it. Rather than give my own personal view, what I would say is that, when one listens to some of the arguments being put forward they strike one as slightly quite interesting. For example, I found it interesting, reading the evidence given to you from Channel 4, that they wanted to reduce the minutage in order to reduce the availability of the product and I wonder what the Competition Minister would say about that. That was in order to restrict the product to push up the price, presumably, which is something all businesses like to do if they don’t have complete control of the product. It is also very important to remember that, in terms of non-PSB channels, this country has a huge amount of inward investment from foreign broadcasters.

The other day I was lucky enough to go to MTV, which is a music video channel, and they employ 800 people in this country—the same amount as Channel 4—and they obviously are able to get nine minutes of advertising. The European Union maximum is 12 minutes. If we were to say, “We’re going to restrict the amount of advertising”, and they broadcast throughout Europe and they broadcast their European channels from London, they might take a view on whether this was the appropriate jurisdiction if that was the regulatory regime they had to work under. So I think that is a very important factor to take into account.

Baroness Deech: That is a technical issue, but what about the public interest? What good does it do the viewers, one way or the other; to have more or less advertising?

Ed Vaizey: I don’t know if I’m going to be asked questions on product placement but I felt, when the product placement debate was taking place, that again I’m instinctively somebody who wants to deregulate the media because I trust to a certain extent the broadcasters. I think it is important that we still have a regulator that can intervene in terms of content issues and quality and so on, obviously. But they know their audiences and I would say that a channel that went down the road of irritating its audiences, in terms of the amount of advertising that was available and so on, would lose market share. I don’t want to prejudge what Ofcom says but I would say that it is important to remember that the current regime for non-PSB channels applies to foreign broadcasters who broadcast out of London throughout Europe. If that was to be harmonised down, I think that would have a significant impact.

Q659 The Earl of Onslow: Several witnesses—Channel 5, ISBA and so on—have said that they support the idea of a wholesale review of television advertising, rather than looking just at CRR and other regulations, as part of a wider review on how television advertising is trading. You have obviously heard my views on the fact that it seems to be arcane. Do you think it would be possible to have a review like that? Could DCMS or BIS examine this issue in a shorter timeframe than Ofcom or the Competition Commission, about six months rather than two years? Would this review require powers to be transferred back from the Competition Commission to the Secretary of State?

Ed Vaizey: I certainly don’t think that review should result in powers being transferred from the Competition Commission to the Secretary of State.

Q660 The Earl of Onslow: I should not have asked that question, because you have already said it.

Ed Vaizey: I am open-minded in terms of a review of television advertising, because I think there are arguments both for and against. The arguments against are that it would create regulatory uncertainty. It goes back to our original exchange, Lord Onslow, in the sense that neither you nor I have a full and comprehensive understanding of the market. But the people who do work in it do seem to understand how it works. It is rather like the bridge across into Queens’ College Cambridge; if you mess with it you can create some investment uncertainty.

The Earl of Onslow: It is a very sound, old-fashioned, high Tory argument, which I find deep sympathy with. But on this occasion I am not so sure at all.

Ed Vaizey: Another argument against it is a resource argument. At the moment Ofcom is not only absorbing Postcomm, it has a lot of other issues on its plate, a question whether it literally has the resource to conduct the inquiry. The arguments for are that an inquiry would play into what we were discussing earlier—the policy thinking around a future Communications Act. I am open-minded about it and I think we will keep a watching brief on it.

Q661 Lord Razzall: I think we will be minded to assume that it should be you who carries out that inquiry, rather than Ofcom. On the ground, looking around, we don’t see any entity, apart from your Department, that could do this within any reasonable time.

Ed Vaizey: An inquiry into the whole television advertising regime?
Lord Razzall: How advertising is sold. One of the things that has shocked almost every Member of the Committee, apart from our two experts who knew it already, is the arcane method under which television advertising is sold. We are told by everybody who gives evidence to us that it would take two to three years to have a proper inquiry into the way television advertising is sold. Bearing in mind there are only about six people in the world who understand it, I fail to quite understand why it would take that long. You could take evidence from those six people and you could form a view. It is a very strong view, I know, among Members of this Committee that it is just an extraordinary system that nobody understands.

The Earl of Onslow: Very few people in the rest of the world have at all, except in Hong Kong and that is solely Chris Patten’s fault.

Lord Razzall: He is the wrong sort of Tory.

Q662 The Chairman: In any event, if you are looking towards a new Communications Bill, you are going to have to deal with aspects of the advertising regulation regime. So why not go the whole hog and have a proper inquiry into the trading system?

Lord Razzall: Ofcom said it would take two to three years.

Ed Vaizey: Isn’t this Select Committee inquiry an inquiry into the television advertising regime?

The Chairman: CRR more or less, but we are including costs as well.

Ed Vaizey: This is an inquiry into the regulation of television advertising, so in fact the answer is that we simply await your report and then the job is done.

Q663 The Chairman: That is very reassuring I would say, very reassuring.

Ed Vaizey: Lord Razzall, presumably, will invite the six key people for dinner at the Garrick and submit his conclusions for the final report. Lord Onslow will host the dinner.

The Chairman: We may have strong opinions on the trading system and, no doubt, there will be a few choice paragraphs on the subject. You will be delighted to hear, particularly since you were so punctual, that we are going to let you off for good behaviour. Thank you very much indeed for coming and thank you, in particular, for having taken the trouble to brief yourselves so effectively. That has been very, very helpful. Thank you.

Supplementary memorandum by the Department for Culture, Media and Sport (RTA 25)

REPLY TO THE COMMITTEE IN RESPONSE TO THEIR HYPOTHETICAL QUESTION ABOUT AN INNOVATION FUND

1. The Committee is considering the scope for introducing some new requirement on ITV to make financial contributions to an Innovation Fund. It is suggested this could form part of a package that would also involve a decision to release ITV from the Contract Rights Renewal (CRR) undertakings provided in 2003 as a condition of approving the merger between Carlton and Granada to form ITV plc.

2. The CRR undertakings were offered by ITV and accepted by the Secretary of State in order to remedy specific detrimental impacts on competition arising from the merger of Carlton and Granada. The only consideration that may be taken into account by the Competition Commission in determining whether or not these undertakings may be released is whether or not circumstances have changed such that they are no longer necessary to remedy that detrimental impact on competition.

3. Whatever the merits of imposing some new requirement on ITV related to investment in programme content, it must be understood that the existence or otherwise of such an Innovation Fund would not be relevant to an assessment of whether or not the CRR undertakings had ceased to be appropriate due to a change in circumstances. Requiring ITV to make contributions into an Innovation Fund would do nothing to prevent or alleviate the negative impacts on other market participants the CRR undertakings are designed to prevent.

4. It may be noted that the Competition Commission’s report includes consideration of ITV’s claims about the extent to which the CRR remedy impacts on its ability to invest in programme content. It is clear the Competition Commission considers programming decisions made by ITV in recent years result from a range of factors and that the Competition Commission believes that ITV exaggerates the link between the CRR undertakings and those decisions.

5. The Committee asks whether legislation that might be made in order to transfer responsibility for future decisions on the CRR remedy from the Competition Commission to the Secretary of State could also create a power for Ofcom to accept and monitor the proposed new undertaking from ITV on an Innovation Fund. If the Government was introducing primary legislation, the scope of that legislation would be open to discussion. It would not appear feasible to achieve either of these outcomes through secondary legislation.

6 December 2010
Supplementary letter from the Rt Hon Jeremy Hunt MP, Secretary of State for Culture, Olympics, Media and Sport, Department for Culture, Media and Sport (RTA 26)

I understand that you have asked me to write to the Committee setting out the Government’s view on Contracts Rights Renewal following reports in the press that appeared to contradict the evidence given to the Committee by Ed Vaizey on 8 December 2010. I am grateful for the opportunity to clarify the situation in respect of the CRR undertakings.

I would like to endorse Ed Vaizey’s evidence, both written and oral. At the moment, changes to the CRR are a matter for the Competition Commission, not Government. I would refer you back to our written evidence to the Committee where we say that, while we don’t want to rule anything out at this stage, we recognise the practical difficulties with transferring responsibility from the Competition Commission to the Secretary of State, and the importance of maintaining the integrity of the wider competition regime. The proposed new Communications Act does though offer an opportunity to consider the CRR undertakings as part of the wider media market and we will also, of course, consider the recommendations of the Lords Committee. My comments quoted in the press were intended to clarify that responsibility for legislation in this area had passed to my Department from BIS, not that any final decisions had been taken.

I hope that this clarifies the position.

4 February 2010
TUESDAY 14 DECEMBER 2010

Examination of Witnesses

Witnesses: MR MICK DESMOND, Chairman, Channel Television, MR ROB WOODWARD, Chief Executive Officer, STV, and MR BOBBY HAIN, Director of Broadcasting & Regulatory Affairs, STV.

Q664 The Chairman: Good afternoon. Thank you very much indeed for coming along. You will be pleased to hear that you are the last of our witnesses, so you can always overturn all our thoughts over the last two months quite easily, I am sure. It is very good to see you. Would you like just to introduce yourself one by one and then we will just fire a series of questions at you—I think we have 20 minutes to half an hour or so to do it in—and it is really up to you as to which of you decides to answer the questions. They will be thrown out in broad terms because each of you has very common interests, basically. Mr Desmond.

Mr Desmond: I am Mick Desmond. I am the non-executive chairman of Channel Television and I also act as Chairman of the ITV Council.

The Chairman: Thank you.

Mr Woodward: I am Rob Woodward. I’m the Chief Executive of STV plc.

Mr Hain: I am Bobby Hain. I’m the Director of Broadcasting & Regulatory Affairs at STV.

Q665 The Chairman: In its written evidence, ITV said that CRR had artificially depressed its revenue below the market level and that of its peers in other countries. What impact do you think CRR has had on the cost of television airtime, (a) on ITV plc, and (b) on the independent licensees like you?

Mr Desmond: I think it has depressed ITV’s revenue, certainly against major European competitors, or indeed, competitors in the US in terms of their networks. I think the quantum price for ITV plc is probably in excess of £250 million over the period, and I think that if you were to count us in as the minority players, in effect it has probably hit us harder on the basis that we don’t share in the interests of ITV plc with the subsidiary channels. So I think the quantum across the minority channels is probably somewhere in the region of £30 million across the period.

Q666 The Chairman: So do you think you are disproportionately hit, in a sense?

Mr Desmond: On that basis, yes.

The Chairman: But you don’t have the other digital—Mr Desmond: ITV has the ability of taking some of the loss that it suffered on the mainsteam channel back on to its subsidiary channels of ITV 2, 3 and 4. So in many ways, because the minority licences don’t share in those channels, our loss has probably been more severe. Also, on that basis, we’ve not shared in any of the merger benefits. So it is a bit of a double whammy in some ways.

Mr Woodward: I think for us it is a key point that ITV plc have benefited from a number of cost synergies in being able to put its businesses together. We’ve not been able to do that, yet at the same time we went from the position where there was competition selling Channel 3 airtime to a position where there is now a monopoly provider, and that is ITV plc. So we have actually been caught by a remedy that was essentially designed to protect us, and for that reason in our submission we have made the very strong case for saying that you shouldn’t be looking simply at the CRR undertaking in isolation to the other remedies that were put in place at the time that—

The Chairman: Yes, I saw the other undertakings that you were keen to have enforced, basically.

Q667 Lord Skelmersdale: Would you make the same remarks as far as internet advertising is concerned?

Mr Woodward: No.

Q668 Lord Skelmersdale: You don’t think that has damaged you at all?

Mr Woodward: Certainly as far as STV is concerned, we sell online advertising completely independently, so ITV does not represent us as a sales house for digital sales—for online sales.

Q669 Lord Macdonald of Tradeston: I declare an interest as a former chief executive and chairman of STV. I have also worked quite closely with Mr Desmond in the past.
I just wonder if you could tell us to what extent CRR has impacted on ITV’s ability to invest in original programming and how it might have affected the STV channel, and I suppose by extension also UTV and Channel Television?

Mr Desmond: I shall take the first part of the question on ITV, and again I declare an interest; up until the end of 2005, I was the chief executive of the ITV broadcasting business. I think it has made ITV play safe. I think it has made ITV go for mostly populist formats and take less risk, to the extent that certainly the amount of high-quality drama reduced. Areas such as arts and documentary, which were in the schedule—and which were propositions in the schedule—diminished, I think, because of it. So I think it made it play safe.

Q670 The Earl of Onslow: Yes. On the effect on CRR on various people’s advertising revenue, surely this is almost a matter of just looking it up. You know what Channel 4’s advertising revenue was in the year 2003 and you know what ITV’s revenues were in 2003. Presumably, you will know what they are in 2007, and so if there is a disparity or a proportion between those two numbers, you should then be able to say, “Perhaps this is applicable to CRR”. If there is no disparity, you will not be able to make a judgment.

Has there been a disparity, in that context?

Mr Desmond: I think the Achilles’ heel in the argument of CRR when it was introduced—and I don’t know whether people are aware of this—there was an almost last-minute change in the process of CRR where the form should have been ITV’s share of commercial viewing versus share of commercial impacts, and there is a fundamental difference. If it was commercial viewing, then I think ITV would have prospered more, because after CRR was introduced you had a plethora of channels that did two things: one, they weren’t selling all their airtime out, and suddenly they decided the best thing to do was to open all their airtime up even if they weren’t selling it, because it just withdrew money away from ITV. Secondly, you had more channels that were just as simply introduced into the system where again, their share of viewing wasn’t necessarily strong, so they may not have had as many people watching, but just by putting those channels into the system they created more commercial impact. I think there is a huge disparity between the former when it was introduced, and I think we have now seen how that has fundamentally changed the loss of revenue.

The Chairman: That is an interesting point.

Q671 Lord Macdonald of Tradeston: I suppose the more general point is that there is a suspicion that, were ITV to prosper more, the benefits would go to the shareholders rather than the viewers in original content production. Is there any way in which we could ensure that they were directed towards the onscreen industry?

Mr Woodward: You would have to end up with a more directive approach in the licence. There is also a further point in answer to your question. There is an assumption that there is currently transparency within the Channel 3 system. Our challenge is that actually there isn’t transparency in the current system.

The Chairman: Because of these other channels?

Mr Woodward: Because of the other channels. The committee will be aware that we—that is, STV plc—are involved in two current High Court actions, one of which includes the performance of the ITV sales function. On top of that, we are currently in the midst of an external audit of ITV plc’s sales function. So I think it is important that the committee understands that the current structure within Channel 3 is not transparent. Certainly the setting up of further channels has added to that lack of transparency.

The Chairman: Making it sort of too sort of team and ladle, and so on.

Q672 Lord Macdonald of Tradeston: Well, what is the broad thrust of your complaint then?

Mr Woodward: We have a number of issues, but the key issue is that a number of merger undertakings were put in place at the time of the Carlton/Granada merger to ensure the safeguard position of the three non-consolidated licensees, and one of the most important of those was that similar terms had to be offered to the non-consolidated licensees, but there were also agreements about the transparency that had to be provided to those licensees. So in answer to that very specific question, it is ensuring that there is sufficient transparency within the current system. If the CRR was to be removed or if there was to be a change to the CRR, on one of the key points that we would want to see addressed is to ensure that there is sufficient transparency for us to see how ITV plc represents and sells ITV1 in isolation from the other family of channels.

The Chairman: That is an interesting point that we might want to come back to on sharing commercial viewing as well.

Q673 The Lord Bishop of Liverpool: You say, “if CRR should be removed”. Do you think that CRR should be removed? If so, why? If not, do you see some sort of revision to CRR?

Mr Desmond: I think CRR should be removed. I think that the world has turned quite dramatically since it was introduced. Certainly, on the strength of the advertising agencies and of the new rating agencies placing airtime, when this was put in place, the prediction was that four or five major media buying groups would buy airtime, and that has come true, where nearly 85% of ITV’s revenue comes from
five buying points. If one of those buying points removed airtime from ITV for a period of three months, it would wipe out the whole of ITV’s profit.

So as a mechanism it is probably past its sell-by date. As Rob said, I think we have given conditional support to ITV for removing CRR from their lobbying on the basis that the other merger undertakings are withheld.

Q674 The Chairman: Can I just clarify? Is “buying point” a media buying point?
Mr Desmond: A media buying point. For example, WPP Group—
The Chairman: One of the big four or five, yes.
Mr Desmond:—probably accounts for nearly 25% to 30% of ITV’s advertising.

Q675 The Lord Bishop of Liverpool: When the Minister was here last week, the point was put to him. He seemed to brush it off and to say that the introduction of CRR had not in fact had that sort of impact. I think you are saying now that 85% belongs to five media buyers. We were saying, “Look, the market has shrunk for the small player”, and he said, “Oh, well, you know, it’s not a monopoly situation”. But you are telling us that there is.
Mr Desmond: Absolutely. I think the dynamics have changed fundamentally since 2003. At that stage, as I say, there were probably 10 to five media buyers. We were saying, “Look, the market has shrunk for the small player”, and he said, “Oh, well, you know, it’s not a monopoly situation”. But you are telling us that there is.

Q676 The Chairman: And you experienced that in the marketplace—that market power that they now have?
Mr Desmond: And I think the other changes are now to the selling points. Sky is a much bigger beast, having now taken over Virgin’s assets, and Channel 4 is a lot bigger beast, having taken over UKTV, so the selling points are much stronger as well. So you see they are shrinking both the buying and selling models.

Q677 The Earl of Onslow: Would you accept, therefore, with these media companies sitting like a great bloated wodge between the person who wants to advertise their product and the person who wants to do the advertising for them, that these people are not necessarily acting in the interests of either one or the other, but both, and consequently that is not having an effect on the market but it is inherently unhealthy?
Mr Desmond: I don’t, actually. I think in the last 12 months in particular we have seen more business move between major agency buying points than at any given time. The major clients are moving in order to get best value, and those major buying points are delivering that value. So I think, if anything, they are working harder to deliver to the clients than they were five to 10 years ago.

Q678 The Chairman: Why would that be?
Mr Desmond: Because, basically, they derive revenue from those clients. I think you are seeing a big fight now between those agency groupings.

Q679 The Chairman: So the competition between them is creating that?
Mr Desmond: They’re pitching very aggressively to win clients’ business, and in order to do that are guaranteeing delivery of price and ratings.

Q680 Lord Gordon of Strathblane: My question is specific to STV, but perhaps should be related to other non-consolidated licensees as well. You mentioned that you contract with ITV for your sales. Why don’t you just do it yourself?
Mr Woodward: Well, we’re currently tied into a sales contract that takes us through to the end of 2011, so certainly during my tenure in the company, taking business away from ITV has not been a possibility.

Q681 Lord Gordon of Strathblane: Would you wish it to be possible?
Mr Woodward: We would wish to have the freedom to be able to review who represents us in the market, yes.

Q682 Lord Gordon of Strathblane: Sure, but why don’t you just represent yourselves? You used to.
Mr Woodward: No, I would include representing ourselves as one of those alternatives.

Q683 Lord Gordon of Strathblane: In a way, why did your predecessors not stick out for that? After all, you decided not to be consolidated as part of ITV. Presumably that required some control over your revenue as well as your expenditure, yet you have apparently signed away control over your revenue.
Mr Woodward: Bobby, you were there at that time.
Mr Hain: One of the parts of the undertakings, which is in fact part of those undertakings that we wish to continue, is that the competitive tension that used to lead to competition for our sales agency business continues. In other words, in the days when there was Carlton and Granada, STV’s business, as represented for national sales, could switch freely between them, and at the point at which the merger happened and ITV plc was created included a merger undertaking that we would be able to get similar terms on the last competitively fought battle with our sales agency. So in that sense, we had a contract in place; we absolutely signed up to that contract. We wish to have the same contract, similar terms as before, but also—and equally—to have the freedom to go elsewhere.
But there is another issue here, which is that as part of Channel 3, if an advertiser wants to buy “Coronation Street” around the UK, it actually wants to do that as easily and as efficiently as possible. So it doesn’t want to have to have lots of different conversations, and on that basis we see the power and the value in being part of a national cell.

Lord Macdonald of Tradeston: I in fact gave up the independence of the sales house in my time—I’ve been out of it for about 13 years. Mr Desmond will remember the times. We had to give it up because with only 5% of the market, you were bullied mercilessly and left at the end of every queue. Given that you are smaller now in a bigger universe, it might be lucky to get some of the meetings from the people involved. But Mr Desmond knows how that works.

Mr Desmond: I don’t disagree with you. It is very different at Channel Television and I don’t have some of the issues that Mr Woodward has pointed out. Channel is a very small revenue-generating proposition and we are sold actually as part of the formula of Meridian Television, so we couldn’t theoretically sell ourselves anyway. Probably my issue with ITV and advertising revenue is more the potential shift of monies between channels, unless we had the protection that we currently enjoy.

The Chairman: Right. I understand.

Q684 Lord Gordon of Strathblane: Just so that we are clear on this and to sign off on it, it wouldn’t be practical for you to sell yourselves. Is that what you are telling me?

Mr Woodward: We have not come to that conclusion because we don’t have the freedom to consider it, but we would welcome the freedom to be able to consider it.

Q685 Lord Gordon of Strathblane: I mean, you must have weighed up whether it was a good idea if you had the freedom.

Mr Woodward: We have not. We can’t come to a definitive conclusion. All I am saying is that we would welcome the possibility of having the freedom to decide who best represents us in the market, and because that contract comes up for renewal at the end of next year that will be a discussion in 2011.

Q686 Lord St John of Bletso: Many would argue that CRR should be scrapped, because the whole television market has completely changed since 2002 when it was introduced. If CRR were to be removed, what impact would this have on your national advertising revenues?

Mr Desmond: ITV’s national advertising revenue?

Lord St John of Bletso: Yes.

Mr Desmond: This year would be a very good example. ITV’s share of impacts is more or less static; you can buy them in different demographics. As a result, ITV has enjoyed an increase in its share of the market. Witness what is happening in nearly every national newspaper at the moment. People are talking about advertisers desperately wanting to buy things like “X Factor” and all those other things. Like any market, there should be a premium price.

Q687 The Chairman: Just to get a direct answer to the question, would CRR removal increase the advertising revenue in those circumstances?

Mr Desmond: I think there would less constraint on the markets and I think advertising major groupings may well decide to place airtime trading in a different way, which would improve ITV’s fortunes.

Q688 Lord Stevenson of Balmacara: On the assumption that that means you would therefore have a higher amount of money and you would get more money out of that deal—CRR having been removed, uplifts having been in place and more money disbursed—does that mean that you would be able to invest more in original content after that?

Mr Desmond: I think as we have said in our submission that we as the minority companies represent around 8% of the voting within ITV plc and therefore we have no influence on the schedule. We sit around the ITV council table. I’ve chaired the ITV council now for three and a half years, and my view of the current management is that they would actually invest more money. I think there will be a greater investment in the schedule if they believed they could take more money out of the schedule.

Q689 The Chairman: You use the third person though, “they”. You mean ITV itself? What about your own company?

Mr Desmond: Channel Television simply produces regional programmes. We don’t produce any national programmes. The Scottish are obviously in a slightly different position, but I can only talk about what I witness. I think the current management realise that if they want to drive their fortunes forward, they have to invest more money in the schedule and deliver a better performance. Without the restriction of CRR, I think they would probably take more risk as well.

Mr Woodward: I would add that in Scotland we have made a decision, which is to invest in more original programmes, and we will provide around about 400 hours a year of peak-time programming that is largely home-produced in Scotland. That was a commercial decision that we undertook some two years ago. Clearly, if there was more money in the system, we could look again at that decision and hopefully even increase the amount of home-grown programming.
Lord Stevenson of Balmacara: Could you just rephrase that? You said something rather sensitive. Would you increase that programming?

Mr Woodward: Well, we’ve more than doubled the amount of home-grown programming over the last three years, so we’ve gone on a trajectory that is completely the opposite.

The Chairman: What, even in the middle of a recession, in terms of advertising revenue?

Mr Woodward: Yes, we have.

Q690 The Earl of Onslow: So would you say the only influence on viewing figures is the content and quality of the programme?

Mr Woodward: Our share of viewing is absolutely on par with the rest of the ITV network.

The Earl of Onslow: But surely people only watch what they want to watch. If it’s good, they’ll watch it, and if it’s rubbish, they won’t—or is that a novel idea?

Mr Woodward: In a sense it’s a very fair idea, and one that our own experience would absolutely endorse.

Lord Stevenson of Balmacara: And they might watch original rubbish more than light rubbish.

The Earl of Onslow: Good quality rubbish.

The Chairman: Let’s move on from that.

Q691 Lord Stevenson of Balmacara: We heard last week about the story of ITV and insufficient training. Do you think that if CRR was removed and you got more money, that might set you back into plentiful training?

Mr Woodward: Yes, as a company we have reached out particularly to the higher education sector and the further education sector, and we’ve launched training partnerships with a number of the Scottish universities and further education institutions. If there was yet more money in the system, then yes, we would be happy and delighted to contribute more to the training, particularly in Scotland.

Q692 Lord Bragg: If you did get CRR removed, do you think you would have to review the airtime sales rules?

Mr Desmond: Sorry, reduce the airtime sales—

Lord Bragg:—sales rules if you had the CRR removed?

Mr Desmond: I don’t think so. I don’t think the station average price as a mechanism should be abolished or got rid of, because I think it’s a good clearing system for the market to work. I also don’t believe that any broadcaster should be obliged to sell out all their airtime.

Mr Hain: Can I just add that the airtime sales rules would concern us as to conditional selling, because at the moment there is no conditional selling by ITV by virtue of the fact that it would cut across the CRR contracts, which are ruled on a different basis, and that may affect the connection in revenue between ITV digital channels, from which we share no revenue, and ITV1, which is absolutely at the heart of this. I think the wider concern for us is that were CRR to be removed, there could be greater obfuscation as to what value ITV1 represents in any sale inclusive of digital channels. So you have the rather awkward situation potentially—and hypothetically at least—that if CRR was removed, more money could come into the ITV system, but there might be just the same or even less for the minority shareholders.

The Chairman: Because they could create a conditionality in the contract?

Mr Hain: Correct, yes.

The Chairman: So that is another safeguard that in a sense you would be asking for. That was in the original undertaking, presumably, or did not need to be in the original undertaking.

Mr Woodward: Correct. It didn’t need to be in the original undertaking, which is why we have a slight nervousness about it and why we’re not sitting here being totally enthusiastic about CRR potentially being removed. If it is simply removed and ITV is not forced to provide sufficient transparency and sufficient assurance over non-conditional selling in the future, we would be no better off. All the benefit would accrue to ITV plc and not the non-consolidated licences.

Q694 Baroness Deech: I have a much broader question for you. We have heard a lot about the economy of this and how it might affect you at Channel 3, a minority shareholding, but what is your view of the public interest with the removal of CRR
or its retention? Which way would the public interest be most benefited? By public interest, I mean everybody. What effect might it have either way on the cost of advertising and what that means to the public—better quality, or indeed worse quality, but very popular programming and so on? I don’t think the Competition Commission have really come to grips with this. So forget you are who you are; you’re someone who is representing the public. What about CRR from that point of view?

Mr Desmond: I think one of the most immediate and great benefits to removing CRR, leaving aside value, which is a separate issue, would be a move away from having to stuff popular programmes as full of commercials as they currently are. The reason goes to the point Mick made earlier on, around having to maximise your commercial impact share and optimise your airtime, which is why you can watch a programme in mid-evening that has 12 minutes of commercials in it, followed by programmes that have zero minutes of commercials. I think the public equates, even implicitly, an amount of commercial value next to a programme with its worth, and if people are watching a programme that has a break with no ads in it, they go, “This can’t be terribly commercial or popular”. So I actually think that in helping to smooth out the schedule and create a better experience for people, a move away from having to stuff popular programmes as full of commercials as they currently are would be immediately beneficial to people. Perhaps Mick is better placed on the detail.

Baroness Deech: But are you suggesting that if there are no ads, they will switch over to something else where there were ads?

Mr Hain: No, no, what I’m saying is that the experience of watching commercial television, particularly on Channel 3, is extremely lumpy. You watch popular programmes, which are stuffed full of ads by necessity and the need to optimise your breaks and your ratings, and then you wander into territory where there are no commercials at all.

Mr Desmond: I think that is probably more prevalent now that a lot of programmes are recorded, which is still part of the currency. A good example would be “The X Factor” this weekend, where nearly 10% of its ratings are recorded. I suspect most people would have fast-forwarded through the commercials. There are 12 minutes of commercials sitting in a programme and now you can fast forward. Going back to your point in terms of absolute cost: because of the station-added price mechanism that exists across all broadcasters and across all sales points and selling points, the cost of television wouldn’t go up. The differential within the price of different channels may well change. I don’t think it would be a huge fundamental change, but the cost of television as a medium wouldn’t increase. You would still have so many channels; you would still have as much minutage. It may well change if people can reduce their minutage.

Baroness Deech: That is if CRR is removed? Mr Desmond: No, they are two different things. If you apply the sales and reduce their minutage, then that would change the balance in terms of the actual cost.

Baroness Deech: I am still trying to think a bit broader than that. What would it do to, say, cost of advertising and then the cost of goods being advertised, the quality of programming and so on?

Mr Desmond: I think, in terms of cost of advertising, it would not be a fundamental change in terms of the cost of television advertising or advertising per se. In terms of programming, I think there would be more risk-taking by ITV, but if we’re being candid as well, if a sudden downturn appeared in 2012 then ITV, probably along with every other commercial broadcaster, would seek to take some money out of their schedule. That’s just the fact of economics, I guess.

Lord Skelmersdale: Yes, one of the things that has been put to us is that prices could be determined by an online auction if we recommend the removal of CRR. Does that make you shudder? That is point one. Point two: would that produce a price differential to come down?

Mr Desmond: I think if you take price differential for specific programmes, I suspect—

Mr Desmond: I think that if you took programmes like a major Champions League football game or “Downton Abbey” returning next year or “The X Factor”, I suspect that a broadcaster like ITV could sell that 10 times over. So on one hand, you would do very well on your auction. I suspect they will then be left with an awful lot of airtime they can’t sell to anybody. So I think the whole idea—

Lord Skelmersdale: So you think it might balance out, do you?

Mr Desmond: Sorry?

Lord Skelmersdale: You think it might balance out on that basis?

Mr Desmond: I think technically both the advertiser and the media owner would lose a degree of control, because most advertisers are trying to achieve a campaign over a certain period. If you’re advertising this week and you want to get 10 peak spots away and some of those prime spots, and you miss the auction, that’s it, you can’t access it, whereas in the current system the objective is to try and sell all your airtime out but at the same time ensure that advertisers meet their communication objectives by delivering those campaigns when they need them and the type of
airtime they need aimed at the demographics they’re trying to hit. So there is a shared objective between both the buying point on behalf of the advertisers and the selling point to meet those shared communication objectives.

Q700 The Chairman: Are you saying you don’t see much wrong with the current trading system?
Mr Desmond: I don’t, and I’ve seen a lot of trading systems around the world. I think it recognises value. I think the difference is the cap that has now come on it. I saw some of the work that has been produced on behalf of ITV in terms of ITV’s decline of shared impacts and its decline of premium. It’s probably easy to sell though, just because of the formula based on a share of impacts versus a share of view.
The Chairman: Any other thoughts on this particular point about trading system? No.

Q701 Lord Dixon-Smith: We’ve heard that ITV takes a pretty robust approach to these plans but despite that it seems as though the atmosphere is pretty peaceful. Why do you think that there have been no formal complaints to the CRR adjudicator against ITV in the last couple of years, if they are taking this very robust approach?
Mr Desmond: Like anything, I think that if you put an adjudicator in place then people want to test the adjudicator; they want to sort of test different formula. I think what has happened over the last two or three years probably is that people now kind of understand exactly the mechanism—I mean, it wasn’t an easy mechanism to understand when it was introduced. I think the media buying companies understood it. I think the average advertiser found it counterintuitive, and therefore I think it took a couple of years to understand the mechanism.
Having said that, I think that having an adjudicator, whether with the CRR or not, is a good thing for the industry. I think most industries, when in dispute, want to go somewhere for some kind of unbiased resolution. I think an adjudicator is probably a good thing for all parties. I mean, we would respect having an adjudicator to go to if we had an issue, which we currently can’t do at the moment. To be able to go along to an adjudicator who could take an objective view on something would be good. So I think even going forward, having some kind of adjudicator is probably not too bad a thing.
Mr Woodward: Indeed, we actually employed the first CRR adjudicator as a member of our staff, so he was able to educate us in some of the kind of bedding down of the system, and I think Mr Desmond was right in that the world has got kind of used to the current system. We would endorse what Mr Desmond said. We would absolutely welcome the opportunity of having an adjudicator that we could actually use within the system, as opposed it being adjudicated outside the system.

Q702 Lord Dixon-Smith: So you are really saying that in fact there is one that exists acts as a sort of lubricant in the system, so you don’t actually need—
Mr Desmond: I think in many ways, in nearly every other part of our industry where we are regulated by Ofcom, we have an expert on a particular area of discipline. I think that within Ofcom, there isn’t that kind of expert sitting there who can take an objective view on airtime trading, and it would seem to me—not just for ITV, but for the industry—that if there was something that was seen as being unfair or malpractice then somebody who would be respected and have the right kind of research resource behind them making a decision, I think, would be a good thing.

Q703 Lord Skelmersdale: Yes, but couldn’t Ofcom do the job?
Mr Desmond: Sorry?
Lord Skelmersdale: Couldn’t Ofcom do the job?
Mr Desmond: I think the point is one of expertise, so Ofcom doesn’t have that level of very specific—
Lord Skelmersdale: But nor does the adjudicator, when you say—
Mr Desmond: But they would employ that person, yes. They can employ that person and that person could be given broader tasks—
The Chairman: Yes, it is possible.
Mr Desmond:—within Ofcom.

Q704 Baroness Fookes: I take it from what you have said already that you can still see a role for an adjudicator, even if CRR were removed?
Mr Woodward: Yes. From what we have said, I think that to have a high level of expertise around the main commercial generator of our industry and have that expertise sitting within the regulator would seem to be a very sensible model, going forward.

Q705 Baroness Fookes: Yes, and you mentioned the possibility of a wider remit or wider powers. Would you like to expand on that?
Mr Woodward: Rather than just being the CRR adjudicator, it would give them broader powers sitting within Ofcom so that they could engage with any component of the industry in terms of sales and commercial practice.

Q706 The Earl of Onslow: Do you think that Ofcom is robust enough?
Mr Desmond: I think it is robust in a lot of areas. I think in this area it is probably not, because it simply doesn’t have that area of expertise sitting within its structure. I mean, it plays a role with the adjudicator, but as a third party.
Q707 The Earl of Onslow: So if CRR were to be abolished, and ITV were to get up to some shenanigans of Adam Smith-onian malpractice, Ofcom would not notice and would not jump on it in time?
Mr Desmond: If the complaint was taken to them, I can’t identify anybody who would be able to resolve that issue within an area of expertise, no.

Q708 Baroness Fookes: Would you find it helpful if the adjudicator came within the direct remit of Ofcom with that expertise, or is there value in him standing outside it?
Mr Desmond: Bearing in mind that Ofcom are there to govern across the commercial sector, I think it would make sense for that person to reside within Ofcom and have the powers not just to technically adjudicate across ITV, but to adjudicate across the industry.

Q709 The Chairman: Thank you very much. One final question: you referred earlier to the original intention of CRR being related to ITV’s share of commercial viewing. What would your preference be for a CRR that related to share of commercial viewing, ie some of CRR or, in a sense, abolition of CRR plus the safeguards that you were talking about earlier?
Mr Desmond: Talking from a Channel perspective, I would like to see the abolition of CRR but ensure that the merger undertakings that were put in place at the time of the merger are protected, taking on board Mr Woodward’s point that there is some protection for minority channels in terms of money between ITV1 and ITV plc subsidiary channels.
The Chairman: Yes, that transparency point.
Mr Woodward: And to ensuring that conditional selling is not permitted in the market going forward, and at the same time we would urge you not to just look at a remedy for CRR in isolation to the other merger undertakings. They were put together as a package at the time of the merger, and if they are to be reviewed, we would argue strongly that they should be reviewed as a package and not take a particular one that someone’s cherry-picked for review on its own.
The Chairman: Thank you very much. That was a very illuminating session.