

**AN ASSESSMENT OF THE MARKET IMPACT OF  
THE BBC'S DIGITAL TV SERVICES**

**(BBC 3, BBC 4, CBeebies, CBBC)**

**A REPORT FOR THE BBC'S SUBMISSION  
TO THE DCMS REVIEW**

---

**By Oliver & Ohlbaum Associates Ltd**

**March 2004**



**AN ASSESSMENT OF THE MARKET IMPACT OF THE BBC'S DIGITAL TV SERVICES  
(BBC 3, BBC 4, CBeebies, CBBC)**

**A REPORT FOR THE BBC'S SUBMISSION TO THE DCMS REVIEW**

**BY OLIVER & OHLBAUM ASSOCIATES**

**MARCH 2004**

**OVERVIEW**

- Oliver & Ohlbaum Associates (O&O) has been commissioned by the BBC to provide an independent assessment of the likely market impact of the BBC's four new digital TV services launched in 2002 and 2003 – BBC 3, BBC 4, CBeebies and CBBC.
- This assessment has looked at the impact since launch<sup>1</sup>, and the likely impact to 2007. It has reviewed the impact of BBC services on overall digital take up, how far the services have increased consumer choice, and how far the production base and the creative community have benefited both directly and indirectly.
- In analysing the impact on consumer choice, the review has assessed how far the BBC services have added to the range of services on offer, and also how much the provision of BBC services has affected the viability of commercial network and thematic channel TV services in the UK. In this last area the review has assessed both the specific impact of BBC services on the economics of near rivals and the broad impact they might have on the economics of commercial TV in general –both advertising and pay TV funded.
- O&O reviewed the potential impact of these services in Spring 2001, before their planned launch, and looked again at BBC 3 in the Spring of 2002, before it was permitted to launch. The intervening period has seen dramatic change in the UK TV market; the closure of one pay TV platform, another – in the form of Telewest and NTL – going into administration, the launch of a new free to air digital platform and one of the worst TV advertising recessions in the last 30 years coming after one of the greatest booms. With such a rollercoaster of events, isolating the specific historic impact of the four BBC services is a difficult challenge.

---

<sup>1</sup> We have been asked to assess the incremental impact of these channels compared to BBC Choice and BBC Knowledge – the BBC's digital channels that they replaced.

- However, it has been possible to reach some indicative and directional conclusions on the impact of the services and to give an estimate – within a range – of the likely financial impact on the commercial market.
- The review has found strong evidence to suggest that the four BBC services have played an important role in driving the take-up of Freeview, and that Freeview has, to a great extent, attracted new people into digital TV rather than cannibalised pay TV. The BBC services may have added 1 million homes to overall digital take-up over the period.
- The historic direct financial impact of the services on near rival thematic channels and relevant networks has been modest with perhaps a £4m to £10m annual negative impact on near rival channel advertising revenue. About half of this impact has been on thematic TV channels and about half on commercial networks.<sup>2</sup>
- This £2m to £5m impact on rival thematic channels represents between 1 and 2.5 per cent of the current advertising revenue earned by those thematic channels. And it should be noted that during the turbulent period under review 44 new non-shopping channels entered the UK market while only 17 exited. The £2m to £5m impact on commercial networks represents between 0.08 and 0.2 per cent of their revenue.
- Within these totals some individual channels might suffer more than others, but no one thematic channel is likely to lose more than £1m of revenue (typically less than 8 per cent of revenue) and no one network more than £2m a year.
- At the same time, the BBC channels are investing about £150m in new UK programming which is more than the 140 basic and free to air thematic channels in the UK spend combined.<sup>3</sup> Much of this investment has been on new talent while a high proportion has gone to the UK's independent production sector. However, evidence suggests that this investment has not, as yet, stimulated greater levels of investment from near rival thematic channels.
- Overall the BBC services have gain 0.8 percentage points of multichannel share. Their combined total share being 2.7 per cent at the end of 2003, up from the 1.9 per cent share gained by BBC Choice and BBC Knowledge at the end of 2001.
- Our specially commissioned review of 17 different channel schedules suggests that each BBC service is offering something distinctive to UK multi channel audiences when compared with other thematic channels - and often to a distinct demographic.
- BBC 3 is hitting its target 25 to 35, slightly ABC1 skewed audience, in contrast to most of its rivals that skew younger and more C2DE. It is doing this with an

---

<sup>2</sup> There is an additional small impact on Artsworld (the a la carte pay TV digital arts and performance channels ) to add to this number– the channel may have seen growth in subscribers curtailed by the arrival of BBC 4, but at the same time it has probably increased its leverage with the platform (BSkyB) – which is also its leading shareholder and which has responded to this leverage by funding the losses of the channel, presumably for the broader benefits to the platform.

<sup>3</sup> Excluding news and home shopping channels

intelligent mix of new comedy, drama, news, documentary, social action and factual entertainment programming, without recourse to the large volumes of network repeats and spin-offs utilised by the likes of E4 and ITV2. Although, its mix of factual entertainment topics – heavily skewed to celebrity, lifestyle, fashion and media – is fairly close to that of commercial channels aimed at a similar audience, and it has been relatively unsuccessful at developing breakthrough drama. However, it has been successful at developing original and innovative breakthrough comedy.

- BBC 4 provides a uniquely broad mix of UK originated programme types and genres, covering drama, performance, arts, music, news, documentary and current affairs. No other channel in the area of factual, arts and performance programming seems to have its depth or breadth of coverage. The channel also attracts a heavily ABC1 skewed audience, but is by no means exclusively the preserve of the over 40s.
- The two children's channels rely much less on animation than any of their rivals. When they do show animation it is much more likely to be UK originated. Each has a significant proportion of UK orientated educational programming unlike any of their near rivals.
- Assessing the impact of the four channels on the broad economics of commercial TV in the UK has proven more difficult than the direct revenue impact on near rivals.
- In terms of their impact on the subscription fee related revenue of thematic channels the impact has probably been neutral or slightly positive. The BBC services' contribution to Freeview take-up – and free to air digital growth in general – has probably been largely additional to pay TV take-up, and therefore can not be seen to reduce the subscription fee related revenue of thematic channels significantly.
- The presence of the BBC channels free of charge has probably increased pay tier channels' leverage with pay TV platforms by giving such channels a credible alternative free to air only business plan and by increasing the pay TV platform's need for a compelling proposition to get people to upgrade to pay TV.<sup>4</sup>
- In terms of the impact of the new BBC services on the broad network and thematic channel advertising market – again through the general impact on Freeview penetration – the outcome is less clear<sup>5</sup>.
- The negative impact across all pay TV thematic channels on their advertising revenue is limited by the low extent of substitution by Freeview of pay TV subscribers. In addition commercial networks gain for every Freeview home that replaces a pay TV home, given their higher share in Freeview homes.

---

<sup>4</sup> We have tentatively estimated this broad subscription fee impact at between a negative £3m and a positive £4.5m per year.

<sup>5</sup> This is the impact associated with the take up of Freeview. i.e. the BBC services have helped drive Freeview penetration, which in turn has an impact on the whole commercial market. This is very different from the specific impact on the share and revenue of near rival channels.

- However, every extra Freeview digital home that replaces a five channel analogue home tends to lead to reduced overall commercial network revenue – their share being generally lower in Freeview homes than five channel analogue homes.
- While those networks with extra thematic channels carried on Freeview do recoup some of this lost revenue, these extra channels do have to meet an extra transmission cost of £2m a year per channel.
- Amongst the commercial networks in the UK, ITV suffers only slightly from the overall negative network advertising impact of high incremental Freeview take up – with its ownership of the leading thematic channel on Freeview - ITV2 - and the rebate it receives on its analogue spectrum licence payments for every new digital home<sup>6</sup>. FIVE tends not to lose share in Freeview homes – and may actually gain from extra Freeview take up. Channel 4, however, loses share, has no analogue spectrum licence payments in the first place, and currently has no extra Freeview thematic channel at the moment – although one is planned.<sup>7</sup>
- The overall advertising market impact of BBC services through enhanced take-up of Freeview is, therefore, currently slightly negative overall, with the largest negative impact currently on Channel 4. However, even this impact on Channel 4 may well have been less than suggested, as the channel has managed to increase its share of the key under 35 and ABC1 demographics during the period under review.
- Overall, the total impact of the BBC services on the market place is broadly what was predicted back in 2001/2002. However, each element of the package is slightly different. The combined audience share at 2.7 per cent of all day multichannel viewing is less than the 4 per cent predicted in the first O&O report – which means that the share taken from competitors is lower than predicted.
- Similarly, the impact of the BBC services on overall digital take up – through Freeview – has been greater than originally assumed. Both these factors suggest the BBC services have had a greater positive impact on the market than originally envisaged in the initial report.
- On the other hand, the growth of Freeview has probably increased the broadly negative impact on network advertising revenue – especially for those networks with no extra Freeview channels. Similarly, the elasticity of demand assumptions used in this review are actually greater than in the original O&O study – suggesting the impact of any given audience share substitution on near rivals' revenue is greater.
- The conclusions on which networks and thematic channels are likely to be the most impacted are broadly in line with the original report and of a similar magnitude to that initially envisaged.

---

<sup>6</sup> ITV currently pays about £150m in revenue linked extra licence payments, but this is only calculated with regard to revenue deemed to be generated in analogue only households.

<sup>7</sup> Channel 4 has announced plans for a new free to air channel on Freeview called More4 concentrating on factual programming. This should reduce the broad impact of the BBC services on Channel 4.

- Looking forward, the next three years are likely to see increased penetration of Freeview and pay TV, slightly rising shares for BBC 3 and BBC 4, taking the overall share of the four services to 3.2 per cent, and a slightly larger direct impact on near rivals' advertising revenue as a consequence of this rising share – moving up to £6m to £15m combined.
- The broad market impact on pay TV subscription fee related revenue is likely to turn more unambiguously positive with the arrival of the digital terrestrial *Top Up TV* proposition. The broad market impact on advertising revenue is likely to turn positive – as thematic channels on Freeview see revenue rising well above transmission costs, and any disproportionate effect on Channel 4 will reduce if it launches an extra free to air service.
- The BBC services are likely to remain distinctive in a thematic channel market where new channel entry combined with pressure on channel subscription related fees are likely to cause further revenue fragmentation, and generally limit any commercial thematic channel's ability to increase significantly investment in new content or a more mixed and varied schedule.
- However, with an advertising recovery and channel ownership consolidation, there might be some selected increases in thematic channel origination, especially from channels in the BBC's market segments, where the BBC's investment might start to stir a limited move into home grown programming.
- Figure 1 summarises the estimated historic market impact by service.

Figure 1

SUMMARY OF OVERALL MARKET IMPACT – 2001 to 2004

IMPACT	BBC 3	BBC 4	CBBC	CBEEBIES	OVERALL
DIGITAL TAKE-UP	MEDIUM	HIGH	MEDIUM/HIGH	HIGH/MEDIUM	HIGH/MEDIUM
DISTINCTIVENESS FROM COMMERCIAL MARKET	HIGH/MEDIUM	HIGH	HIGH/MEDIUM	HIGH/MEDIUM	HIGH/MEDIUM
IMPACT ON OVERALL COMMERCIAL MARKET (PLATFORM LEVEL)					SLIGHTLY NEGATIVE/ NEUTRAL (C4 worst hit)
DIRECT ADVERTISING CASH FLOW IMPACT ON RIVAL CHANNELS PER YEAR	-£1.2M TO -£4M	-£0.9M TO -£2.0M	-£1.0M TO -£2.4M	-£0.7M TO -£1.4M	-£3.8M to £9.8M
MOST IMPACTED NETWORK	CHANNEL 4	BBC 2	BBC 1/ITV	BBC 1/ITV	CHANNEL 4
MOST IMPACTED COMMERCIAL DIGITAL CHANNEL	E4	ARTSWORLD	THE DISNEY CHANNEL	NICK JNR	
IMPACT ON PRODUCTION TALENT	POSITIVE (esp new talent in Drama and Comedy)	POSITIVE IN FACTUAL PROGRAMMING	SLIGHTLY POSITIVE (esp in drama and comedy)	POSITIVE (especially UK Animation)	POSITIVE
PROGRAMMING BUDGET 2002/03	£97M	£30M	£26M	£15M	£168M

## SECTION BY SECTION SUMMARY

### MARKET TRENDS

- The period since the BBC's four new digital services were proposed in the winter of 2000/2001, has seen a number of dramatic changes in the UK TV market. In the course of three years one of the UK's digital pay TV platforms – ITV Digital – was closed, while another – UK cable in the form of NTL and Telewest – went into administration. At the same time the UK has been through one of the worst advertising recessions of the last 30 years.
- The launch of the Freeview platform – using the digital terrestrial frequency vacated by ITV Digital to provide 21 extra channels for no extra subscription fee – has established a new installed base of over 2 million digital households outside the pay TV market.
- While thematic channel share in pay TV households has risen from 40 to 48 per cent of viewing, overall thematic channel share in all multichannel homes including Freeview homes has risen to just 43 per cent. New market entry, slow advertising growth and pressure on subscription related channel fees from pay TV platforms – especially BSkyB which now accounts for two thirds of all pay TV subscribers – has meant the continued fragmentation of thematic channel audience share and revenue.
- 44 new thematic TV channels have been launched in the UK while only 17 have exited<sup>8</sup>. Ownership of, and audience share among, these channels have consolidated around BSkyB, the major US media groups and the UK's main commercial networks. Yet combined, all commercial thematic TV channels (excluding news and home shopping services) probably spend little more than £100m on new UK programming, compared with the £2 billion spent by the UK's five main networks.
- With all this market turbulence over the last three years, isolating the precise impact of the four new BBC services on the market and individual commercial channels is likely to prove rather difficult. Despite this, the report sets out to assess the evidence available and to determine broadly and directionally, what the impact might have been, and what it might be going forward.

### PERFORMANCE

- The four new BBC services now gain a share of about 2.7 per cent of all day multichannel viewing<sup>9</sup> – compared with 1.9 per cent for the BBC Choice and BBC Knowledge services that predated the BBC's new digital strategy. These services gain almost 5 per cent of all day viewing in Freeview homes, but just 2 per cent in pay TV cable and satellite households. Together they reach about 33 per cent of all multichannel homes in any week.

---

<sup>8</sup> Excluding home shopping channels

<sup>9</sup> This is nearer 5 per cent of viewing in transmission hours.

- BBC 3 gains 0.7 per cent of all day multichannel viewing (compared to the 1.5 per cent the BBC originally forecast and the 0.5 per cent BBC Choice was getting prior to the BBC 3 launch), and attracts a 25 to 34 year old skewed audience with a slight bias to ABC1s. BBC 4 gains a 0.2 per cent share of all day multichannel viewing, versus an initial forecast by O&O of about 1 per cent and a BBC Knowledge share of 0.05 per cent. Its average viewer is in his/her mid-forties and the audience skews heavily to ABC1s.
- CBeebies obtains a 1.4 per cent share of all day viewing in multichannel homes, about 0.2 percentage higher than the audience attracted by the pre-school programming on BBC Choice before launch. CBBC tends to attract children from 8 to 12 and has a 0.4 per cent share of viewing, about 0.3 percentage points higher than the children's programming slot on BBC Choice.

#### DISTINCTIVENESS

- Our especially commissioned survey of channel schedules<sup>10</sup> confirms that each BBC service demonstrates a degree of distinctiveness from its nearest thematic channel rivals. BBC 3 has greater amounts of news, current affairs and factual programming than E4, Sky One, ITV 2 and Paramount, and a greater variety of programme types and genres across the whole schedule.
- BBC 3's commitment to new UK drama and comedy especially commissioned for the channel differentiates it from all other under 35 year old focused entertainment channels. Unlike E4 and ITV2, it does not make extensive use of main network repeats and spin-off programmes, and unlike Sky One and Paramount, the vast majority of its schedule is made up of UK originated material.
- The channel manages to attract an audience focused on the early 30's, older than most of its rival thematic entertainment channels except ITV2, yet with much more of an ABC1 skew than ITV2. Its factual entertainment output focused on this demographic does, however, tend to skew to celebrity, relationship and lifestyle subjects, similar to that used by commercial channels to attract a similar audience profile.
- BBC 4 has a far greater range of programme genres and types than any factual, arts or performance focused thematic channel. It also attracts a very distinct, heavily skewed ABC1 audience profile, although its age profile is a bit younger than many factual channels. Its reliance on UK and continental European originated material differentiates it from anything else in multichannel TV homes.
- CBeebies utilises far less animation and shows more educational programming than its nearest rivals. When the channel does use animation/puppet based output it shows a far greater proportion of UK originated material.
- CBBC also tends to use far less animation than all its rivals, although a fair proportion of what it does use is US originated. Overall its schedule has far more

---

<sup>10</sup> This was commissioned from DGA Metrics, a company specialising in schedule and audience analysis and covered the May 2003 month for 17 different channels. For E4 the sample was extended to April and May due to the fact that May 2003 saw the start of Big Brother which it was felt would distort the overall picture given that we were trying to use the month's data as broadly indicative of schedule mix.

factual and current affairs programming than any near rival, with far more educational programming than any of its rivals except Discovery Kids. However, almost all Discovery Kids educational output is non UK originated, and the channel only obtains about 0.3 per cent of children's viewing in multichannel homes compared to CBBC's 3.2 per cent.

#### DIGITAL TAKE-UP AND THE BROAD MARKET IMPACT ON THE COMMERCIAL SECTOR

- The evidence suggests that the new BBC services have been the lead driver of Freeview penetration, and that Freeview penetration has been largely additional to, rather than a substitute for, digital pay TV take-up. The BBC channels may well have helped increase overall digital take up by about 1 million households over the period.
- New BBC services have probably also made a small contribution to the take up of digital pay TV platforms by enhancing the overall offer.
- New BBC services have, therefore, made a significant contribution to bringing forward the likely date of analogue switch-off and the release of large amounts of spectrum.
- The new BBC services have probably had a broadly neutral impact on thematic channel subscription related fee revenues over the last three years. Given that evidence suggests most Freeview penetration has been additional rather than substitutational, the direct negative impact on total subscription fee related revenue is probably limited.
- At the same time the existence of Freeview and the BBC's services on the platform, has probably provided basic tier thematic pay TV channels with their best effective leverage in securing limited subscription fee reductions in a fast consolidating pay TV platform market. Gaining free to air access to all of the UK's estimated 13 million multichannel homes being the only viable alternative business model to doing a pay TV carriage deal with BSkyB.
- In addition, for some Freeview homes – surveys suggest about 10 per cent of them – free digital TV may just be an entry tier for subsequent subscription to pay TV. (We estimate that the net impact of these subscription fee effects combined is between -£3m to +£4.5m)
- The impact of increased Freeview penetration – and the new BBC services' contribution to it - on the total advertising market is even more difficult to quantify. On the one hand the networks as a whole lose out on audience share and revenue for every Freeview home that replaces a five channel analogue home, while thematic channels lose out for every Freeview home that replaces a pay TV home.
- However, networks gain for every Freeview home that replaces a pay TV household, and any operator that owns a thematic free to air channel on Freeview gains with the growth in the platform.
- The impact is further complicated by the rebate ITV receives for every new digital home on its revenue related extra analogue spectrum licence payments –

Freeview or pay TV - and the fact that FIVE actually loses no share in Freeview homes.

- Overall, O&O tentatively estimates this may cause a small negative impact per year on the commercial network advertising market as a whole in the short term, with a disproportionate amount of this impact affecting Channel 4 currently, as it pays no analogue spectrum fee – and so obtains no rebate on digital homes- and owns no free to air Freeview thematic channel. Although, Channel 4's recent gain of 16 to 35 year old and ABC 1 viewing share may have lessened this effect.
- However, in the next few years – as Freeview thematic channels gain in share, reach and revenue – the overall impact on networks that own such channels could turn positive. If Channel 4 does launch More4 as planned, the disproportionately negative impact on them should also reduce.

#### SPECIFIC IMPACT ON NEAR RIVAL CHANNELS

- The specific incremental impact on close rival channels' advertising revenue and programme costs has probably been small given the limited incremental audience share gains by BBC channels since launch, and the nature of advertising demand in the UK (where market prices rise in response to the reduction in commercial "impacts" associated with loss of share by commercial services to BBC services).
- For all four channels taken together we have estimated a range of a combined reduction of £3.8m to £9.8m in commercial channel revenue, with just over 50 per cent coming from commercial networks, and just under 50 per cent from thematic channels.
- BBC 3 has probably only taken 0.2 percentage points of share at most since launch in multichannel homes, and given its high share in Freeview homes, much of this has probably come from the BBC and commercial networks rather than thematic channels. Overall this has probably caused a £1.2m to £4m per year negative impact on other commercial channels of which half has come from thematic channels.<sup>11</sup> Sky One, E4 and ITV 2 have probably all lost some revenue with E4 perhaps losing the most.
- BBC 4 has probably taken about 0.15 percentage points at most from other channels, and about half of that from BBC 2. Overall it may have displaced £0.9m to £2m, with the majority coming from networks – especially Channel 4.
- CBeebies and CBBC have together taken £1.7m to £3.8m, with about 60 per cent coming from networks – especially ITV. The most affected thematic channels have probably been Nick Junior, Nickelodeon and the Disney Channel.

---

<sup>11</sup> The range reflects the different methods we have used to calculate revenue impact. We have conducted one assessment with a single UK TV market elasticity of  $-1.7$ , and another with a network TV elasticity of  $-2$ , and a thematic channel elasticity of  $-2.5$ . Finally, we have also assessed the impact on demographic advertising sub-markets, which generally yields slightly higher revenue impacts. The high estimate of £4m comes from the specific characteristics of the 16 to 35 year old advertising market, which is probably more elastic than the general advertising market.

- In the specific case of Artsworld, BBC 4 may have caused a reduction in potential new direct subscribers of 5,000 or so, converting to an lost annual net revenue (after subscription management costs) of £150K. However, the existence of BBC 4 as a free to air proposition has probably increased the channel's leverage with pay TV platforms.<sup>12</sup>
- BBC services are unlikely to have pushed up the programming prices for rival channels given the BBC's disinterest in obtaining top end acquisitions for the services. Although the lack of access to BBC archive may mean that channels such as Nickelodeon and Artsworld have had to pay higher prices for the alternative archive which was available<sup>13</sup>, the investment in new programming by all the BBC services is generating new archive in comedy, drama, documentaries, animation etc that could well help keep overall market prices of acquired material down in the future.

#### THE PRODUCTION BASE

- The £150m spent on originated programming in 2002/03 represented a more than 100% increase in new programming investment by UK thematic channels (outside of news and sports production).
- BBC 3 in particular has played an important role in bringing new talent – in front and behind the screen – to TV. BBC 4's coverage of new UK and World music and performance events has helped bring TV exposure to artists and performers who seldom obtain such coverage.
- CBeebies and CBBC have helped boost investment in UK animation, while all the channels have made a greater than average UK use of home grown independent production than the UK average (about 33 per cent of spend across the channels compared to a UK average of about 30 per cent). BBC 3 sources 40 per cent of programming from independents and both BBC 3 and BBC 4 have utilised independent producers who had previously not worked with the BBC.
- However, there are few signs as yet, of the BBC's investment in programming actually encouraging a significant increase in the original programming budgets of near rivals. But this may be due to short term market pressure caused by the combined impact of channel subscription fee revenue reductions per household, more market entry and an advertising market in recession.

#### COMPARISON WITH THE INITIAL REVIEW IN 2001/2002

- The overall impact has been of the order of magnitude predicted back in Spring 2001 and Spring 2002.
- However, each element of the market impact has proven different in its extent and importance. While the channels' distinctiveness has proven to be what was

<sup>12</sup> In the case of an a la carte channel, this increased leverage can not result in a reduced subscription management charge as this is dictated by regulation. Instead, it will manifest itself in BSkyB's willingness to run the service in which it has a significant shareholding at a loss – effectively subsidising the channel so it will attract certain subscribers to upgrade to pay TV from free to air digital TV.

<sup>13</sup> This does not apply to channels such as The History Channel, where access to BBC archive is prevented by its use by UK History rather than BBC 4.

expected, their combined share – and therefore the share taken from rivals – has been lower than expected – 2.7 per cent compared to an expected 4 per cent.

- The impact of each percentage point share loss on rivals' has, however, been calculated to be larger in this review due to a more thorough review on the likely elasticity of demand for TV advertising in the UK (i.e the impact of share loss on the price of advertising and, therefore, revenue loss).
- The impact on digital take up has been greater than originally envisaged, while the potential negative impact on network TV advertising has also been slightly greater.
- The channel's likely to be most affected by the BBC services have been very much as expected, with Channel 4 being the most impacted commercial network, and Artsworld, E4, The Disney Channel and Nick Jnr being the most affected thematic channels. The scale of the impact on any one of these services has also proven to be in line with original expectations.

#### LIKELY FUTURE MARKET DEVELOPMENT AND IMPACT

- Over the next three years, the UK market is likely to see continued growth of free to air digital TV, with a recovery in overall pay TV as cable emerges from administration and an additional pay service is added to digital terrestrial – *Top Up TV*.
- BBC services are likely to remain one of the key drivers of Freeview penetration, while also helping to drive penetration of pay TV through digital terrestrial distribution.
- While BBC 3 and BBC 4 are likely to gain further share, CBeebies' share is likely to level off. With the addition of pay TV channels in some Freeview homes, and potential new free to air channels launches by the likes of Disney, the overall share of the four BBC channels is likely to rise to 3.2 per cent from the current 2.7 per cent in multichannel homes – an incremental rise of 0.5 per cent – yielding an additional 50 per cent to the direct impact on rivals' share per year in total – or about £6m to £15m in total at current advertising prices.
- BBC services are likely to remain distinctive within the thematic channel market, although with ownership consolidation and an improving advertising market, some channels might increase their programming spend, especially those channels closest to the BBC services.

<b>CONTENTS</b>		
<b>INTRODUCTION</b>		<b>14</b>
<b>A. AN ASSESSMENT FRAMEWORK</b>		<b>16</b>
<b>B. RECENT TRENDS IN THE UK TV MARKET</b>		<b>20</b>
1. General Background		20
2. Delivery Platforms		21
3. Competition and Audience Share		23
4. TV Advertising		27
5. Thematic Multichannel TV Economics		32
6. Programming and Content		34
7. General Implications for the Market Impact Analysis		37
<b>C. THE OBJECTIVES OF THE BBC'S DIGITAL SERVICES AND THEIR PERFORMANCE SINCE LAUNCH</b>		<b>40</b>
1. The Evolution of the New BBC Services		40
2. Combined Share and Reach		41
3. The Children's Channels		42
4. BBC 4		44
5. BBC 3		46
<b>D. AN ASSESSMENT OF THE MARKET IMPACT OF BBC DIGITAL SERVICES SINCE 2001</b>		<b>48</b>
1. The Likely Impact on Digital Take Up		48
2. The Distinctiveness of BBC Services		51
3. The Broad Impact on Platform Market Structure and Channel Leverage		61
4. The Specific Cash Flow Impact on Rivals		66
5. The Impact on the Creative Production Base		75
6. Overall Summary of Likely Market Impact Since 2001		76
<b>E. A COMPARISON OF THE MARKET IMPACT WITH THAT PREDICTED IN 2001</b>		<b>78</b>
<b>F. LIKELY FUTURE TRENDS TO 2007 AND THE LIKELY FUTURE MARKET IMPACT</b>		<b>79</b>

## INTRODUCTION

In September 2003, the Secretary of State for Culture, Media and Sport announced a review of the BBC's digital TV services launched in 2002/03 – CBBC, CBeebies, BBC 3 and BBC 4. As part of that review, it wished to assess both the BBC's performances so far, against the specific commitments entered into, and the market impact of these services – both since launch and over the next few years.

O&O conducted an initial set of reviews of the potential market impact of these services prior to their launch, in Spring of 2001, and subsequently conducted a review of the likely impact of the modified BBC 3 proposal in Spring 2002, when the initial BBC 3 plan had not been accepted by the Secretary of State. As part of the modified BBC 3 proposal review O&O also worked closely with the ITC – following the publication of our initial report – in order to reconcile the findings of our analysis and evidence submitted by third party channel providers.

The framework and approach adopted by O&O for this review – and set out in the next section - is very similar to those initial reviews conducted in 2001/2002<sup>14</sup>. However, the evidence and analysis used to reach an assessment of the market impact can now include a review of actual channel performance and the evolution of the TV market over the last two to three years, as well as a projection for the next three to four years.

The report consists of 6 main sections.

- a description of the assessment framework to be used in detail
- an analysis of the main market trends over the last three years
- a review of the BBC's digital channels' objectives and performance to date
- an historical impact analysis for each of the four services, concluding with a cross service comparison of impacts and a discussion of the likely cumulative impact of the four services taken as a whole.
- a comparison of the impact from 2001 to 2004, with that initially predicted in the Spring of 2001, (and for the modified BBC 3 proposal in the Spring of 2002).
- an analysis of the likely market trends to 2007 and an assessment of the likely future impact of the BBC's digital services to 2007

Like the previous review, O&O has been asked to assess only the incremental impact of the launch of BBC 3, BBC 4, CBeebies and CBBC, over and above the previous performance of BBC Choice and BBC Knowledge.

O&O has drawn upon a vast amount of information combining its own market information gathered across a number of assignments for broadcasters, investors and

---

<sup>14</sup> Although when assessing the actual likely financial impact on rival channels, we will be focusing on the likely cash impact over the last two years and over the next three years – as we did for the modified BBC 3 proposal review - rather than the Net Present Value measurement used in our initial report in Spring 2001

regulators, and BARB data (supplied by the BBC at our request). We have also been given access to BBC commissioned market research and commissioned our own review of a sample month's output of the BBC channels and their likely nearest commercial counterparts.

In many cases we have pushed the data available to the limits of interpretation. We have, for instance, analysed the demographic profile of channels which often only obtain a 0.1 per cent share of the audience overall, in detail. Such an analysis comes with a relatively high margin for error built in to what are very small samples. However, we have tried to use such data to suggest broadly indicative trends and issues rather than suggesting they provide conclusive proof.

## A. AN ASSESSMENT FRAMEWORK

A broadly similar framework to the initial report in 2001 is adopted in this review. Our analysis has covered three broad questions. The overall aim is to assess whether:

- i. the **conversion to digital TV** in the UK is likely to be (or has been) more rapid;
- ii. effective **consumer choice** is likely to be (or have been) improved; and,
- iii. the UK creative **production base** is likely to be (or has been) strengthened.

### 1. The Impact on Digital Conversion

The first area of assessment, the impact on digital take-up – is a matter of trying to discern the specific impact any particular service, or all the BBC services taken together, might have on the overall penetration of digital TV, and therefore the likely date of analogue switch off and release of spare spectrum.

Clearly, the impact of any BBC service on the scale and mix of digital take-up also has an indirect effect on the overall reach and share of rival services – which is included in the first dimension of an assessment of the impact on competitor viability described below.

### 2. The Impact on Consumer Choice

To analyse the second of the three areas, three separate questions have had to be addressed:

Is the BBC offering something **distinctive** from the commercial market ?

Will the BBC services **threaten the viability** of existing – or potentially new – commercial channels by reducing their revenue or increasing their costs – forcing those channels to either exit the market or dilute their offering to the consumer?

What is the likely net effect of the two factors above?

#### a. Distinctiveness

We have measured and assessed distinctiveness in four different dimensions. First, the target demographic or audience grouping – is the BBC service targeting a gap in the commercial market’s demographic positioning? Second, the mix of programme genres and subjects covered – does the BBC service exhibit a greater range of subjects and programme types, or provide a specific more challenging subject or programme type in more quantity?

Third, the sourcing and cultural relevance of the material – does the BBC reflect UK wide, UK regional or ethnic cultures and tastes more than rivals? Lastly, the format of the

programming – does the BBC employ innovative and distinctive approaches to programme subjects and types when compared with rivals.

To determine this, O&O commissioned the TV programming and classification specialists DGA Limited, to conduct a special review covering 4 weeks of sample schedules of both the BBC services and nearest rival thematic channels – categorising each programme using their proprietary *Microgenres* classification that determines the genre, subject, and format of any specific programme title. They also assessed the sourcing of the programme – UK origination versus acquisition - and then the country of origin of the acquisition.

## **b. Competitor Viability**

We have approached the analysis in two dimensions. First, the broad impact the BBC services may have on multichannel platform take-up and market structure which in turn impacts rival thematic and network services' overall economics and prospects.

Second, we assess the specific impact of BBC services on rival channel audience share, advertising revenue and programming costs which in turn affects short and medium term cash flow.<sup>15</sup>

### **i. The Broad Impact on Platform Take Up, Market Structure and Sub Fees**

The broad impact assesses the likely effect on rival thematic channels and networks of the BBC service's availability on free to air digital platforms in terms of the impact on:

commercial channels overall reach and share; and,

commercial channel leverage with platform owners (and consequently their likely sub fees from platforms)

This level of impact is best assessed across the whole BBC portfolio of new services albeit with some notion of the comparative contribution of each service to the overall effect.

For instance, we have to balance, on the one hand, the likely fact that the presence of BBC services on Freeview may have helped reduce net pay TV take up, and therefore the reach of any rival channel relying on basic tier carriage on pay TV platforms. And on the other hand, the likely fact that, first, BBC services and Freeview have helped bring some rival channels with free to air digital access significantly increased reach (noting that each major channel owning group has such a service), and, second, the increased leverage the availability of BBC free to air services and Freeview has given basic tier pay channels in securing decent satellite carriage fees (now that satellite faces no serious direct pay TV platform competitor).

In the end, the broad platform impact of BBC services on different types of commercial channels and networks is linked to whether free to air digital take up – which is in part driven by BBC services – is a substitute for, additional to, or complementary to pay TV take-up. We provide an overall framework for such an assessment later in this review.

---

<sup>15</sup> The ITC review of the modified BBC 3 proposals focused very much on the specific cash flow impact while recognising the relevance of the broader impact on market structure when assessing the overall impact of all the BBC services combined.

We have used relevant research commissioned in the past by the BBC from independent sources to help ascertain what role BBC services have played in driving free to air digital TV, and whether such take up has been additional to, or at the expense of pay TV.

## ii. The Specific Cash Flow Impact on Share, Advertising Revenue and Programming Costs

This specific cash flow impact is calculated by assessing the likely impact on rivals':

- audience share within relevant multichannel homes,
- advertising revenue (through any reduced share and reach), and,
- programming cost inflation

Rivals assessed include both thematic channels covering the same genre and/or demographic, and commercial networks, where those networks have particularly strong appeal to the target demographic or focus on the target genres. We have reviewed BARB data on the demographics and programming of a large number of channels in order to determine which can be seen as being in the same market segment as each of the relevant BBC services.

The impact on audience share is assessed by tracking the pattern of share – of total audience and key demographics – of the BBC service and the nearest rivals since just before launch of the BBC service. Account is also taken of the extent to which new BBC services have taken share from BBC traditional networks – BBC 1 and BBC 2 – rather than commercial services. We have also had to take account of the variable platform technical reach of different channels so as to determine the extent of likely audience substitution.

In each case, any share changes are measured in terms of incremental changes over and above the previous performance of BBC Choice and BBC Knowledge after the launch of the new channels – BBC 3, BBC 4, CBeebies and CBBC.

The impact of share loss on competitors advertising revenue is assessed by reference to evidence on both general elasticity of demand for TV advertising<sup>16</sup> – where we draw on a recent new study<sup>17</sup> – and more specific analysis of the demand for thematic channel advertising and advertising to key demographics.

A review of the likely impact on programming costs relates to whether the BBC is directly competing with rival channels for specific programmes, and in particular whether they are competing for key demand sensitive programme and film acquisitions.

This specific cash flow impact can be assessed very much on a service by service basis – although there may be some areas where the combined impact of all four services is greater than the sum of their parts.

---

<sup>16</sup> Elasticity of demand for advertising measures the change on quantity demanded in response to a price change, or the response of price to a quantity change. An elasticity of -2 for instance, means that for every reduction in quantity supplied (commercial impacts) of 10 per cent, the price will rise by 5 per cent.

<sup>17</sup> Davies and Moffat, University of East Anglia, to be published Spring 2004.

The approach to measuring the impact on BBC 4 rivals will, however, differ slightly from the other services in order to capture any impact on Artsworld, an a la carte pay TV service specialising in performance and arts documentaries. In this special case, we will have to assess the broad platform impact of BBC services on overall take-up and pay channel leverage with platform owners, along side the likely specific impact on the number of a la carte subscribers to the Artsworld channel.

### **3. The Impact on the Production Base**

To analyse the third main impact area – the creative production base – we looked specifically at:

what are the BBC services likely contributions to new UK programme investment and talent?

What is the value and worth of such investment?

What is the likely impact on commercial channel investment?

The first two of these areas involve assessing the BBC's overall investment in new programming in the context of its relative contribution to overall spending on all TV programming and spending on UK programming for the specific group targeted by the BBC service. It also assesses the types of programme invested in, and whether such investment makes a significant contribution to nurturing new talent both in front and behind the screen.

In the last of these areas, we try to assess whether the BBC's investment has encouraged rivals to similarly up their investment in new programming, and more expensive types of programming.

## B. RECENT TRENDS IN THE UK TV MARKET

### 1. General Background

The £8.5 billion UK TV market, is divided into three main segments which together support a £3 billion original TV content creation sector which represents the largest content spend per head of any developed nation – including the USA.<sup>18</sup>

The first segment is the network TV market, worth about £4.5 billion, and made up five main network broadcasters all available free to air to almost all the UK population, and each spending a significant amount of money on a mixed schedule of largely home grown programming. These networks still account for 75 per cent of all viewing, and over 80 per cent of peak time viewing.

The second segment is the UK multi-channel TV market which is worth about £3.5 billion and is only available to those who purchase appropriate reception equipment (now nearly all digital) and which supports three more distinct sub-segments. First, the premium pay TV market, providing early run film, live sports, pornography and ethnic channels charging between £5 and £15 per month per full channel or £3 to £8 on a pay per view basis.

Second, the basic package thematic channel segment providing groups of 20 to 100 genre based channels (children's, music, news, entertainment, documentary services) usually for a combined package price of between £5 and £15 a month. Each channel receives a small sub fee per month from the pay TV provider which supplements their advertising income. Third, a free to air sub-segment – available on purchase of appropriate reception equipment –which currently includes a mixture of spin off mini-networks such as ITV2 and BBC 3, and a collection of music, general sports, entertainment and religious channels.

The third segment is the transactional and interactive TV market which is worth about £0.5 billion and which includes 20 or more home shopping channels and various interactive information and gaming services. These services are also usually available to anyone who purchases the relevant reception equipment although further charges are levied on a per transaction or per play basis and income is earned through the either premium phone lines or automatic dial up modem services.

Reception of TV is either through:

analogue terrestrial TV – which gives access to the five networks, or

digital terrestrial TV, which gives access to the five networks plus some of the free to air mini networks and thematic services plus some interactive and transactional services, or

cable and digital satellite TV reception, which gives access to the networks, the free to air mini networks and thematic channels, the premium and basic tier thematic pay TV channels, and a wide range of interactive and transactional services

---

<sup>18</sup> See the ITC Programme Supply Market Review – November 2002.

Most individual households retain multiple reception methods with, for example, most cable and satellite households maintaining reception of analogue terrestrial services to portable sets and as a back up should their digital system fail.

A very small number of homes also receive their TV through DSL telecom connections to bespoke TV services that offer premium pay TV types of service on a pay per view type basis – so called video on demand (VoD) systems.

The UK TV market has been through some significant changes since O&O's initial potential market impact report in 2001 (and even since O&O's assessment of the revised BBC 3 proposals in the Spring of 2002). Set out below are the main trends over the last three years. We have assessed the market in terms of TV distribution, market dynamics and viewer choice. We have also reviewed each of the market segments identified in our initial report in 2001, namely, network TV, thematic channels, premium pay TV and interactive/transactional services.

## **2. Delivery Platforms**

### ***Digital TV Penetration has Risen from 30 per cent of households to about 45 per cent***

Total digital penetration has grown from 7.5 million homes in the first quarter of 2001 to 12 million homes by the end of 2003. Growth has been driven by three main factors.

First, the continued conversion of cable households to digital reception encouraged by more channels, enhanced interactive services and the cross promotion and provision of broadband internet access. At the beginning of 2001 just one third of all cable TV homes were digital, this had risen to two thirds by the end of 2003.

Second, the continued expansion of digital terrestrial as a distribution mechanism despite the high profile collapse of the ITV Digital pay TV service that occupied over half the digital terrestrial capacity in May 2002. The number of households whose sole form of digital reception is terrestrial have risen from 1.1 million at the beginning of 2001 to 1.9 million by end of 2003, with a further 250,000 households having both digital terrestrial and another digital system.

Third, the expansion of digital satellite following the complete conversion of the installed base of analogue satellite receivers by the second quarter of 2001. At that point there were 5.6 million satellite homes, this had risen to about 7.8 million homes by the end of 2003, approximately 6.9 million of which were paying Sky subscribers.

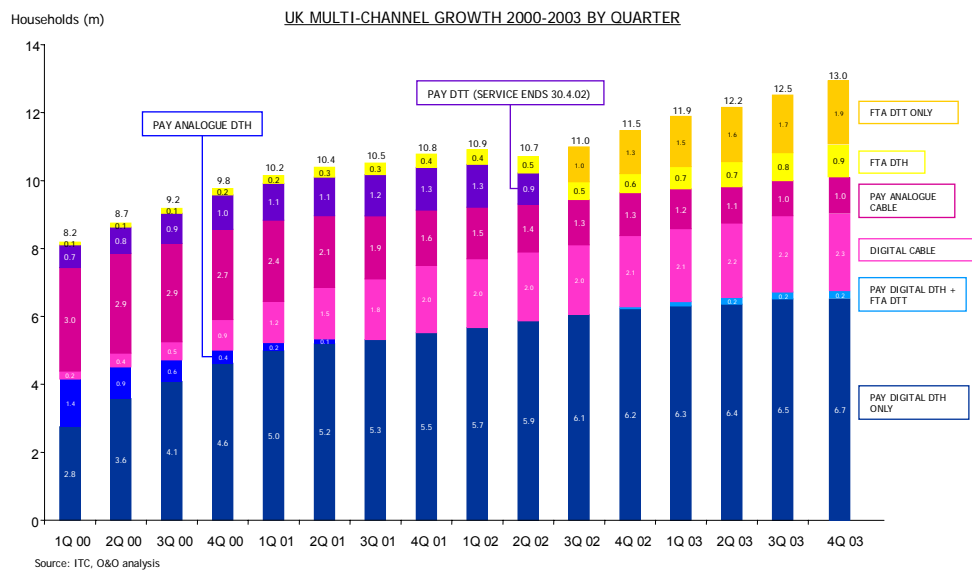
### ***Total Pay TV Penetration Has Stalled While Free to Air Distribution Has Grown – the Total Number of Pay TV homes at the end of 2003 was little more than in Early 2001***

The collapse of ITV Digital, the stagnation and bankruptcy of UK cable operators, and the healthy growth of both free to air digital terrestrial and digital satellite reception have meant that while digital penetration increased significantly pay TV subscriber levels have risen slightly and then fallen back.

There were 9.9 million pay TV homes in the UK at the beginning of 2001, this had risen only slightly to 10.2 million by the end of 2003.

In contrast, the number of free air digital homes has risen from 0.2 million to 3.0 million<sup>19</sup> from the beginning of 2001 to the end of 2003, a growth averaging more than 100,000 homes per month. (See Figure 2 below)

Figure 2



***While Multichannel Access is Now Available at Home to About 55 per cent of UK Viewers, the Level of Access Varies More Widely.***

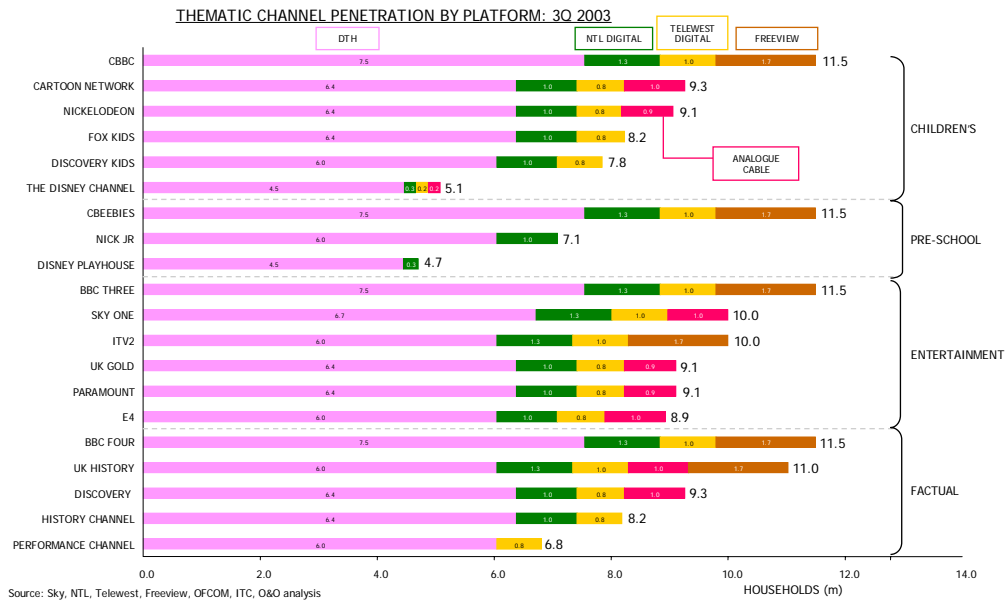
Total multichannel access has grown from 10.2 million households to 13.0 million households, and now reaches over 50 per cent of all TV households and about 55 per cent of all viewers. But the level of access to services now varies more widely than in 2001, with 1.9 million homes having access to just 26 free to air channels, and only about 6.5 million homes choosing to pay for access to the whole range of free, basic package and premium pay TV services.

This has meant that individual thematic TV channels now have very different levels of technical reach across all the UK’s multichannel homes – with BBC services typically reaching nearly all the 13 million multichannel homes (with the exception of analogue cable) while E4, for example, only reaches about 9 million homes.<sup>20</sup> (See Figure 3)

<sup>19</sup> The latest OFCOM report has suggested that free to air digital satellite homes having been about 900,000 have shrunk to just 200,000 due to the need to buy a new smart card (previously all the networks had clubbed together to subsidise the smart card). However, it is more likely that those who do not have the smart card are still watching the BBC channels, and other channels such as Turner Classic Movies etc rather than abandoning the receiver box entirely. These channels, unlike Channel 4, ITV and FIVE are available unencrypted and therefore can be seen without the use of a smartcard.

<sup>20</sup> This will be relevant to audience share impact assessment. BBC services can not be considered to have a direct impact on the audience share of a potential rival within homes that do not receive the rival service.

Figure 3

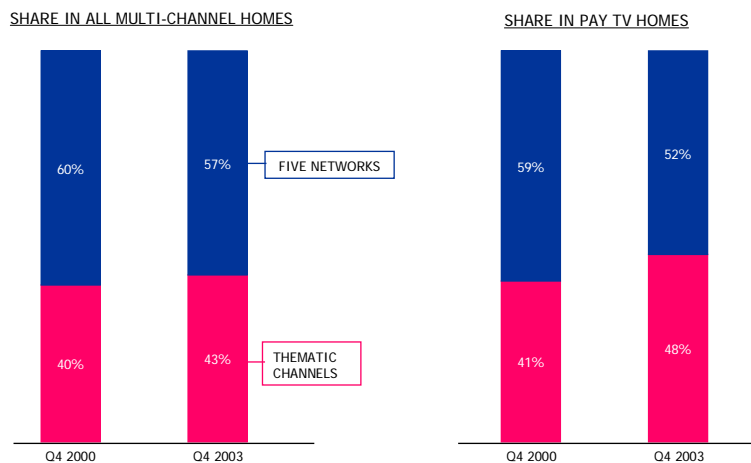


### 3. Competition and Audience Share

*Non-Network Share of All Viewing Has Risen from about 19 per cent to 24 per cent, this has been driven by Both Increased Overall Multichannel Penetration and Significantly Increased Share of Thematic Channels Within Cable and Satellite Pay TV Homes.*

The overall share taken by non-network channels in multichannel homes has risen only marginally in the last two years – from 41 per cent to 43 per cent of all viewing. But this hides two separate trends – with a growing number of 26 channel digital terrestrial households where just 16 per cent of viewing goes to non network channels, and the fairly fixed number of pay TV homes over the period, where non-network audience share has risen from about 41 per cent to 48 per cent of all viewing hours. (See Figure 4)

Figure 4

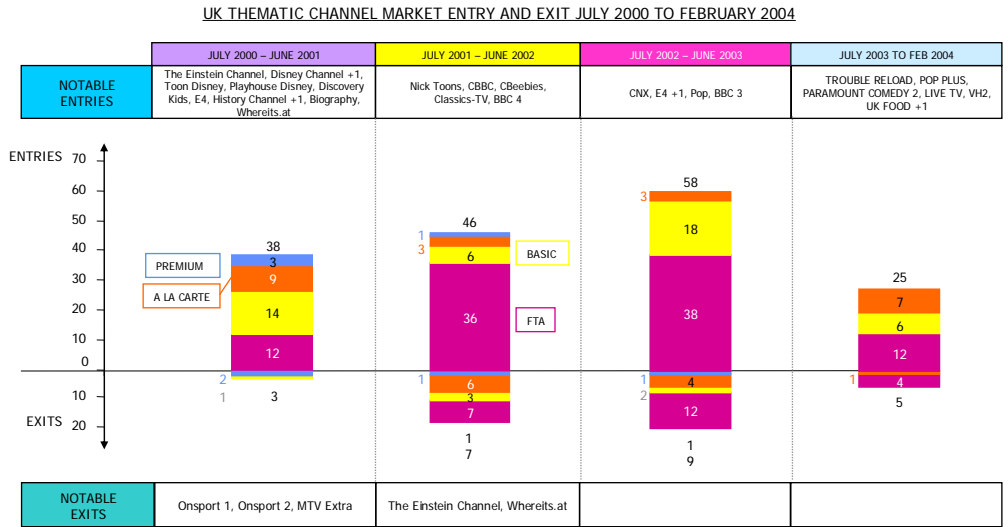


Source: BARB, O&O analysis

***Net New Market Entry to the UK Multichannel Market Continues At a Rapid Pace But Mostly in Home Shopping and Time-Shifted Versions of Existing Channels***

The total number of non-network channels available in the UK has continued to increase over the last three years rising from 155 in 2001 to 243 by the beginning of 2004. Expansion has come mainly in the new free to air home shopping, religious and ethnic channels, and new basic pay tier entertainment, factual, children's and music channels. Much of the basic tier channel growth has come from the launch of so called multiplexed or time shifted channels (e.g. Sky One Mix, Trouble Reload, and E4+1), where existing channels recycle their schedule in different combinations to help protect audience share. (See Figure 5).

Figure 5



Source: Company accounts, BARB, Flextech, O&O analysis

***The Two Main Networks Continued to Lose Share to both Other Networks and Thematic Channels, But Channel 4 Has Gained Share in Each Household Type, Especially amongst 20 to 40 year olds.***

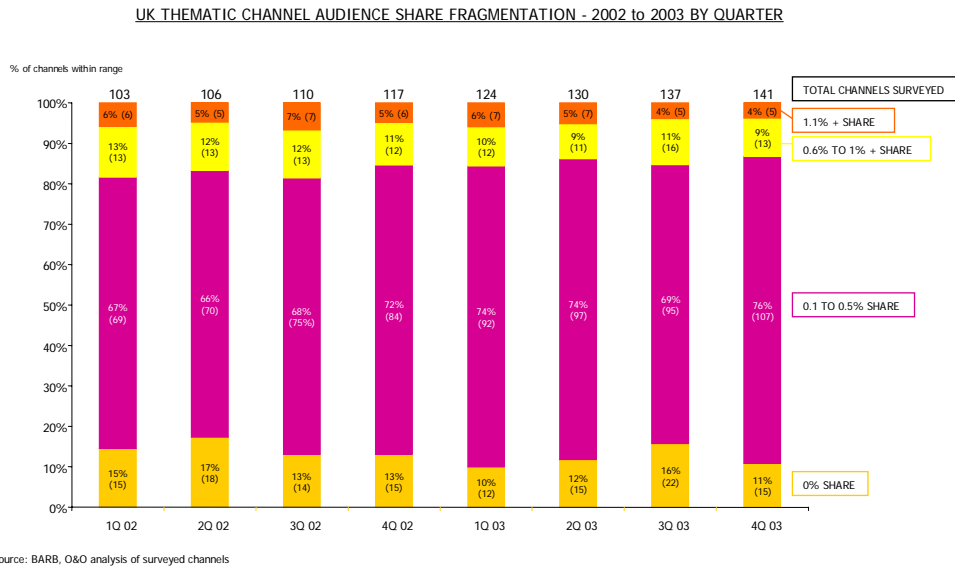
The main networks – BBC1 and ITV1 – have been losing share since 2001 to BBC 2, Channel 4, and FIVE in analogue five channel homes, while also losing share to thematic channels in multi-channel homes.

Channel 4 in contrast has gained share in traditional terrestrial households, Freeview homes and multi channel pay TV homes since 2001. Channel 4 has, therefore, only lost share overall across the last two years due to the rising penetration of all multi channel TV.

Channel 4 has also gained most share in the 10 to 40 age groups in pay TV homes despite the number of thematic entertainment channels targeting the 16 to 35 age group including its own E4 channel.

BBC 2 in contrast, has gained share in traditional five channel homes, but lost share in multi-channel homes. It has also lost most share amongst audiences aged 20 to 34 in mutlichannel pay TV homes.

Figure 6



**Audience Fragmentation between Thematic Channels Continues**

With the number of channels rising by about 50 per cent over the last three years, and share in all multichannel homes rising by less than 10 per cent (from 40 to 43 per cent) it is perhaps not surprising that thematic channel audiences continue to fragment, with the average channel share falling from 0.25 share to 0.18 share from 2001 to 2003. Within pay TV multichannel homes the average share has fallen from 0.26 to 0.19 while the total number of pay TV households has hardly risen at all.

This fragmentation has probably had most impact on the leading thematic channels. While at the beginning of 2002, about 1 in 5 thematic channels measured by BARB had audience share of 0.6 and above, by the end of 2003 it was just 1 in 8 channels. Although many of these leading channels have compensated for share loss in their main channel by creating time-shifted extra versions, this has effectively increased the costs of maintaining their previous share. (See Figure 6)

***Thematic Channels Owned and Operated by Commercial Networks – E4 and ITV 2 – Are Making Increasing Use of Network Spin-Off and Catch Up Programming and Are Generally Resisting the Fragmentation Trend***

Two commercial thematic channels to buck the overall fragmentation trend to some extent have been ITV 2 and E4. Both channels have made extensive use of main network spin off and repeat programming from ITV1 and Channel 4 respectively to help protect or increase their share. This scheduling policy has allowed both channels to exceed 2 per cent share within their relevant multi-channel household universe when transmitting major network strands or spin off versions.

#### **4. TV Advertising**

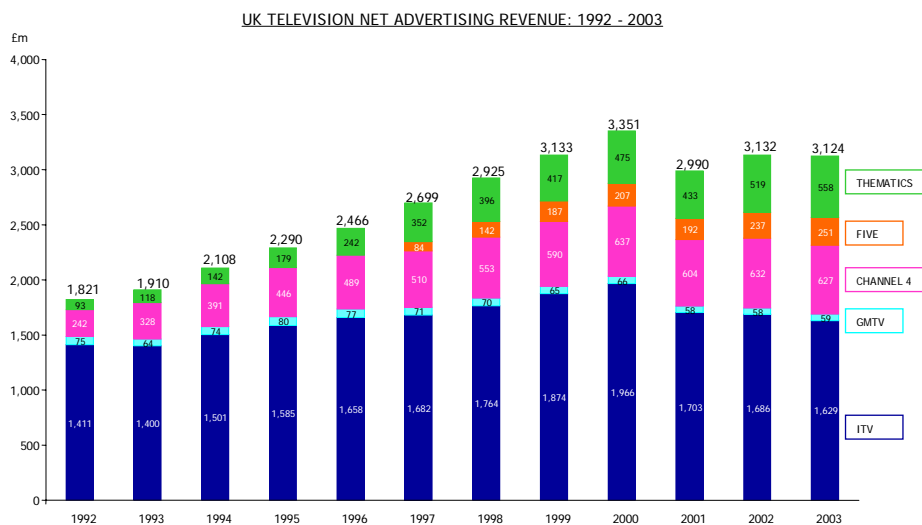
***A Significant Advertising Recession has Confirmed the Cyclical Nature of TV Advertising But Only Really Stalled the Commercial Market***

Most studies of TV advertising have suggested that demand is driven by consumer spending (sales) and corporate profit levels (margins). With consumer spending growth in the UK tending to average about 2 per cent in real terms a year, this then tended to drive an underlying growth of about 3 to 4 per cent a year in real terms in TV advertising.

While consumer spending growth can vary from year to year causing cyclical fluctuations in growth, its variance is not as great as corporate profit margins which can change dramatically from year to year. Changes in margins on products sold has been behind most the dramatic swings in TV advertising growth over the last 40 years, and was the main factor behind the recent slump, from 2000 to 2002, where total TV advertising revenue fell by 15 per cent in real terms, despite strong consumer spending growth fuelled by low interest rates. (See Figure 7)

Dotcom boom related over investment and generally high levels of overcapacity in the UK economy in 2001, caused a rapid drop in corporate profit margins and TV advertising. However, as these margins improved, advertising revenue growth began to return – with consumer spending growth holding up fairly well despite anticipated interest rate rises.

Figure 7



Source: ITC, BSKyB, Bear Sterns, Advertising Association, O&O analysis

N.B. Excludes FTA sponsorship revenue and S4C

**Overall UK TV Advertising Elasticity of Demand May Well Now Be Below -2**

The economic analysis which has established the main economic drivers of demand for TV advertising over time has also attempted to measure the reaction of TV advertising to changes in the volume of supply – which is measured as total commercial home impacts (i.e. commercial audiences per hour X transmission hours per year X advertising minutes per hour).

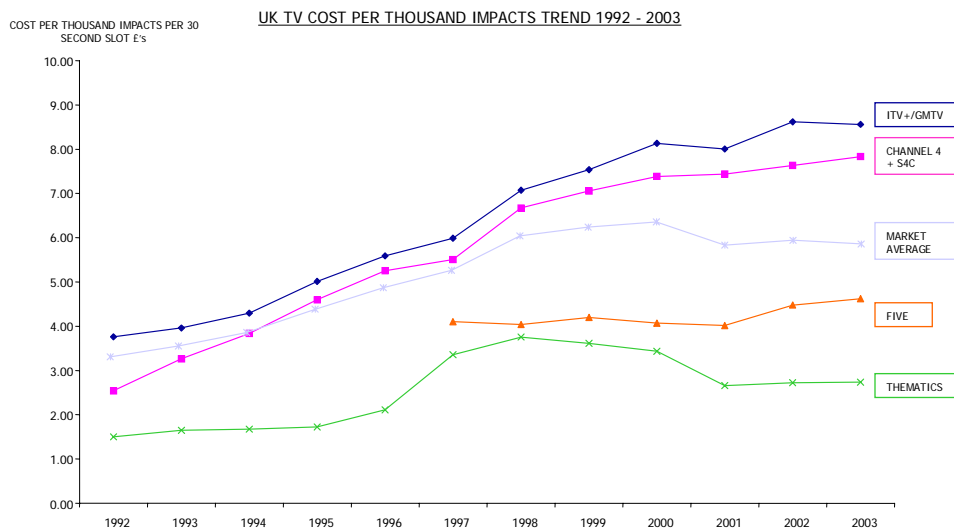
The most thorough statistical economic analysis of the UK TV advertising market up until this year was a study conducted by Professor David Hendry back in 1993 using market data up to 1989. This study had suggested that the elasticity of demand for TV advertising in the UK was about -2.5, which implies that a 10 per cent reduction in commercial audience would increase price by 4 per cent, and therefore revenue would fall by 6 per cent.<sup>21</sup>

Recent research by Stephen Davies and Peter Moffatt of the University of East Anglia which has tried to replicate Hendry’s results for the period to 1989, and then to use a similar approach to trends from 1987 to 2002, suggests that the elasticity of demand for all TV advertising may well be reducing with the increase in total commercial audience and the advent of satellite and FIVE in the 1990s. Their analysis suggests a market elasticity of -1.7, which would suggest that a 10 per cent reduction in viewing impacts would reduce revenue by just 4 per cent, as prices increased by 6 per cent.

<sup>21</sup> This study was used in our previous impact reviews in 2001 and 2002 and by the ITC in their analysis of the impact of the modified BBC 3 position. It

This study also suggested that elasticity of demand for network TV advertising was probably below -2, but it could not obtain any sensible results for satellite advertising given the relatively short period over which data is available and the relative immaturity of the medium.

Figure 8



Source: ITC, BSkyB, Bear Stearns, Advertising Association, O&O analysis

***While Thematic Channels Have Increased Their Overall Impacts Considerably, Advertising Prices Per Impact have Fallen Since 1998 Suggesting Limited Elasticity***

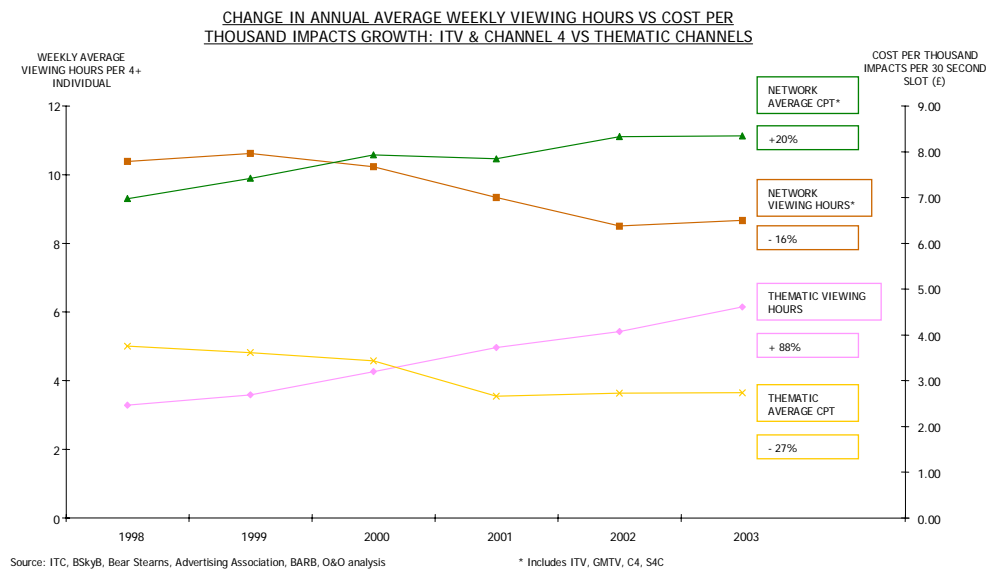
Observations on the pattern of volume growth and price growth for thematic channels in the UK since 1992, do, however, tend to suggest that the demand for thematic channel advertising might also have an elasticity of -3 or less.

The outturn price of advertising on thematic channels in the UK remained fairly flat from 1992 to 1995, as multichannel TV penetration remained below 20 per cent, and thematic channel overall share of viewing below 10 per cent. But with growth in both satellite and cable penetration between 1995 and 1998 – and prior to the full impact of Channel 5’s launch – the price of these impacts doubled – as thematic channel advertising probably started to register with larger advertisers for the first time. (See Figure 8)

However, since 1998, while the volume of impacts on thematic channels has increased by a further 88 per cent to the end of 2003, the average price achieved on thematic

channels has dropped by 27 per cent.<sup>22</sup> This suggests that increases in the volume of impacts offered by satellite do depress the price – and conversely, that a reduction in volume might increase the price.

Figure 9



***While Commercial Impacts for Leading Networks have Fallen Advertising Prices Have Increased***

While thematic channels have seen their volume of impacts increase by 88 per cent over the last six years, the leading networks taken together – ITV and Channel 4 - have seen their viewing hours fall by 16 per cent while the price of advertising has increased by 20 per cent. This tends to suggest that demand for leading network advertising is not very elastic, with declines in volume pushing up price significantly and cushioning revenue loss. (See Figure 9)

***If 10 per cent of the Respective Price Changes in Thematic and Network Channel Advertising Since 1998 have Been Due to Increases in Overall Demand From the General Economy this Might Suggest an Elasticity of Network Advertising of about -1.6 and Thematic Advertising of -2.5.***

Demand for both network and thematic channel advertising is likely to rise relatively equally with the state of consumer spending and corporate profit margins. The studies that have been conducted suggest that real TV advertising tends to grow by 1.5 times

<sup>22</sup> While price changes are also due to changes in demand for advertising related to the economy, the period of 1998 to 2003 has seen both a demand boom – from 1998 to 2000 - and slump –from 2000 to 2002, year the price has dropped consistently over the period.

the rate of real consumer spending growth, and at about 0.8 times the rate of corporate profit margin growth.

Given consumer spending growth and corporate margin growth and decline since 1998, it is likely that about 10 per cent of the price growth over the period from 1998 has been due to changes in the economy.

This would suggest, other things being equal, that the elasticity of demand for airtime on ITV and Channel 4 is about -1.6 and for thematic channels about -2.5.

That is, a 16 per cent fall in network audiences causing a 10 per cent price fall (excluding demand factors), and an 88 per cent volume increase for thematic channels causing a 37 per cent price fall (excluding the same demand factors). The elasticity for network advertising this suggests also seems to be similar to the long term result from the recent econometric study by Davies and Moffatt.

### ***Networks Still Enjoy a Significant Price Premium to Thematic Channels***

The net impact of the likely elasticity of demand for network and thematic channel advertising is likely to be a continued premium on leading network TV advertising prices versus the market average – indeed, it could well be an increasing premium.

### ***Advertising Sub-Markets Also Exist for Distinct Demographic groups Such as Children and 16 to 35 year Olds – They are a Combination of the Audiences provided by Thematic Channels Focused on the Specific Demographic and Individual Network Programmes with a Significant Skew Towards the Demographic***

Children's advertisers in the UK clearly utilise both the children's slot on ITV and airtime on commercial children's thematic channels. Similarly, advertisers targeting 16 to 35 year old viewers – who tend to watch less TV and are, therefore, expensive to reach - tend to buy slots in programmes with a strong skew to the demographic.

Thematic channels that attract a particularly valuable demographic will attract a significantly higher advertising price than the average market price for thematics – especially those that attract the demographic in numbers. Networks that have programmes skewed to a valuable demographic are, however, only likely to attract a small premium to the average network price per thousand impacts for those programmes, as network programmes – even skewed ones – always have a certain significant proportion of the audience outside the target demographic that has zero value to the specialist advertiser.<sup>23</sup>

The market for advertising to these specific valuable demographics is probably also more elastic than the average for all thematic channels, with advertisers keen to buy extra impacts when they become available. Elasticity of demand for this demographic could well be -3 or more.

---

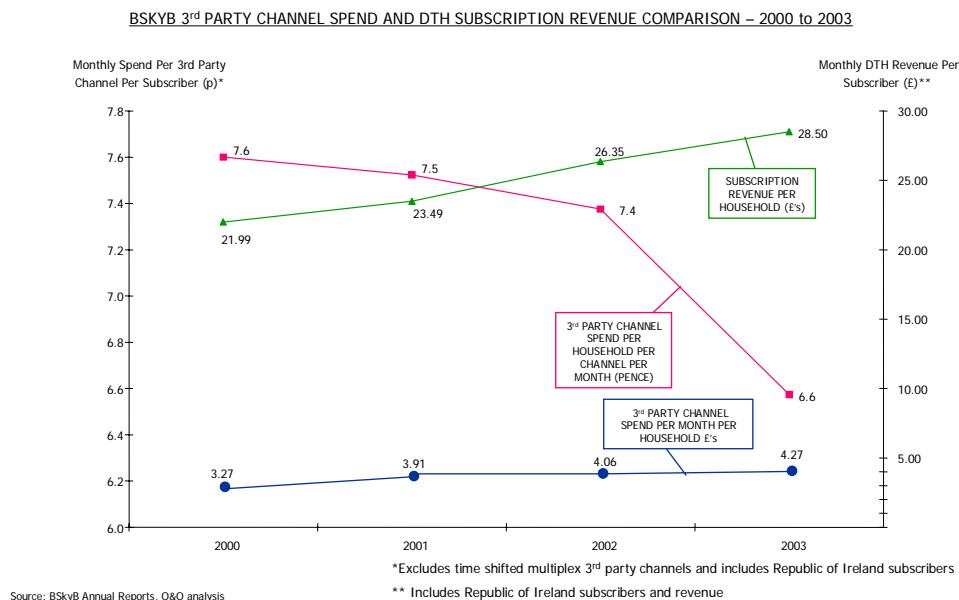
<sup>23</sup> It should be noted that even though Channel 4 had a general skew to 16 to 34 year old viewing, not all of Channel 4's slots and advertising is part of the 16 to 34 year old advertising market – only programmes with a strong skew to this audience are actually bought by advertisers targeting this market.

## 5. Thematic Multichannel TV Economics

### *Pay TV Distribution has Concentrated*

While the overall number of pay TV homes has grown only marginally from 2001 to 2003, the mix of distribution has shifted significantly towards satellite. With the collapse of ITV Digital and the financial restructuring of cable TV, Sky satellite homes now account for 67 per cent of all pay TV homes versus 52 per cent two years ago, and with cable subscribers more or less at a standstill, is the only real engine of pay TV growth.

Figure 10



### *Audience Fragmentation and Sub Fee Pressure has Dampened Down the Revenue Growth of Thematic Channels.*

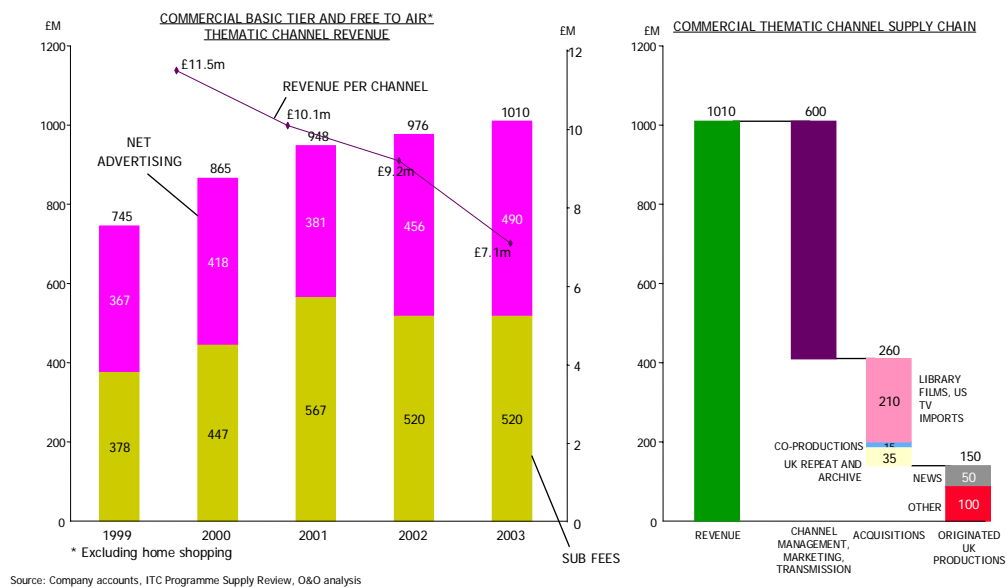
With little strong competition for content and channels in the UK pay TV market, Sky has been able to exert downward pressure on the sub fees per channel it pays to services in the basic tier package, with the average price per channel carried per household per month falling from 7.5 pence in 2001 to 6.6 pence in 2003. (See Figure 10)

This downward pressure is only constrained by the need to keep the package strong enough to drive future growth, and the presence of Freeview and free to air satellite reception which gives some channels the option of adopting an advertising only strategy outside the basic tier package, and gaining the extra 3 million household reach such a strategy brings.

While satellite pay TV homes have been growing over this period which in part compensates for reduced rates from BSkyB per household, total pay TV home numbers have not been growing, which has led to a reduction in average subscription fee income per channel per year. Add to this, the fragmentation of audiences within multichannel homes, and the declining or at best flat price of thematic channel advertising impacts, and it is not surprising that over the last three years the average revenue per thematic channel has declined.

O&O's own analysis of the market suggests that while the total sub fee and advertising income of all basic tier pay TV channels and free to air commercial thematic channels (excluding home shopping and gaming channels which rely on a different economic model) has increased from about £850m to just over £1 billion, the average revenue per channel has fallen from £11m to £7m a year – although some of this reduction reflects the growth of multiplex channels that can be added at very low marginal cost. (See Figure 11)

Figure 11



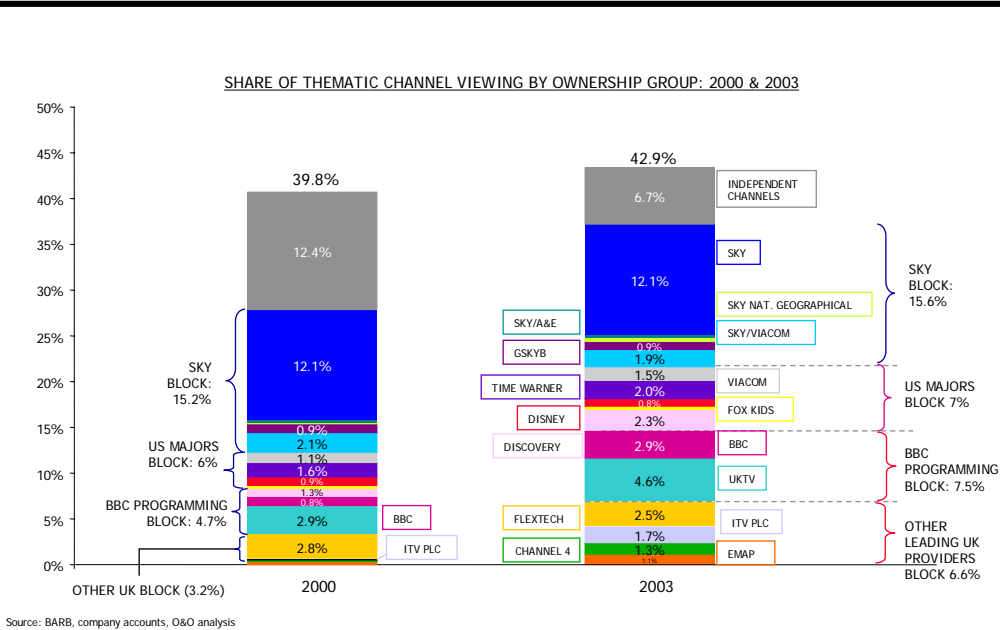
**Channel Ownership Consolidation and Channel Portfolio Realignment Have Been the Routes to Greater Profitability within Basic Tier Channel Revenue Growth**

Given these financial pressures on individual channels it should not be surprising that the share of all thematic channel viewing taken by leading channel owning groups has increased from 70 per cent to 84 per cent over the last 4 years, with Flextech/UKTV, ITV, Channel 4 and EMAP emerging as the leading independent UK channel owners, and the US major studios (Disney, Time Warner, Viacom, Universal) consolidating their share of audience.

Over the last three years – faced with relatively low growth income – most thematic channel owners have focused on realigning their portfolio of channels to ensure they “own” as many audience sub-segments as possible, rather than increasing programming budgets significantly. Even E4 and ITV2 have cut their overall programme budget over the last two years.

Most significant thematic channels in the UK are now owned by much larger UK or USA based media and TV groups. (See Figure 12 and Exhibits A and B in the Appendix).

Figure 12



## 6. Programming and Content

### *Thematic Channels Spending on New Programming Is Still Relatively Small*

With the average revenue per basic tier pay TV channel declining, and only the strongest channels and channel owners experiencing significant revenue growth over the last three years – and even then often only as a consequence of adding channels to their portfolios and introducing time shifted versions - thematic channel funding of new programming has probably not increased much over the last three years. Most still rely heavily on imports and UK archive repeats.

Work initially done by O&O for the ITC programme supply review in 2002 and updated for 2003, suggests that commercial thematic channels combined (excluding news, sports and home shopping) probably only account for about £105m of new programming and co-production spend. This represents just 5 per cent of total UK spending on such programming.

Most of this original programming spend is focused on leading commercial entertainment channels such as Sky One, E4 and ITV 2, or international channel owning groups such as Viacom and Discovery, who can share the costs of new UK production across several channels in the UK and overseas.

Much of the investment on E4 and ITV2 now goes into spin offs and extensions of Channel 4 and ITV1 shows rather than truly original strands.

***Most Thematic Channels Will Still Spend More on Marketing and Interstitial Presentation Programming Than New Commissions***

A typical basic tier pay TV thematic channel getting 0.2 per cent share will probably have annual revenues of about £10m. Transmission, playout, marketing, administration and presentation programming costs will be about £5m, leaving a programme budget of just £4m consistent with profitability – or about £1,000 an hour for a 12 hour a day service.

Only channels with 0.5 per cent share or more of the multichannel audience –or a group of channels with a combined share of 0.5 per cent and sharing the same programming - can contemplate any significant investment in new programming.

***Imports and Archive still Dominate Commercial Thematic TV Channels***

Imports and – to a lesser extent UK archive programming – still dominate the schedules of thematic channels. O&O has estimated that thematic channels spend about £45m of UK repeats and archive programming, compared to an estimated £200m spent on films, programme imports and music videos.<sup>24</sup>

Of the 14 commercial channels surveyed for this report, non UK programming accounted for the majority of output on 12 of the channels – the only two exceptions being E4 and ITV2, both of whom make extensive use of network spin off and repeat programming. Across the whole UK market – and excluding news, sport and home shopping again – only the UKTV channels – 50 per cent owned by the BBC – manage to show mostly UK programming – and then almost entirely repeats of BBC network material.

***The Market for Top Acquisitions has Probably been strong, but the Market Has Probably Been Fairly Flat for the Bulk of Material***

The thematic channel acquisitions market is still made up of a number of effective sub-segments with the prices for top new US drama, comedy and entertainment shows often exceeding £250,000 per purchased hour (usually allowing 6 repeat days, and a number of showings per day), but the price of most archive and less strong new material tends to be at the £4,000 to £10,000 per purchased hour level, implying a cost per transmitted hour of perhaps £500 to £1,000.

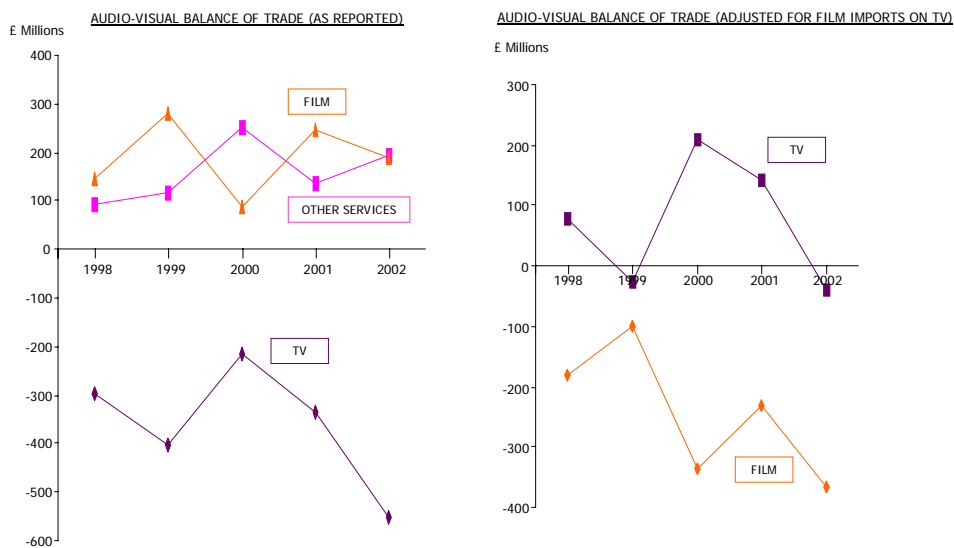
The growth of multiplex or timeshift channels has probably meant that channels have to negotiate more repeats per purchased hour, forcing the price of a purchased hour up, but probably leaving a lower price per transmitted hour. This in turn allows incumbent channels to run extra multiplex channels at low incremental cost.

---

<sup>24</sup> Within some international channel groupings this spend may not be directly recognised as an expense but may be given effectively free of charge to UK channel versions.

Competition between E4 and Sky One – and one or two other channels such as Living – for top US acquisitions has probably pushed the price up at the top end of the market. In addition, Sky One’s strategy of securing a window on the programming before the main networks, may have forced the price up for the very top strands even further. But overall, volume of purchased hour increases rather than price increases are probably driving import spending, and purchased hours are probably increasing much more slowly than transmitted hours given the higher repeat rates.

Figure 13



Source: O&O, ONS, company accounts, O&O analysis

***The UK's Balance of Trade in TV Is Adversely Impacted by This Reliance of Thematic Channels on Imports***

UK exports of TV programming and programme related rights have grown by about 6 per cent per year over the last 5 years, about the same as overall UK production spending growth. With thematic channels investing relatively little in new UK programming they are contributing little to this export growth while bringing in an estimated £200m or so of TV programme imports.

Overall, and even adjusting for the usual presence of feature film imports in the UK TV sector trade figures, UK TV channels and programme makers actually imported more than they exported in 2002, despite the UK having the highest originated local content spend per head in the world. (See Figure 13)

## **7. General Implications for the Market Impact Analysis**

The above market analysis has several direct and indirect implications for the impact assessment in the following sections.

### **a. Audience Share Impact**

#### ***Analysis needs to take account of different channel technical reach***

The significant differences in the levels and rates of change in technical reach amongst individual thematic channels in the UK caused by their availability on different platforms and on different tiers within platforms, means great care has to be taken when assessing the impact of one thematic channel on the share of another. For instance, a channel carried on pay TV platforms only can only lose share directly to a rival channel in those homes, it can not lose share to a rival channel in Freeview homes. (Of course, it may suffer indirectly if the rival channel helps drive a platform that the pay TV channel is not carried on – and the rival platform is a substitute for the pay TV platform – but that is a general and indirect impact which needs to be assessed in a different way).

#### ***New Commercial Channel Entry and General Audience Fragmentation May Have A More Significant Impact on the Audience Share of Incumbent Channels than New BBC Services***

With a high rate of new channel entry and exit, and a general fragmentation of audiences between thematic channels, care has to be taken in attributing any share loss specifically to the launch of BBC services.

Any share, reach and demographic changes within rival channels are likely to be the result of these general market trends as well as the entry of new BBC services.

### **b. Financial Impact**

#### ***Audience Share Losses From the Arrival of BBC Services Are Likely to Cause a Less Than Proportionate Loss in Advertising Revenue***

The market analysis suggests a certain range of elasticities to be used when estimating the likely impact of audience share loss amongst rival channels on their advertising revenue. These are set out in Figure 14 and in each case the implications for advertising revenue from a 10 per cent reduction in commercial audiences is also highlighted.

Figure 14

UK ADVERTISING MARKET – ELASTICITY ESTIMATES

SOURCE	ELASTICITY ESTIMATE	IMPLIED IMPACT OF 10% REDUCTION IN COMMERCIAL IMPACTS ON ADVERTISING REVENUE
HENDRY TV MARKET ELASTICITY (1974 TO 1989 DATA)	-2.5	6%
DAVIES/MOFFATT TV MARKET ELASTICITY (1987 TO 2002 DATA)	-1.7	4%
O&O ESTIMATED NETWORK TV ELASTICITY (1995 TO 2003 MARKET OBSERVATIONS)	-1.6	3.8%
O&O ESTIMATED THEMATIC TV ELASTICITY (1995 TO 2003 OBSERVATIONS)	-2.5	6%
O&O ESTIMATE – 16 TO 35 YEAR OLD ADVERTISING MARKET	-3.0	6.7%
O&O ESTIMATE – CHILDREN'S ADVERTISING MARKET	-1.25	2%

The main implications of these elasticities are that a ten per cent share loss of audience impacts by commercial networks due to the existence of a new BBC digital service is only likely to lead to a 4 per cent reduction in commercial network revenue, while a 10 per cent audience impact loss by thematic channels taken together is only likely to reduce revenue by 6 per cent. Within the 16 to 35 advertising market- should it be capable of measurement given that it combines advertising within 16 to 35 skewed programmes on Channel 4 with a selection of thematic channels' advertising - a 10 per cent audience impact loss might cause a 6.7 per cent loss of revenue.

**c. The Broad Impact of BBC Services on the Commercial Market**

***Increased Concentration in the Pay TV Platform Market May Have More Impact on Rival Thematic Channels than New BBC Services***

Over the period being analysed, one pay TV platform was closed down and another – cable – went into administration – while BSkyB's share of pay TV subscribers went from 52 per cent at the end of 2000 to 67 per cent at the end of 2003. At the same time, TV advertising, which had been growing at a rate of 5 to 6 per cent a year, suddenly fell by 11 per cent in 2001, and has still not recovered to 1998 levels in real terms. Such seismic changes in the UK TV industry structure are likely to have a larger impact on the economics of thematic channels than the entry of four BBC services – even within the sub-markets where these channels operate.

***BBC Services Contribution to the Relative Growth of Freeview Is Likely to Be the Main Indirect Impact***

The significant reduction in pay TV platform competition, accompanied by flat pay TV penetration but rapidly growing free to air digital reception, imply that the BBC's services – which are a large component of the free to air digital proposition, especially on

Freeview – may have had a significant impact on the general economics of the commercial channels.

BBC services have probably helped drive overall digital penetration, may have helped substitute for extra pay TV penetration, but may also have helped establish the main competing digital platform to digital satellite, and as such may represent an important driving force behind the main alternative route to financial viability for any new thematic channel – i.e. free to air digital distribution versus carriage in the Sky basic pay package.

#### **d. Programme Costs and the Production Base**

The new BBC services are only likely to force up the price of competitor programming if they becomes involved in bidding for top acquisitions – something their current strategy is unlikely to involve.

If BBC digital channels were significant users of BBC archive and this archive was of particular importance to a rival channel, then the channels could be said to be raising rivals costs. But none of these channels is a significant user of BBC archive, and very few areas of BBC archive are likely to be vital to the success of failure of commercial channels.<sup>25</sup>

With the UK thematic channel market still contributing little to new UK programming investment the comparative impact of the BBC service on the overall UK production base and new programming making talent is likely to be positive.

To the extent the BBC does take some share and revenue from competitors, this is unlikely to result in a significant reduction in their new programme spend given that most channel operators – encouraged to some extent by pay TV platform owners- seem to be pursuing a strategy of expanding the number of repeats of archive and imported programming rather than investing in new strands.

This seems to be common to both channels that compete with new BBC services and ones that do not, which tends to suggest it is a feature of the market rather of having to compete with new BBC services.

---

<sup>25</sup> It should be noted here that the BBC does sell a great deal of its archive to the UKTV commercial joint venture with Telewest. This policy might have an affect on other thematic channels competing with UKTV, but this has little to do with the impact of the BBC's digital licence fee funded channels assessed in this report. This report is concerned with the impact of the digital's channels use of archive, and eventually the exploitation of programming originally commissioned for the new channels when it becomes archive.

### C. THE OBJECTIVES OF THE BBC'S DIGITAL SERVICES AND THEIR PERFORMANCE SINCE LAUNCH

Set out below is a brief overview of the way the channels have performed in terms of share, reach, programme mix and sourcing and demographic appeal. Share, reach and demographic data is sourced from BARB, while programme mix and sourcing information comes from our especially commissioned survey of one months output (May 2003).<sup>26</sup>

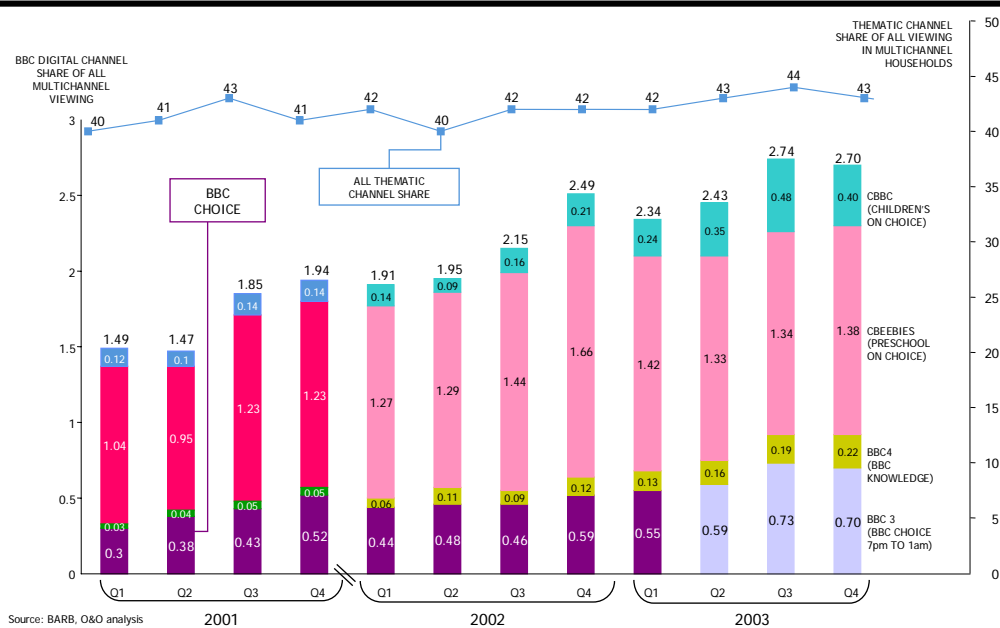
#### 1. The Evolution of the New BBC Services

Three of the BBC's new digital services (CBeebies, CBBC and BBC 4) launched in early 2002 (CBBC and CBeebies in January 2002 and BBC 4 in March 2002), while BBC 3 launched in February 2003.

Prior to January 2002, the BBC had carried children's programming on BBC Choice alongside some entertainment programming in peak time. Prior to January 2002, the BBC had carried a range of factual and education programming on BBC Knowledge.

BBC Knowledge stopped broadcasting in January 2002, while BBC Choice continued broadcasting entertainment programming from 7pm to 1am from January 2002 to February 2003.

Figure 15



<sup>26</sup> The main aim of this survey was to compare the channel with their closest rivals rather than to judge compliance with promises. Given the data is based on one months survey evidence, it is possible that it shows the BBC achieving levels of output types that fall short in that specific month of the annual target level. This does not imply that the BBC is not meeting its annual target.

## 2. Combined Share and Reach

Overall the combined all day share of all four channels in multichannel households was 2.7 per cent at the end of 2003. This compares with a combined share of BBC Choice and BBC Knowledge at the end of 2001 of 1.94 per cent – a rise of about 40 per cent.<sup>27</sup> (See Figure 15)

However, combined BBC share in cable and satellite households has risen less sharply. The BBC services' access to Freeview homes contributes about 0.45 share points to its end of 2003 share, while digital terrestrial access contributed only about 0.1 per cent to BBC Choice and Knowledge share at the end of 2001.

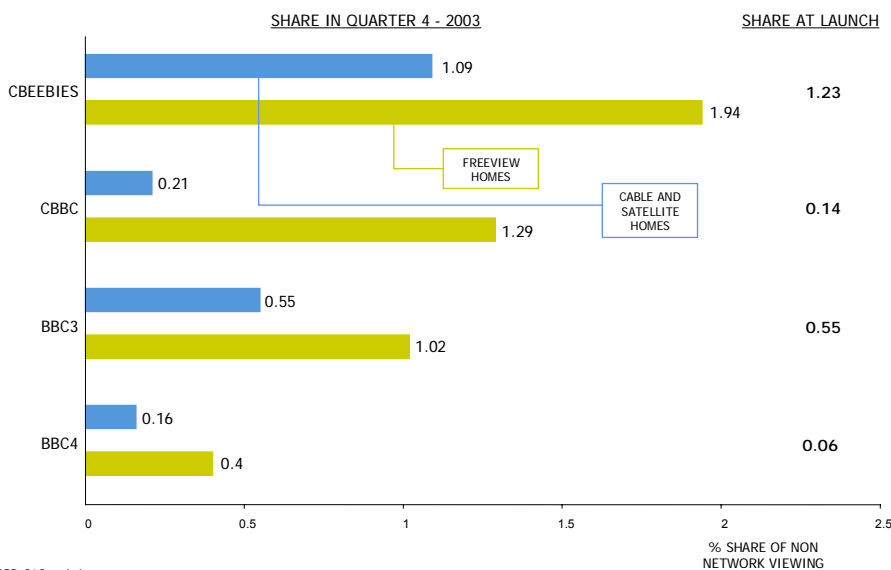
Share in cable and satellite homes has therefore risen from about 1.85 per cent to 2.25 per cent, a rise of just over 20 per cent in share point terms since the launch of the new services. This compares to a significant rise in share for all thematic channels in cable and satellite homes from 41 per cent to 48 per cent. Therefore, the BBC services share of all thematic channel viewing in pay TV cable and satellite homes has actually held steady since launch of the new services at about 4.5 per cent. (See Figure 16 for comparative Freeview and pay TV all day shares).

The combined weekly reach of all four channels ran at about 33 per cent of all multichannel viewers.

---

<sup>27</sup> Throughout this section the focus is on all day share not share within the BBC channel's transmission times – which are considerably less than 24 hours and often less than rival channels. This is primarily because the direct financial impact on advertising revenue is generally related to the channel's share of all impacts irrespective of what time they are lost. This is especially true of thematic channels which often get comparative large audiences outside peak time. In so far as it might impact the total lost revenue of commercial networks, where peak time is more valuable, the will be reflected in an adjustment to the estimated impact rather than basing the whole analysis on share of audience within a specific time slot.

Figure 16



### 3. The Children’s Channels

Both CBeebies and CBBC launched in February 2002 as dedicated channels for pre-school children and 6 to 12 year olds respectively.

The aim of CBeebies was to create an educationally orientated channel that encouraged a playful approach to learning, contained a high degree of UK and EU programming – in particular staying away from large volumes of US and Japanese animation supplied by the commercial market – and which was free of adverts. The service was also required to involve a high degree of interactivity. It had an initial programme budget of £15 million a year.

Similarly, CBBC was aimed at providing a more educationally oriented channel than commercial rivals with a mix of home grown programme genres such as news, factual, drama and studio magazine shows, with less reliance on imported animation and which was free of adverts. The channel has an initial programming budget of £26 million.

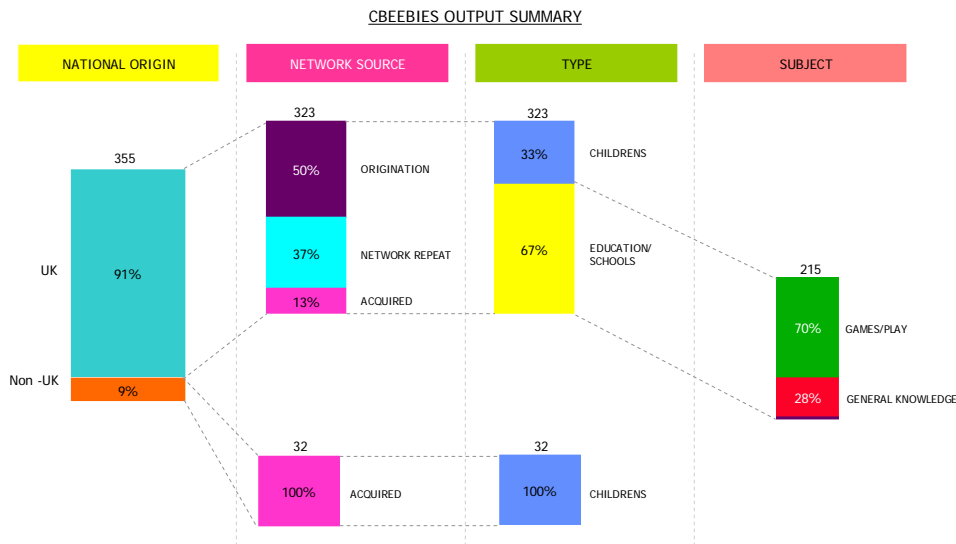
CBeebies now obtains an all day multichannel audience share of about 1.3 per cent of all viewing<sup>28</sup>. It also obtains an estimated 14 per cent share of all 4 to 6 year old childrens’ viewing in multichannel homes, although given the nature of pre-school age children about two thirds of viewing to the channel is actually done by parents and carers. The channel reaches 6 per cent of all digital homes with children in any week.

This all day share figure of 1.3 per cent is, however, only about 0.1 to 0.2 percentage points higher than the pre-school period on BBC Choice obtained in 2001. In addition,

<sup>28</sup> BARB does not measure the viewing of children younger than 4 for any channel, so this share probably underestimates the actual amount of viewing, but it does so for all pre-school channels.

about 0.2 percent of the audience is taken from Freeview homes where it is the only Pre-school service. Back at the end of 2001, very little audience was derived from the much smaller number of free to air digital homes in the UK.

Figure 17



Overall then, CBeebies has probably increased its share only marginally in the pay satellite and cable homes where most its rivals are available.<sup>29</sup>

The DGA analysis of schedules in April/May 2003 suggested that only 8 per cent of CBeebies output was animation, and of that over half was UK in origin. 90 per cent of all programming was sourced from the UK, and 60 per cent was educational. (See Figure 17)

CBBC all day share in all multichannel homes is lower than CBeebies but has risen substantially since launch rising from 0.14 per cent to 0.4 per cent in just two years. About 70 per cent of all viewing is by children and it reaches 14 per cent of all digital homes with children in any week. The channel accounts for about 4 per cent of all 7 to 12 year old's viewing in multichannel homes.

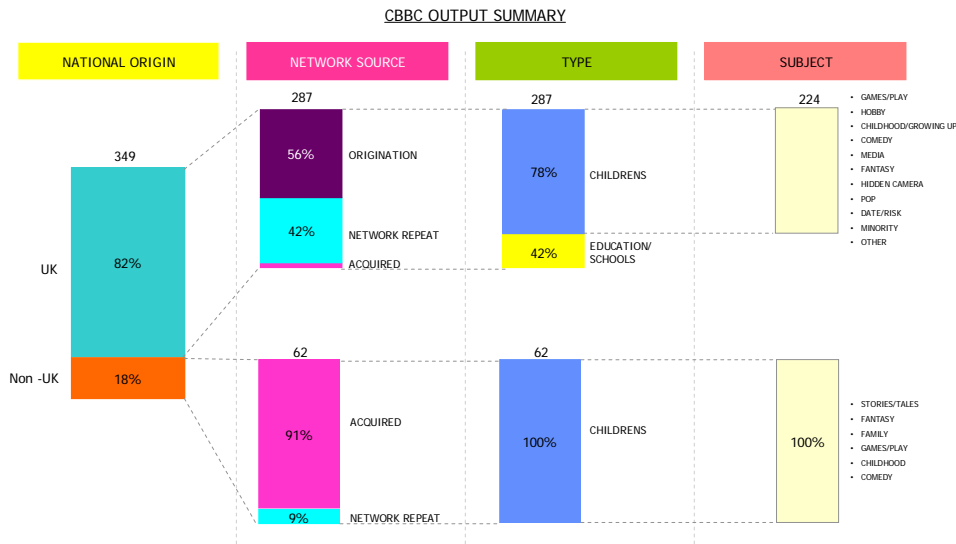
However, CBBC's share in pay cable and satellite homes is currently about 0.21, most its rising share has been due to the fact that it is gaining a 1.3 per cent all day share in Freeview homes – where it is the only children's channel rather than 1 of 13 in pay TV homes. The contribution to share from free to air digital homes at launch was extremely small, suggesting that CBBC share has only really increased by 0.7 percentage points since February 2002.

CBBC's average viewer age is about 9 to 10 years old, it has an equal appeal to boys and girls and the same socioeconomic skew as multichannel viewing in general.

<sup>29</sup> Boomerang is available to free to air satellite homes but not Freeview homes.

The DGA analysis of the April/May 2003 schedules suggested that only 17 per cent of the output was animation, of which about 30 per cent was UK originated, and overall 80 per cent of all output was UK in origin. The channel contained 11 different genre of programming including a significant amount of factual programming, and about 20 per cent of the output was specifically educational in nature. (See Figure 18)

Figure 18



#### 4. BBC 4

BBC 4 was launched in March 2002, with the aim of appealing to anyone interested in arts and culture and ideas with a mix of news, current affairs, arts, philosophy, science, history, music, performance and film.

Within each genre BBC 4 was given specific objectives with, for example, its news focusing on global issues, its film bringing world cinema to the UK audience and its performance programming focusing on classical and world music and reflecting the tastes and output of the Nations and Regions.

Its aim was to offer a wider choice than many of the more narrowly focused niche commercial thematic factual and performance channels already in the market, and to bring in as wide an audience to its challenging programme mix as possible. BBC 4 was also charged with ensuring that about 70 per cent of its output annually was of programming originally commissioned for the channel – new or repeat. Its overall programming budget has been about £30m a year.

BBC 4 had managed to reach a 0.2 per cent share of the audience in multichannel homes in the last quarter of 2003, or about 0.15 per cent within pay TV homes. While this is

a relatively small share it is a reasonably strong performance in a market where incumbent channels such as the History Channel, the Biography Channel, Discovery Civilizations, and the Performance channel also gain share of between 0.1 and 0.3 per cent.

In addition, BBC 4 manages to obtain about 0.4 per cent of the audience within its 7pm to 2am transmission hours – ahead of channels such as the History Channel and Discovery Science.

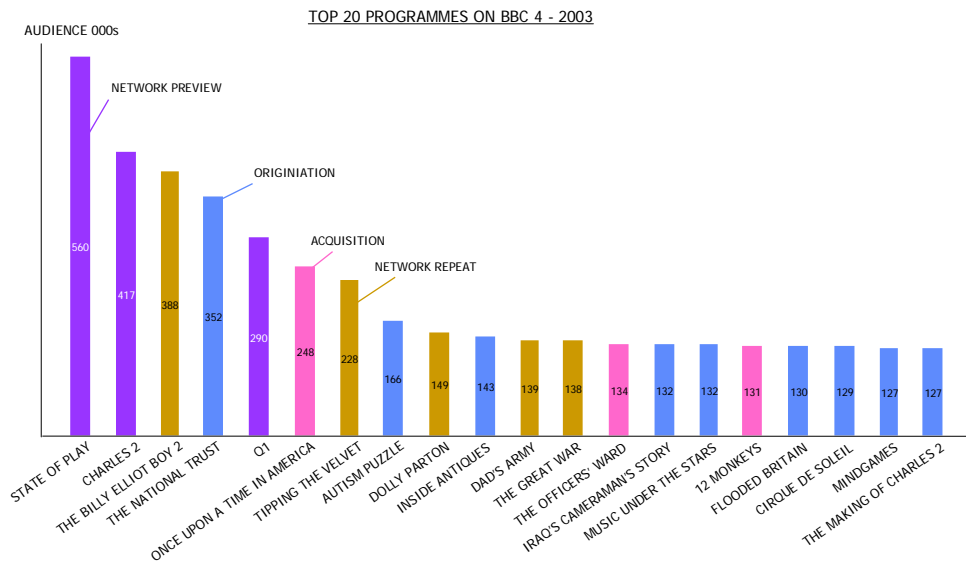
The average age of channel viewing is in the mid-forties which is not unusual for factual channel in multi channel homes (with only lifestyle and health based factual channels tending to skew younger). While the channel’s highest share is gained among the over 60s, as with many factual channels, it does have important relative peaks among the early 30s and early 40s age groups – unlike commercial channels that focus in history, performance or science etc.

BBC 4 is, however, exceptionally skewed towards ABC1 socio-economic group viewers, both among all thematic channels, and among more serious factual channels. Only news channels come anywhere near such levels. It also has a heavy skew towards men, heavier than the usual factual channel bias.

The average weekly reach of the channel at about 5.7 per is fairly consistent with a 0.2 percent share of viewing, and confirms that the channel probably appeals mainly to a group of loyal viewers rather than attracting too many light or occasional viewers.

BBC 4’s highest rating shows include network spin offs and previews. (See Figure 19).

Figure 19



## 5. BBC 3

BBC 3 was launched in January 2003 with the aim of providing an innovative and challenging entertainment led service focused on the mindset, life stage and programming needs of the 25 to 34 year old age group. Commitments were made to ensure the service had significant levels of music, arts, news, education and current affairs programming in addition to drama and entertainment and that at least 80 per cent of programming was especially commissioned for the channel and 90 per cent of the output originated in the UK.

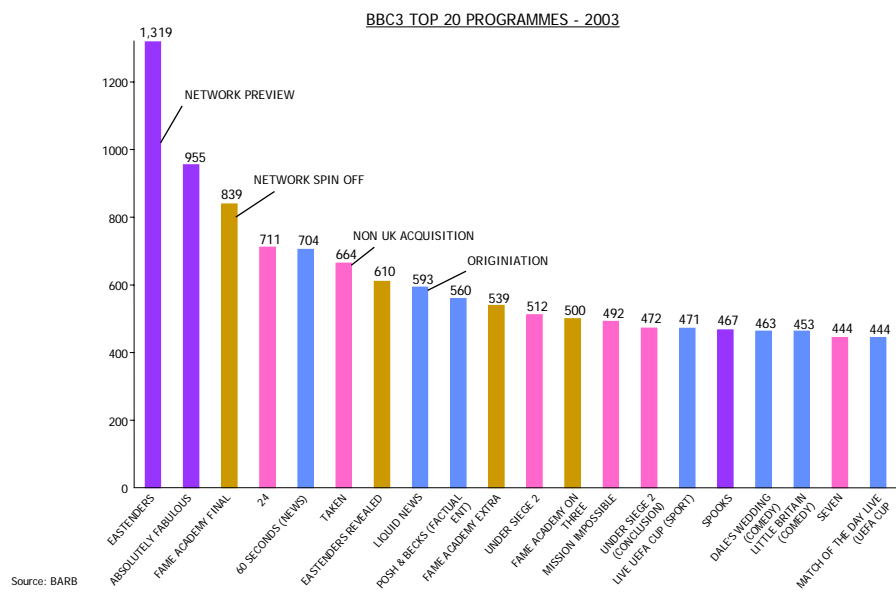
The channel was also given a duty to reflect the diversity of the UK and to make a significant contribution to the promotion of new talent on and off the screen. The total programme budget was to be £97m a year.

At 0.7 per cent share in multichannel homes, BBC 3's headline audience share across all multichannel homes now stands approximately 0.2 percentage points higher than the share gained by BBC Choice between 7pm and 1 am prior to launch. BBC 3's share in non Freeview homes has only risen by about 0.1 per cent, however, and some of that may well have been as a result of an improved placing on the digital satellite Electronic programme guide in the third quarter of 2003.

BBC 3 achieves its highest audience share in multi-channel homes amongst the 30 to 34 year old age group, and its second highest share among 25 to 29 year olds, with a slight skew towards the ABC1 audience and with a balanced gender appeal. The channel's weekly reach runs at about 17 per cent, which is relatively high compared to its share of viewing suggesting it attracts a significant number of occasional viewers with its mixed schedule of drama, comedy and factual programming.

BBC 3's highest rating shows tend to be network spin offs and previews (see Figure 20), but limits were placed on the use of this source of programming when the channel launched.

Figure 20



## D. AN ASSESSMENT OF THE MARKET IMPACT OF BBC DIGITAL SERVICES SINCE 2002

### 1. The Likely Impact on Digital Take-up

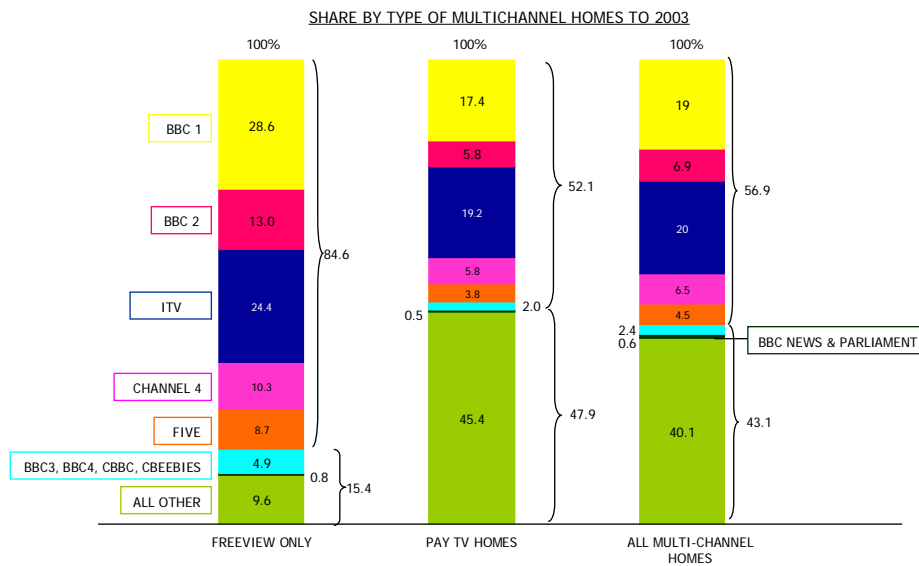
Overall digital take up has increased by 2.1 million households since BBC 4, CBBC and CBeebies were launched at the beginning of 2002, and 1.1 million since BBC 3 launched in February 2003. While pay TV take up has grown and then fallen back (with the demise of ITV Digital) over the period, free to air digital penetration has increased from 0.5 million households to about 3 million. About two third of these free to air households receive their services through the Freeview digital terrestrial reception package that was launched in the last quarter of 2002.

#### *BBC Digital Services Seem to Have Been An Important Driver of Recent Free to Air Digital TV Growth*

Evidence suggests that the extra BBC services available through Freeview and digital satellite and cable, have played an important role in the take up of free to air digital reception and the rapid adoption of Freeview.

The BBC services make up over one quarter of the extra channels on Freeview and separate consumer research suggests that the presence of the six extra BBC services (the four being studied in this report, plus 24 hour news and parliamentary coverage) are an important reason for consumer adoption of free to air digital services. This observation is reinforced by the fact that extra BBC services gain about 6 per cent of Freeview household viewing. (see Figure 21).

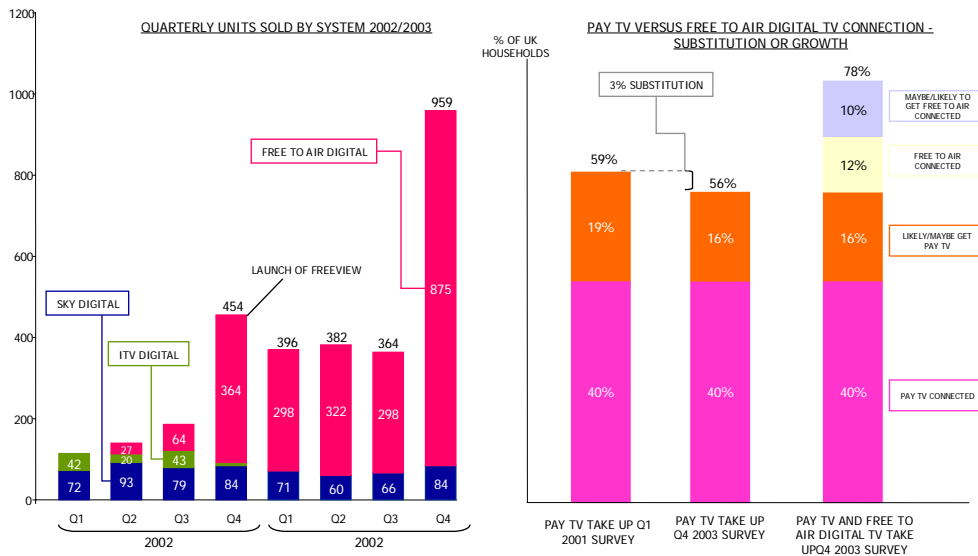
Figure 21



***Cross Promotion of Extra Digital Services on BBC 1 and BBC 2 has Probably Helped Drive Digital Penetration.***

The strong share enjoyed by both BBC 1 and BBC 2 compared to ITV and Channel 4 in Freeview households suggests that Freeview adopters have previously been heavy BBC viewers and part of the core BBC audience. This suggests that cross promotion of BBC services on the main BBC channels has probably had a strong impact on Freeview take up and overall digital penetration.

**Figure 22**



***Free to Air Digital TV Growth Appears Largely Additional to the Underlying Demand for Digital Pay TV, which remain at between 55 and 60 per cent of UK Households.***

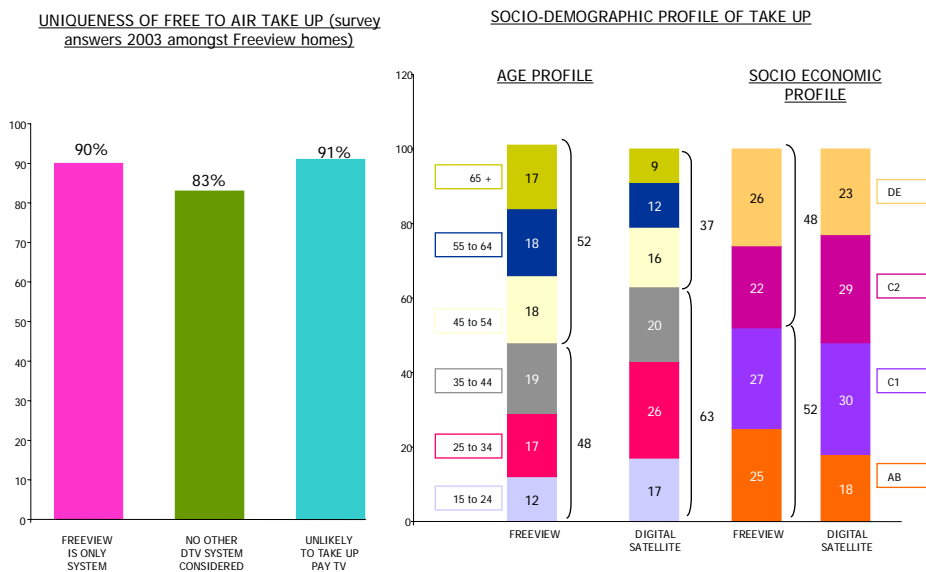
There is also a great deal of evidence to suggest the free to air digital take up being encouraged by the BBC services is largely additional to the projected digital pay TV take over the last couple of years rather than being a substitute. Back at the beginning of 2001, about 40 per cent of households had pay TV, and about another 20 per cent were interested in taking pay TV in the near to medium term.

A similar survey at the end of 2003, suggests that there are still about 15 to 18 per cent of UK households interested in taking pay TV in the near to medium term, while another 10 per cent are interested in taking free to air digital services – to add to the 12 per cent of UK households that have the service already. (See Figure 22)

Surveys of Freeview subscribers and analysis of their demographics reinforces the notion that free to air digital subscribers are largely additional to pay TV subscribers and those considering getting pay TV. More than 8 out of 10 Freeview households had not

considered getting any other digital TV system before they bought the necessary reception equipment, and the make up of Freeview homes is skewed – although by no means exclusively - over 45, compared to satellite pay TV take up which is heavily skewed to the under 45s. (see Figure 23 and Exhibit 3.3 in Appendix 1).

Figure 23



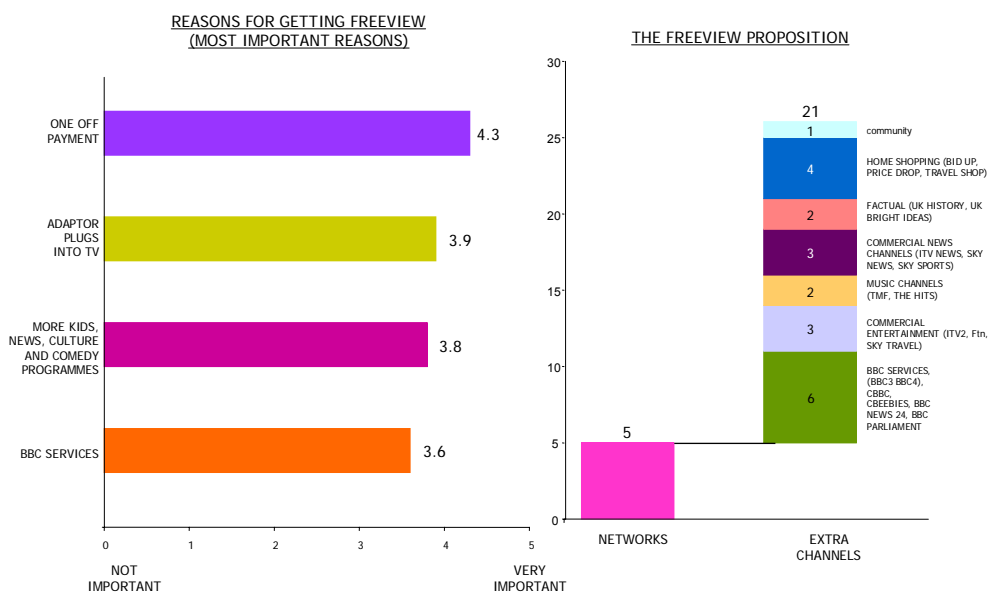
***BBC4 is Likely to Have the Largest Proportionate Impact on Digital Take up, but the Childrens Services are Likely to Have the Largest Absolute Impact***

With digital penetration already high among the 25 to 34 year old age group, the proportionate impact on digital take up from BBC 3 is likely to be relatively low. However, the analysis conducted in early 2002 did suggest that there were still about one quarter of all 25 to 34 year olds who had no likely intention of getting digital TV.

In contrast, the proportionate impact of BBC 4 with an older ABC1 skew was likely to be higher given the low penetration of digital TV among this group. However, it should be noted that Freeviews comparative success seems to have been in persuading older C2DE's to convert to digital.

While about 60 per cent of families with children already had multichannel TV back in 2001, there were a significant number of ABC1 homes with children who were resisting the upgrade to digital. The absence of advertising and imported animation on the BBC channels is likely to have been attractive to this group, and given the subsequent high levels of consumption of the BBC children's services in Freeview homes, it is likely that these services have had the highest absolute impact.

Figure 24



## 2. The Distinctiveness of BBC Services

We have set out below a brief review of the distinctiveness of each channel within the multichannel TV market. We have looked at four different dimensions of distinctiveness:

demographic positioning and appeal (age, socio-economic grouping, ethnicity and gender);

Schedule sourcing (repeats, acquisitions, network spin offs etc)

Schedule genre mix (drama, arts, news, documentaries etc)

Mix of programmes and topics within genre (live performance, scripted entertainment, celebrity versus social issues etc etc).

We used independent access to BARB audience information and an especially commissioned survey of BBC and rival channel schedules to assess the level of distinctiveness.<sup>30</sup>

### a. BBC 3

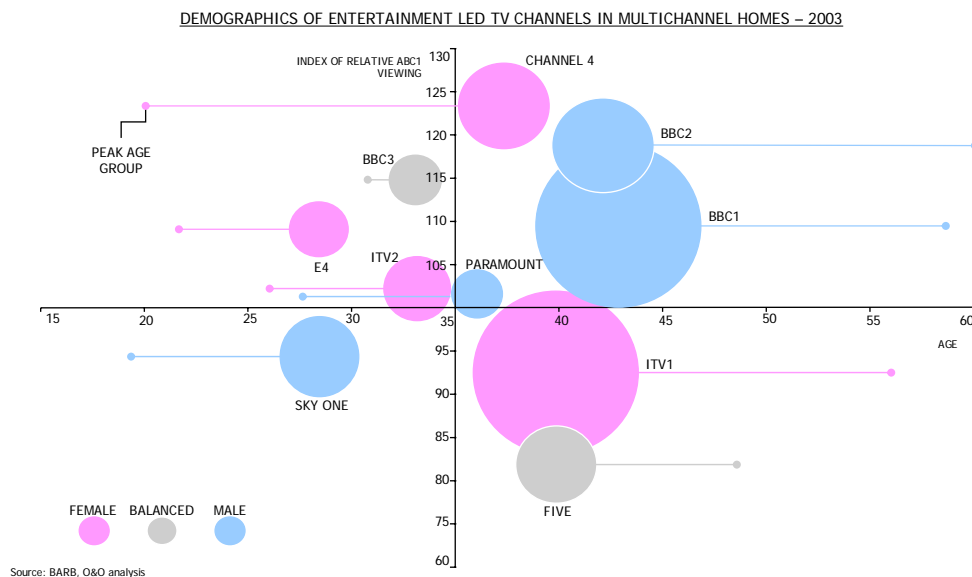
BBC 3 has a distinct schedule from all its thematic channel counterparts in the UK. The programming mix used by commercial entertainment led channels to attract an audience centred on 20 to 35 year old viewers is either heavily skewed to US drama and

<sup>30</sup> The survey was commissioned from DGA a specialist in programme classification and schedule analysis

comedy imports and/or factual entertainment programming dealing primarily with the subjects of celebrity, romance and human relationships/reality situations.

BBC 3 is the only channel trying to attract this audience with significant amounts of new comedy and drama, some serious factual and social action programming, and with limited recourse to main network repeats and spin offs, although its factual entertainment output is still quite heavily skewed to celebrity, fashion and romance.

Figure 25



### Competitive Landscape

BBC 3 is one of six main thematic entertainment led channels focused on the 16 to 40 age group available in multi-channel homes – the others being E4 (with E4+1), ITV2, Sky One (with Sky One Mix), Paramount (with Paramount 2), and Bravo (with Bravo +1). Of these only ITV2 and BBC3 are available on all multichannel platforms, and ITV2 is only available to basic tier subscribers in satellite homes not free to air satellite homes.

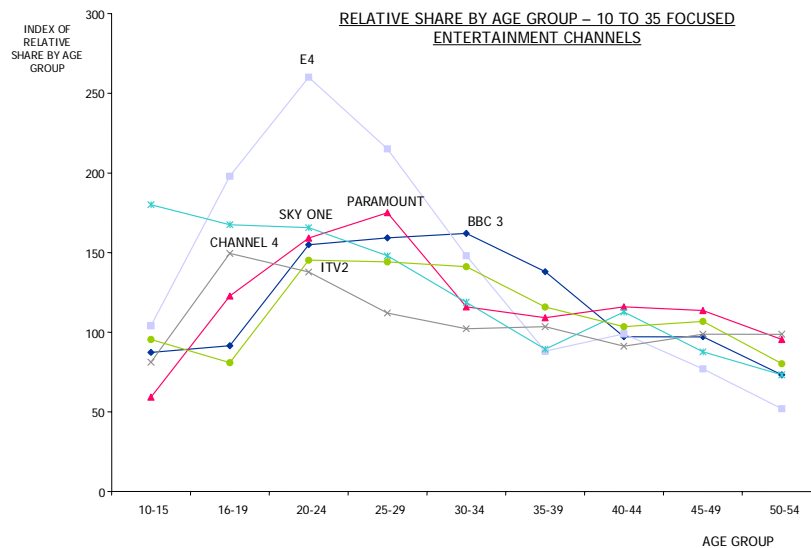
BBC 3's closest competitors in terms of age, programming mix and socio-economic mix of the audience are probably Channel 4, E4 and ITV 2.

### Demographic Positioning

Within its market, however, BBC 3 seems to be delivering a distinct audience demographic within multichannel households in the UK. Its peak share – and therefore – its strongest relative appeal – is to 30 to 34 year olds and its average viewer age is about 34 making it younger than Channel 4's average viewer but older than E4's average viewer age. (See Figure 25)

BBC3's audience is also more ABC1 than Sky One, E4 or ITV2, positioning uniquely in a mid thirties slightly ABC1 position. Unlike Channel 4, E4 and ITV2, BBC 3 does not have a particularly female bias, and unlike Sky One, Paramount and Bravo, it does not have a specifically male bias.

Figure 26



Source: BARB, O&O analysis

### Programme Sourcing

BBC 3's programme schedule has more UK originated material originally commissioned for the channel than any other entertainment led thematic channel for the under 40s.

BBC 3 uses network material – repeat, spin-offs and previews, less than either E4 or ITV2. E4's schedule is almost entirely made up of programming already shown on Channel 4 – both acquisitions and UK material - or spin off shows from main network strands such as *Big Brother* or *the Salon*.<sup>31</sup> Over the last year E4 has switched its original policy of offering network previews of top acquisitions on E4, and instead shows most of the strands on Channel 4 first releasing them as repeats for later showings.

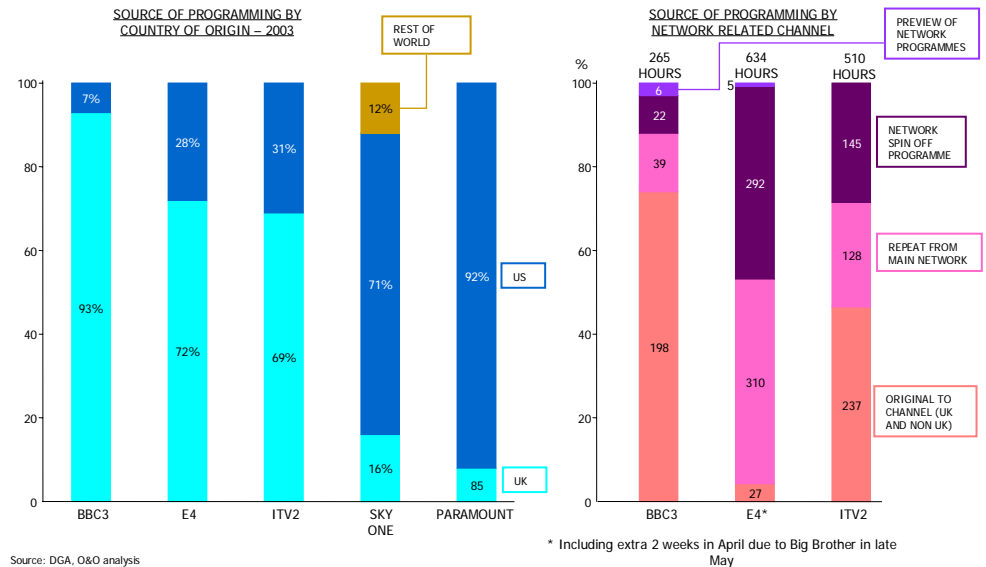
ITV2 also makes extensive use of ITV1 network repeats, and spin offs. Overall, whereas about 24 per cent of BBC 3's schedule in the sample period was made up of network repeats, previews and spin offs, about 95 per cent of E4's schedule was from this source and about 50 per cent of ITV2's schedule.

Our survey of April/May 2003 schedules suggests that while over 9 in every 10 programmes was UK sourced on BBC 3, only about 7 out of 10 and 6 out of 10 were

<sup>31</sup> Our original sample of May 2003, had two weeks of Big Brother output within the sample. We therefore extended the E4 sample to almost 6 weeks to reduce any distortion in the overall figures.

sourced from the UK on E4 and ITV 2 respectively. On Sky One and the Paramount Channel – neither of which has ready access to network material – the numbers fall to 1 in 5 and 1 in 10 UK sourced programming respectively. (See Figure 27)

Figure 27



### Genre Mix

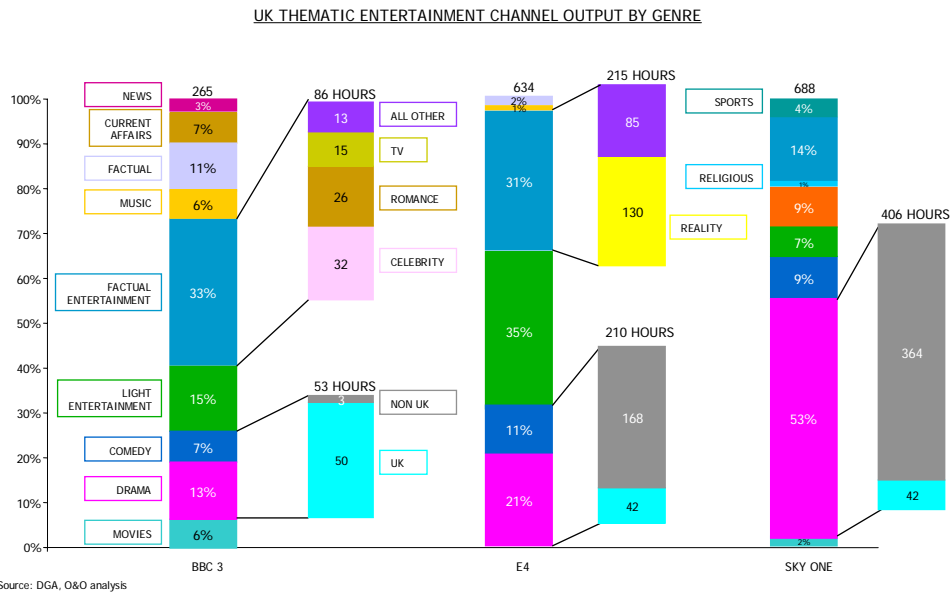
BBC 3 has a wider genre mix than any other entertainment led thematic channel targeting the under 40s. BBC 3's schedule both has genres not covered by rival thematic channels – such as news and current affairs, and a greater proportion of drama and comedy than either E4 or ITV2, the only other channels to make extensive use of UK material.

### Types, Formats and Subjects Within Genre

Within factual programming, BBC 3 is the only thematic channel service to have significant amounts of arts, social action and investigative documentary programmes, although within the factual entertainment category the channel does tend to adopt the more standard industry mix of celebrity, lifestyle and human relationship topics.

BBC 3 is the only thematic channel within its demographic market with a significant commitment to new UK animation, one off drama and mini series, or situation comedy. (See Figure 28)

Figure 28



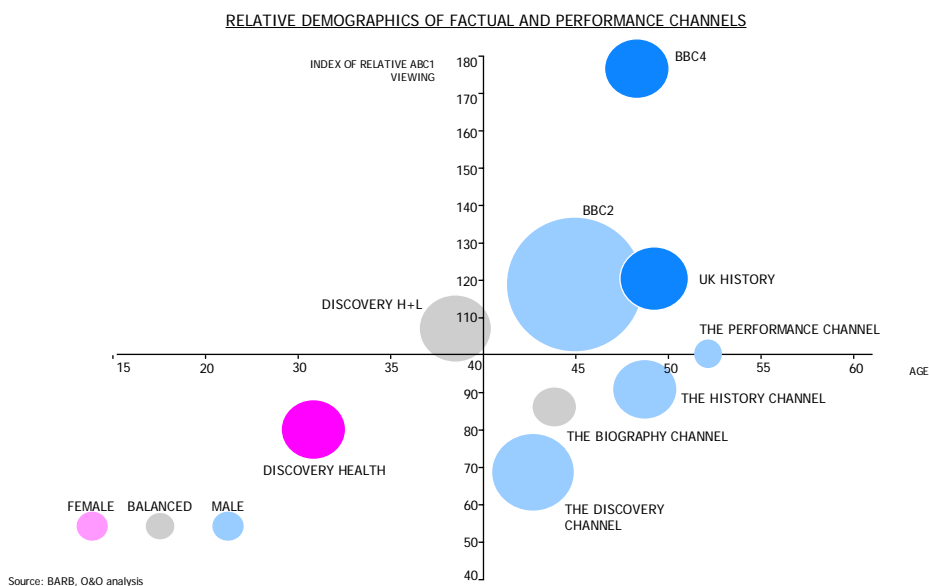
**b. BBC 4**

*Competitive Landscape*

BBC 4 competes with both the arts, cultural and serious documentary output of Channel 4 and BBC 2 ( and to a lesser extent FIVE), and with a range of factual and performance channels such as *The History Channel, The Biography Channel, UK History, Discovery Civilisations, Discovery Science, the Performance Channel, Classic FM TV* and the a la carte premium service *ArtsWorld*.

It probably competes less with the more general factual channels such as *The Discovery Channel, Discovery Home and Leisure, and UK Style and UK Horizons* which tend to show more lifestyle and human interest documentaries rather than history, science, current affairs, arts and cultural programming. Nor does it compete with more specialist channels such as *Discovery Health and Discovery Wings* both of which concentrate on topics hardly covered by BBC 4.

Figure 29



### Demographic Positioning

Like most factual channels concentrating on history, performance and science, BBC 4's average viewer age is in the forties, although the channel does have a relative appeal to those in their 30s and 40s when compared with these other channels.

BBC 4 does, however, have a uniquely strong appeal to the ABC1 audience, with no other factual channel attracting anything like its levels of relative appeal, and nearest in positioning to BBC 2. Its relative positioning to *Artsworld* is not known as no BARB data exists on *Artsworld's* audience. It is likely that *Artsworld* does have a strong skew to ABC1's but probably still not as strong as BBC 4's. (See Figure 29).

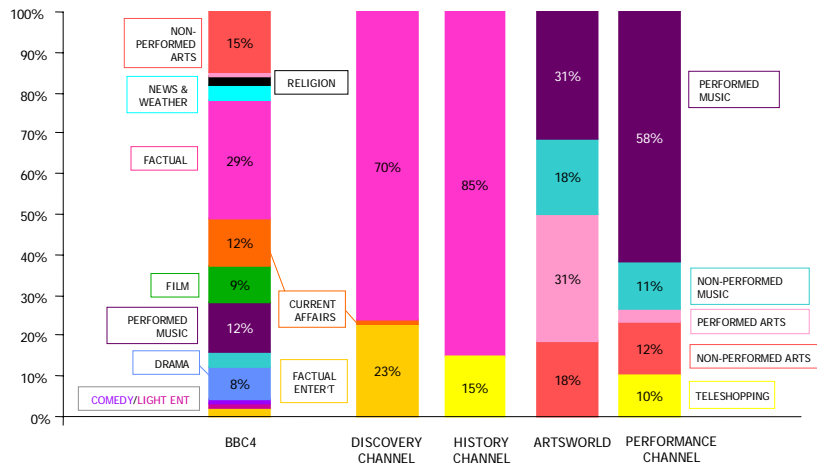
### Programme Sourcing and Output Mix

80 per cent of BBC 4's output is UK originated while much of its non UK output is foreign language films. The channel has a far wider range of output than any factual or performance/arts channels – combining the two channel formats and adding some drama, news and current affairs.

Within its arts and music output BBC 4 has a far greater proportion of documentary and talk show coverage in contrast to both *ArtsWorld* and the Performance channels which consist largely of recorded performances. Within the factual programming area BBC 4 covers a much wider range of subject than any other individual factual channel. (See Figure 30).

Figure 30

BBC4 AND COMPARISON CHANNELS OUTPUT BY GENRE



c. CBeebies

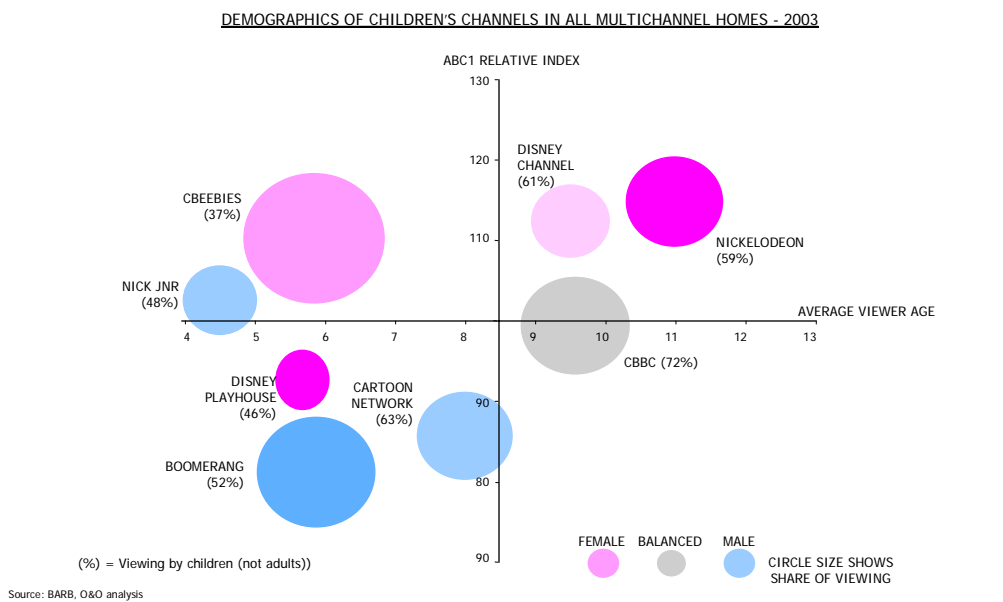
*Competitive Landscape*

CBeebies is one of four primarily pre-school focused thematic channels in the UK market – the others being *Nick Jr*, *Disney Playhouse* and *Boomerang*. *Nick Jr* is available to nearly all Sky subscribers and most analogue and digital pay TV homes. *Disney Playhouse* is only available on higher tiers of cable TV packages and to premium movie subscribers to Sky’s digital satellite service.

The other main broadcasters of pre-school programming are BBC1 and BBC 2, with very limited amounts on ITV1 and FIVE, none of these network broadcasters can offer pre-school children and their parents all day access to programming.

Other animation led thematic children’s channels – such as the *Cartoon Network*, *Fox Kids* and *Nick Toons* and *Disney Toons*, do have the occasional strand that might appeal to pre-school age children, but for the most part they focus on the over 6 age group.

Figure 31



### Demographic Positioning

CBeebies is focused on the 5 year old viewer, appeals more to girls than boys and has a slight skew to children in ABC1 homes, probably entirely due to its greater audience share in Freeview homes. It is nearest in its positioning to Nick Junior which tends to attract a slightly younger age group and more boys. (See Figure 31)

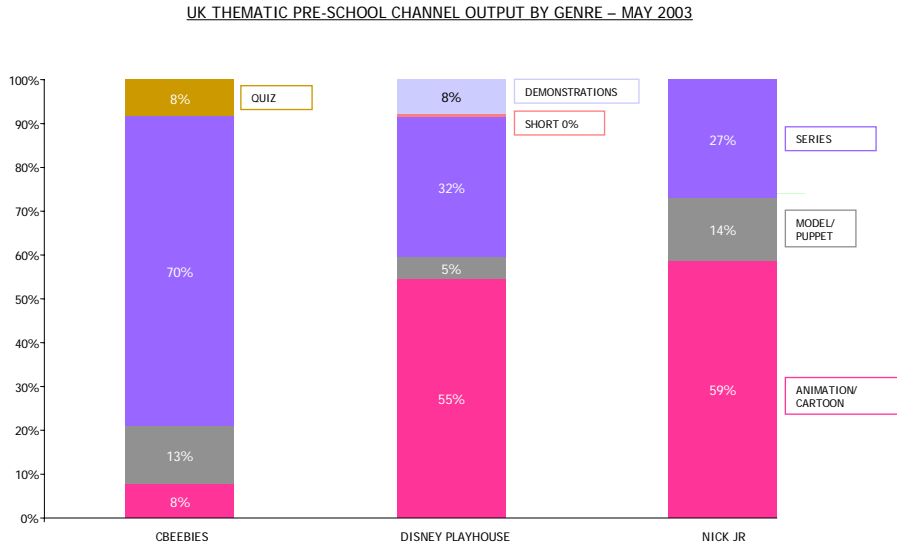
### Programme Sourcing and Output Mix

The survey of channel output conducted by DGA suggests *CBeebies* offers pre-school children and their parents a distinctly UK orientated schedule when compared with its two nearest rivals – *Nick Jr* and *Disney Playhouse*, with less reliance on animation than its rivals in the pre-school market and considerably more educationally orientated material.

Animation and puppets/model based programming accounts for just one fifth of *CBeebies* output, but 55 per cent of *Disney Playhouse* schedules and three quarters of *Nick Jr* transmissions. Moreover, while about 60 per cent of *CBeebies* animations are UK originated, just 3 per cent of *Disney Playhouse* animations are UK originated, and 44 per cent of *Nick Jr* animations.

Across all types of output, *CBeebies* sources 90 per cent of its programmes from UK originations compared with just 10 per cent on *Disney* and 42 per cent on *Nick Jr*.

Figure 32



Source: BARB, DGA, O&O analysis

#### d. CBBC

##### *Competitive Landscape*

There are 13 children's channels in the UK focusing on children between 6 and about 14. Of these one is a music channel focused on children, leaving 12 children's entertainment and information channels. Three of these are simple time shift versions of existing channels, which leaves nine distinctive channel brands – *Nickelodeon* and *Nick Toons* (owned by Viacom and BSkyB), *the Cartoon Network* (owned by Time Warner), *the Disney Channel*, *Disney Toon* and *Fox Kids* (all controlled by the Walt Disney Corporation<sup>32</sup>), *Toonami* (owned by Sony), *Discovery Kids* (part of the Discovery Network) and *CBBC*.

Of these channels, five are almost entirely animation based – *Toonami*, *Disney Toon*, *Nick Toons*, *Fox Kids* and *Boomerang* – which leaves *Nickelodeon*, *Discovery Kids* and *the Disney Channel* as the leading mixed schedule thematic children's channels aimed at 6 to 14 year olds.

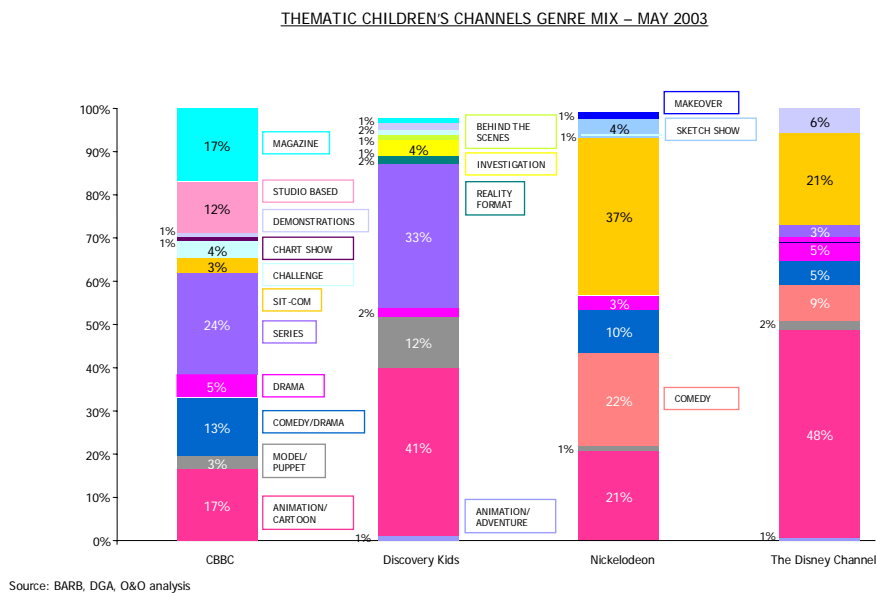
##### *Demographic Positioning*

CBBC tends to be positioned between the age groups and genders attracted by the commercial thematic channels with an average viewer age around about 9 to 10 and with a balance of girls and boys. Nickelodeon tends to attract older girls, while the

<sup>32</sup> Strictly speaking Fox Kids in the UK is actually still part of Fox Kids Europe which is only 70 per cent controlled by Disney, the rest being quoted in the stock markets.

cartoon orientated channels tend to skew younger except Toonami which heavily skewed to 10 to 13 year old boys. The Disney channel has a slight ABC 1 skew and tends to appeal to 10 to 14 year girls and boys, and so is probably the nearest to the CBBC audience.<sup>33</sup>

Figure 33



### Programme Sourcing and Output Mix

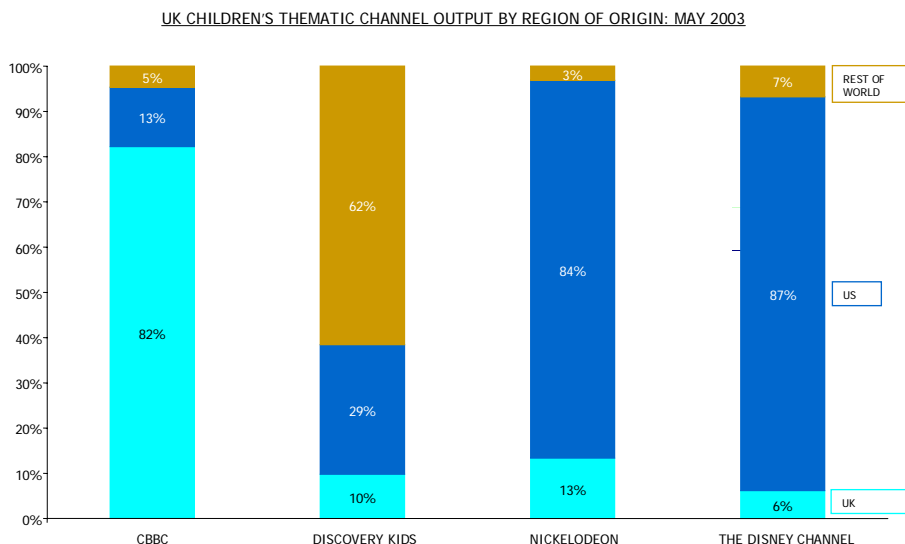
DGA were asked to take four week samples for *CBBC* and the nearest demographically positioned channels – *Discovery Kids*, *the Disney Channel*, and *Nickelodeon*.

CBBC had a much more diverse schedule than any of the three other channels, with 80 per cent of its programming consisting of UK originations versus 10 per cent for *Discovery Kids*, 13 per cent for *Nickelodeon* (which uses a significant amount of ITV Children's material) and 6 per cent for the *Disney Channel*. All three commercial channels rely more heavily on animations than CBBC, with both the *Disney Channel* and *Discovery Kids* relying on animation for more than 40 per cent of their schedule, and all three channels sourcing animation from outside the UK. (See Figure 33)

*Discovery Kids* includes the most educational output in its schedules, but almost all of this is sourced from overseas – mostly the USA. CBBC has far more educational output than either *the Disney Channel* or *Nickelodeon*.

<sup>33</sup> Discovery Kids only gets a 0.1 share of viewing and a 0.3 share of children's viewing in multichannel homes, and therefore, the audience is too small to try to sensibly split by age, but it is probably targeting a similar age group to CBBC.

Figure 34



Source: BARB, DGA, O&O analysis

### 3. The Broad Impact on Platform Market Structure and Channel Leverage

While there is strong evidence to suggest that the BBC services have helped drive free to air digital reception, the impact on commercial competitors and rivals depends crucially on whether such growth has been:

- at the expense of pay TV penetration ( i.e. substitution) , or
- additional to pay TV take up, or
- a complement to future pay TV take up

Within the last of these the overall impact on the commercial market will also depend on whether free to air digital is a complement to satellite and cable delivered pay TV or a complement to future digital terrestrial pay TV platform.

#### a. Free to Air Digital as A Substitute for Pay TV

To the extent the BBC services have helped increase the penetration for free to air digital TV at the expense of pay TV, they will have reduced the reach and share of all pay TV services, but protected the reach and share of commercial networks – who lose less share in free to air digital homes than pay TV homes.

But, in addition, by creating a substitute platform to pay TV, they will have increased the leverage enjoyed by third party channel operators vis a vis the pay TV platforms, in particular BSkyB (i.e. in so far as each channel can threaten to go free to air instead of becoming part of the basic pay tier of channels). Other things being equal, this should help increase the sub fees of these channels, compensating for reduced reach.

Figure 35

THE POTENTIAL BROAD IMPACT OF DIGITAL BBC SERVICES

NATURE OF FREE DIGITAL TV	BROAD ECONOMIC IMPACT ON COMMERCIAL MARKET			
	PAY TV CHANNEL REACH AND SHARE	COMMERCIAL NETWORK REACH AND SHARE	PAY TV CHANNEL LEVERAGE AND SUB FEES	FREE TO AIR THEMATIC CHANNELS
A SUBSTITUTE FOR PAY TV	NEGATIVE	POSITIVE	POSITIVE	POSITIVE
COMPLETELY SEPARATE MARKET	NONE	NEGATIVE	NONE	POSITIVE
A COMPLEMENT TO CABLE AND DTH PAY TV TAKE UP	POSITIVE	NEGATIVE	NONE	SLIGHTLY POSITIVE
A COMPLEMENT TO DTT PAY TV TAKE UP	POSITIVE FOR SOME CHANNELS	POSITIVE	POSITIVE	SLIGHTLY POSITIVE

**b. A Unique and Separate Market**

To the extent that the BBC services have created a totally unique and separate free to air digital TV household market, then they may have helped extend the reach and share of other new free to air channels while not reducing the reach of basic tier pay TV channels. However, they may have reduced the share and reach of commercial TV networks more rapidly than otherwise might have been the case.

**c. An Access Service for Future Pay TV Take Up: DTH/Cable or DTT**

If free to air digital services act as a complement to medium term pay TV take up, in effect providing an access tier from which households will later upgrade to pay TV, then the BBC services may have boosted the medium and long term prospects of pay TV tier channels, while damaging commercial network audience share.

In addition, if free to air digital services act largely as a complement to a future digital terrestrial pay TV platform, then not only will pay TV channel reach have been increased but also their obtainable sub fee due to platform competition. In these circumstances, the negative impact on the commercial networks audience will be less, as any digital terrestrial pay TV service household is likely to have less channels and therefore fragment network share less.

#### **d. Scenarios and Impacts**

Figure 35 summarises the overall impact of all 4 scenarios on each part of the commercial market. The evidence suggests that most of the Freeview take up has been additional rather than substitutional – with between 1 and 2 per cent of all TV homes deciding to get Freeview instead of pay TV – i.e. 250,000 to 500,000 households.

At the same time, about 10 per cent of Freeview homes, i.e. about 200,000 might consider getting pay TV in the future.

These numbers tend to suggest that the overall impact of the BBC services on the economics of commercial channels is likely to be – on balance – neutral.

##### ***i. Sub Fees***

Of the reduction of pay TV penetration of 250,000 to 500,000, may be half can be attributed to the existence of the BBC channels. This represents about £7.5 million to £15million a year in reduced sub fees for pay TV channels.

However, the existence of some substitution between the platforms should give increased leverage to channels when they negotiate their sub fees with Sky and cable operators given that the Freeview makes a free to air alternative strategy more viable, and forces the pay TV platforms to upgrade their offering to reduce future substitution and get Freeview homes to upgrade to pay TV. Just a 2 per cent increase in the average sub fee gained by pay TV thematic channels – about 10 pence a month in total, or £1.20 a year, would yield £12 million extra from the UK's 10 million pay TV homes – about £6 million of which could be said to be attributable to the BBC channels.

If in addition, about 200,000 homes are now more likely to upgrade to at least entry tier level pay TV, this could be worth £12m a year eventually in total sub fee revenue –again half might be due to the existence of BBC channels which have encourage household's first step into digital TV.

Overall, then it is probably best to assume that the broad sub fee income effect is either neutral or slightly positive. Figure 36 sets out the various elements which suggest an impact of between -£3m and + £4.5m.

Figure 36

BROAD CHANNEL SUBSCRIPTION FEE INCOME IMPACT

	IMPACT	ATTRIBUTABLE TO THE BBC
REDUCED PAY TV PENETRATION	<ul style="list-style-type: none"> <li>• 1% to 2%</li> <li>• 250k to 500k subscribers</li> <li>• £15m to £30m A year in sub fees to channels</li> </ul>	<ul style="list-style-type: none"> <li>• 50% responsible for Freeview take up</li> <li>• £7.5m to £15m negative impact</li> </ul>
INCREASED LEVERAGE WITH PAY TV PLATFORM	<ul style="list-style-type: none"> <li>• Extra 10p per month across all 80+ basic channels</li> <li>• A 2% increase in payments</li> <li>• £12m per year extra income from satellite and cable</li> </ul>	<ul style="list-style-type: none"> <li>• 50% responsible for Freeview take-up</li> <li>• £6m positive impact</li> </ul>
POTENTIAL FUTURE UPGRADE OF FREEVIEW HOME TO PAY TV	<ul style="list-style-type: none"> <li>• 10% said they were interested</li> <li>• 200,000 homes</li> <li>• £12m per year in sub fees to channels</li> </ul>	<ul style="list-style-type: none"> <li>• 50% responsible for Freeview take-up</li> <li>• £6m positive impact</li> </ul>
OVERALL IMPACT RANGE		<ul style="list-style-type: none"> <li>• -£3m to +£4.5m</li> </ul>

*ii. Advertising Market*

The overall net advertising revenue impact of the BBC service's role in helping Freeview penetration is positive – somewhere between £1m and £16m. However, at the moment this has to be weighed against the £20m or so extra transmission costs for those extra thematic channels on Freeview which means in the short term – until Freeview penetration increases further – the overall impact might be negative.

We have set out below the steps in the calculation in more detail.

With between 250,000 and 500,000 Freeview homes substituting out of pay TV due to the presence of BBC services, this might be worth about £5m to £10 million in lost thematic advertising revenue once account is taken of the response of price to volume changes.

But with these viewers moving to Freeview plus the extra new viewers in incremental Freeview homes, thematic channels on Freeview actually gain almost £40m in revenue, which converts to £22m with price changes, of which £11m could be attributable to BBC services.

At the same time, commercial networks gain from Freeview substitution out of pay TV, as their share holds up better in Freeview homes. This represents a benefit of £2.5m to £5m was account is taken of elasticity effects half of which could be attributable to the presence of BBC services.

However, commercial networks also lose out from extra Freeview homes substituting five channel analogue homes. With an 8 per cent lower share in Freeview homes this

represents lost revenue after price effects of £18m. But ITV pays less in licence fees to the UK Government for every digital home, which means that the net impact is £12m. Again about £6m might be attributable to the BBC services.

The net effect of all these factors is a net positive impact of between £1m and £16m a year currently on advertising revenue. However, this is outweighed by the £20m in extra transmission fees paid by thematic channels.

Within this overall impact, the effect is very different for different commercial channel owners. For instance, ITV's ownership of the leading thematic channel - ITV2 - on the Freeview platform combined with its rebate on payments made to the UK Government for every new digital home implies that they get a positive boost.

In contrast, Channel 4 with no such rebate (it pays nothing to the UK Government in the first place) and no free to air thematic channel on Freeview, probably losses out. This should change if Channel 4 goes ahead with its plan to launch a new free to air factual channel in 2005.

Over time, as Freeview penetration increases, incremental income for thematic channels on the platform will rise well above extra transmission costs and the overall advertising market impact will turn positive.

Figure 37

BROAD ADVERTISING INCOME IMPACT		
FACTORS	IMPACT	ATTRIBUTABLE TO THE BBC
LOST THEMATIC PAY TV ADVERTISING REVENUE	<ul style="list-style-type: none"> <li>• 250k to 500k subscribers</li> <li>• Worth about £12m to £25m per year</li> <li>• But elasticity of 2.5 means only £5m to £10m is lost</li> </ul>	<ul style="list-style-type: none"> <li>• 50% responsible for Freeview take-up</li> <li>• £2.5m to £5m NEGATIVE IMPACT</li> </ul>
BENEFIT TO NETWORKS OF FREEVIEW HOMES RATHER THAN PAY TV HOMES	<ul style="list-style-type: none"> <li>• 250k to 500k subscribers</li> <li>• Extra 15% share points in Freeview homes</li> <li>• Worth £5m to £10m per year</li> <li>• But elasticity means only £2.5m to £5m</li> </ul>	<ul style="list-style-type: none"> <li>• 50% responsible fore Freeview take-up</li> <li>• £1.3m to £2.5m POSITIVE IMPACT per year</li> </ul>
HARM TO NETWORKS FROM FREEVIEW RATHER THAN 5 CHANNEL ANALOGUE	<ul style="list-style-type: none"> <li>• 1.8m extra homes</li> <li>• 8% less share</li> <li>• £45m less revenue</li> <li>• But elasticity means only £18m</li> <li>• 50% tax rebate to ITV and no share loss to FIVE means this is £12m</li> </ul>	<ul style="list-style-type: none"> <li>• 50% responsible for Freeview take-up</li> <li>• £6m NEGATIVE IMPACT</li> </ul>
BENEFIT TO THEMATIC CHANNELS ON FREEVIEW	<ul style="list-style-type: none"> <li>• 10% extra share in Freeview</li> <li>• Extra £37m, but elasticity means £22m</li> </ul>	<ul style="list-style-type: none"> <li>• 50% responsible for Freeview take-up</li> <li>• £11m POSITIVE IMPACT for 10%</li> </ul>
OVERALL IMPACT RANGE		<ul style="list-style-type: none"> <li>• +1.3m to +£16m</li> </ul>

### *iii. Overall Impact*

With the overall sub fee impact neutral to slightly positive, and the advertising impact only negative in the short term, and then only strongly negative for one or two specific owners– it is probable best to consider the platform impact broadly neutral.

## **4. The Specific Cash Flow Impact on Rivals**

The main focus in assessing the direct cash impact on close rivals network and thematic channels is any lost advertising revenue as a consequence of lost share. This in turn is related to the responsiveness of the relevant advertising market to any reduction in commercial “impacts” (i.e. the level of audience, multiplied by the number of 30 second advertising slots per hour).

The share impact effect involves three stages of analysis. First, an assessment of how much share the relevant BBC digital channel has actually gained since launch is needed.<sup>34</sup> This is initially based on the all day share gain in all multichannel households by the BBC service – even though they all transmit less than 24 hours a day – for ease of comparison with other channels.

Second, an assessment of where share has been taken from – i.e. BBC networks, commercial networks or thematic channels is needed. Third, a conversion of any share loss by commercial networks or thematic channels into a percentage reduction in commercial impacts.

Fourth, a translation from change in commercial impacts to change in advertising revenue is needed– which involves assumptions about elasticity of demand for advertising (price responsiveness to changes in volumes). In terms of converting commercial impact changes to advertising price and revenue changes we have adopted three approaches.

The first assumes the same elasticity (or responsiveness of price to volume changes) across the whole market – network or thematic channel – as measured by the new Davies/Moffatt study into price elasticity. This elasticity is measured at -1.7, which means a 10 per cent reduction in impacts only reduces revenue by 4 per cent.

The second, approach assumes that different elasticities apply to the network market and the thematic market. Based on analysis in the previous section, these are -1.6 and -2.5 respectively. This implies that a 10 per cent reduction in network impacts leads to just a 3.8 per cent reduction in revenue, while for thematic channels, a 10 per cent reduction leads to a 6 per cent revenue loss.

The third approach, has been to look, where possible, at the demographic advertising market relevant to the channel, and try to estimate whether the elasticity is higher or lower than the sector average, and then adjust the impact accordingly. This analysis also requires us to separate out the specific TV advertising spend in the UK aimed at the target demographic. This can only be a guess at best as no proper information exists in this area. Our general assumption on elasticities in this area has been based on the

---

<sup>34</sup> This gain is when compared with the relevant slot share prior to launch of BBC Choice and BBC Knowledge.

likelihood of substitute media. Where no real substitute media exist for reaching the target audience, elasticity will be low, where plenty do exist elasticity is likely to be higher.

**a. The Likely Cash Flow Impact of BBC 3**

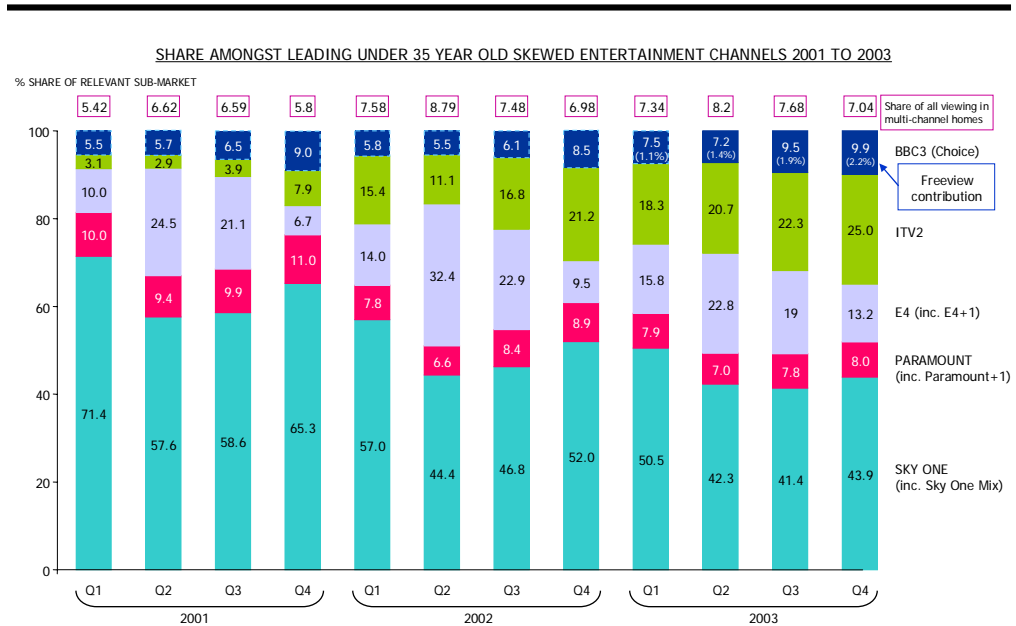
*Audience Share*

With only a 0.2 per cent increase in audience share points since the launch of BBC 3 from the existing audience of BBC Choice, and with an even smaller increase in the pay TV multichannel homes where most its rival channels are carried, the overall audience share impact of BBC 3 on rivals is likely to be limited.

Furthermore, over the period from the beginning of 2003, the greatest impact on the 16 to 35 year old orientated thematic entertainment led channel market in terms of audience share has been the continued growth of ITV 2, and the gains Channel 4 has made, rather than the launch of BBC 3.

While any extra share BBC 3 has taken of the 20 to 40 year old viewing market has probably mostly been at the expense of commercial rivals rather than BBC 1 or BBC 2 (although BBC 2 has lost disproportionate share of this audience over the period), such share loss is likely to have been spread across a number of channels given BBC 3's different age, gender and socio-economic skew to most its counterparts.

Of all the channels E4 is, however, probably the closest to BBC 3's demographic, and has probably lost slightly more than the other 16 to 35 year old focused channels.



### *Advertising Revenue*

Within the 0.2 per cent share gain, BBC 3 probably took 0.05 from BBC 2, leaving a 0.15 share gain from all commercial channels in multichannel homes. This equates to about a 0.075 share loss across all commercial viewing, which is about a 0.1 per cent reduction in overall commercial impacts. Across the whole £3 billion UK advertising market, with an elasticity of  $-1.7$ , this implies that revenue reduce by about 0.04 per cent, or about £1.2m.

Assuming that of the 0.15 share reduction about two thirds came from thematic channels, network commercial impacts reduce by about 0.06 per cent and thematic channel impacts by about 0.25 per cent. With elasticities estimated at  $-2$  and  $-2.5$  respectively, and the size of each market in 2003 being £2,560m and £558 million respectively, this yields a reduction in network revenue of £0.8m in each of the markets.

Reviewing the likely influence of demographic sub markets, it is likely that the 16 to 35 age group advertising market is more elastic than advertising in general with substitutes such as radio advertising, magazine advertising and cinema advertising being readily available. This might suggest that the overall negative impact could be as much as £4 million a year.

### *Programme Prices*

With limited use of acquisitions or BBC archive BBC 3 is unlikely to be pushing up programme prices for other channels. In fact, given its investment in new comedy and drama, it might be producing its own archive material, which if exploited in the UK market – either generally or just to the BBC's joint venture UKTV channels, could help reduce prices of such material.

## **b. The Likely Cash Flow Impact of BBC 4**

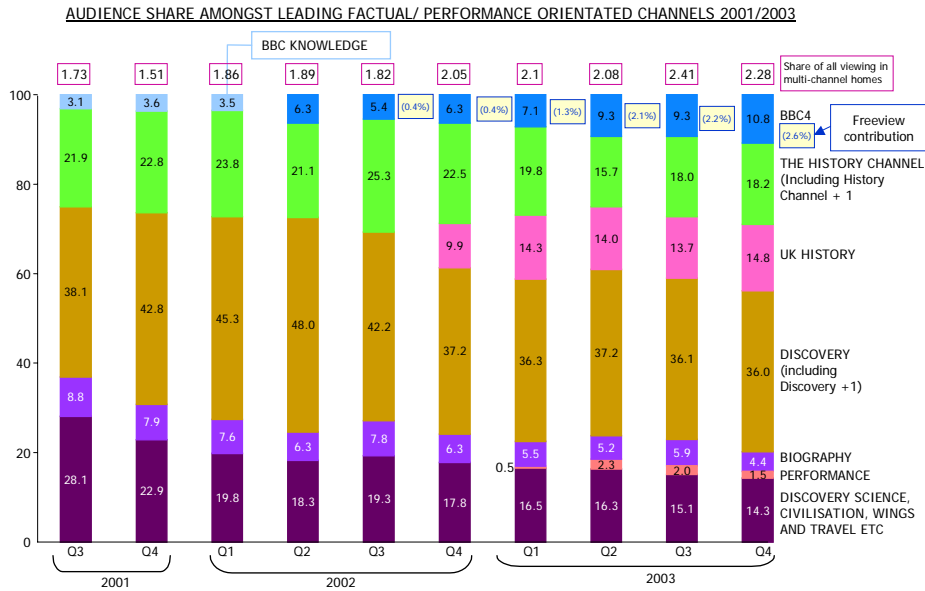
### *Audience Share*

BBC 4 has increased share by about 0.15 per cent since it was launched in March 2002. It does not appear to have taken significant audience from any one factual or performance related thematic channel, with the introduction of UK History seeming to have more of an impact in 2003.

Given that BBC 2 has the closest demographic fit with BBC 4, and the likelihood given the level of cross promotion and the sharing of certain network programmes that viewers often come across from BBC 2, it is probably safe to assume that about half of BBC 4's share comes from BBC 2. Of the rest, the majority is likely to come from Channel 4, the only other channels – except probably Artsworld - with significant comparative reach of older ABs. Very little share is likely to have come from other thematic factual channels especially within the pay TV cable and satellite market.

We have assumed that of the 0.15 percentage point gain, 0.07 came from BBC 2, 0.06 came from Channel 4, and that only 0.02 came from commercial thematic channels – excluding Artsworld which we deal with separately below. This low substitution from thematic channels is partly related to its unique audience demographic, and partly due to the fact that a large proportion of this share gain has been in incremental Freeview homes, where the only non network channel likely to suffer audience loss would be UK History.

Figure 39



*Advertising Revenue*

The 0.08 percentage point gain from all commercial channels in multichannel homes – thematic and network – equates to a 0.075% change in network impacts and 0.05% - with a single market elasticity of -1.7, this implies a loss of revenue of £0.9million a year.

Applying the separate elasticities of -1.6 and -2.5 for network and thematic channel advertising respectively, yields a reduction in network advertising of £0.7 million a year and a reduction in thematic channel advertising of £0.2 million per year. A large proportion of the network advertising reduction would be at Channel 4, while the thematic channel revenue reduction would be likely to be spread across a very large number of channels with none losing more than £50,000.

The specific advertising market for over 40 year old ABs is likely to be less elastic than the 16 to 35 year olds of BBC 3, but more elastic than the market average, given that there are other ways of reaching this audience through broadsheet newspapers in particular. Taking this into account, loss of revenue might rise to about £2m. Again the majority would come from Channel 4.

*Programme Prices*

BBC 4 makes limited use of acquisitions and those it does purchase tend to be European and non US films, and the occasional non mainstream US TV programme. This is unlikely to push up market prices. BBC 4's use of its own archive – especially performance and arts archive, might push up the price of alternative libraries to the likes of Artsworld and The Performance Channel, or alternatively – and more likely- reduce the effectiveness of the spending they do engage in.

### *Artsworld and Subscription Revenue*

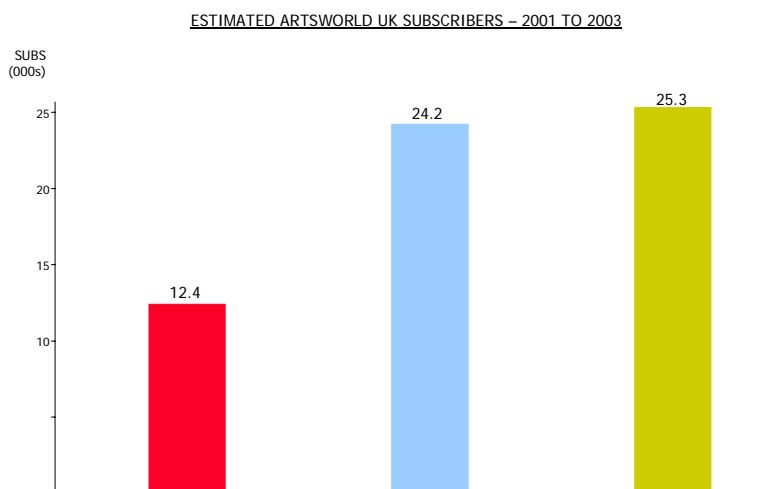
Artsworld is an a la carte subscription channel charging £5.99 a month to subscribers for a performance and arts based channel probably primarily aimed at over 40 year old ABs. It probably pays about £2 per subscriber per month for conditional access ( the ability to switch individual subscribers on and off) and another 50 pence month for subscription management – this leaves it with about £2.50 a month – net of VAT – as gross profit to the channel before programming and management costs.

Turnover of the channel business in the six months to end June 2003 was £775,000, nearly all of which we assume came from subscriptions – this converts into about 25,300 subscribers over the six months. In the previous 12 months turnover figures – ending December 2002, suggests they had 24,000 subscribers, while in the previous year to that – 2001, their turnover suggests they had 12,300 subscribers.

BBC 4 launched in March 2002, so is it was to impact subscribers it would probably be in 2002 and 2003. Artsworld subscriber penetration of the pay TV satellite homes it is available to increased from 0.24% in 2001, to 0.4% in 2002, but then slipped a bit to 0.39% in 2003. This could suggest some loss in subscribers from the launch of BBC 4. An assumption of 5,000 lost subscribers might be a reasonable assumption based on a forecast that penetration might have risen to about 0.5% without BBC4. 5,000 subscribers is worth about £150,000 to Artsworld after conditional access and subscription management charges.

However, countering this direct loss of subscription income, is the increased leverage Artsworld probably gained with BBC 4 available on Freeview and free of charge to satellite homes. This should increase the importance of the channel to BSkyB in terms of persuading free to air digital homes to upgrade to pay TV. Unfortunately, increased leverage for an a la carte channel can not convert into a lower conditional access charge from BSkyB as regulation prevents this. It is more likely to manifest itself in a willingness for Sky to underwrite the channels losses. Indeed, over the period, BSkyB, already a shareholder, increased its share holding and implicitly took on a greater share of the companies losses and funding requirements.

Figure 40



### c. The Likely Cash Flow Impact of CBeebies

#### *Audience Share*

The launch of CBeebies in the first quarter of 2002 seems to have taken some share from both Nick Jr and Disney Playhouse within cable and satellite households initially, but Nick Jr seems to have recovered a large proportion of this initial share loss, and Disney's continued overall share decline has in large part been due to stagnation in the number of premium movie households in the UK while the overall number of multichannel households increased.

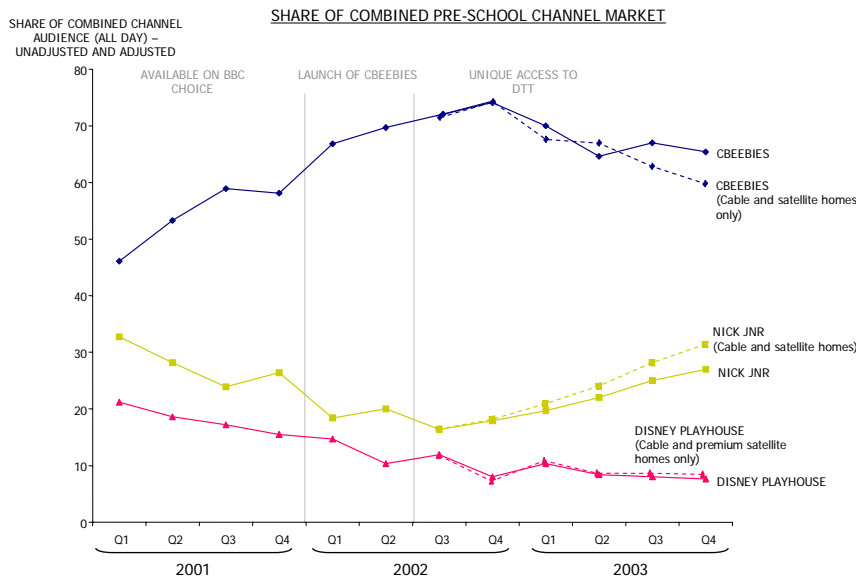
CBeebies increased overall share over the last 12 months is almost entirely due to its current unique reach - amongst the group of pre-school channels - within the growing number of Freeview only households - where it gains almost 2 per cent of all viewing time. The channel's share in cable and satellite homes is only 1.1 per cent, just above the share BBC Choice had been getting for its pre-school programming segments prior to 2002.

Overall we have estimated CBeebies has taken 0.2 percentage points of share from all channels in multichannel households, but that given most of this gain has come in incremental Freeview homes, a quarter of the share has probably come from BBC networks, and another quarter from commercial networks especially ITV. The remaining

0.1 per cent share point has come from a combination of *Nick Jr*, *Disney Playhouse* and *Boomerang*.

The total 0.2 per cent switch of viewing probably represents a 1 to 2 per cent switch in children under 6's viewing.

Figure 41



### Advertising Revenue

A 0.15 percentage point switch in multichannel audience share is about a 0.1 per cent increase in impacts. With a  $-1.7$  elasticity across the whole market, this equates to a 0.04 per cent reduction in total advertising revenue, or about £1.2m a year.

Taking the £2.5 billion network advertising and the £0.5 billion thematic advertising market separately and applying the  $-2$  and  $-2.5$  elasticities to each market respectively, and measuring the impact of the 0.05 network loss in share and the 0.1 thematic loss in share, we obtain revenue losses of £0.8m for each of the two markets. This yields a total of £1.6m.

With no separate estimate of the UK children's advertising market, it is difficult to judge the precise impact on from a demographic advertising market perspective. But with few alternative ways of advertising to very young children (but perhaps more alternative ways of advertising to new mothers), we might expect the elasticity of demand to be lower for children's advertising, perhaps quite close to  $-1$ , suggesting that maybe the revenue loss is just £0.7m.

### Programme Prices

With limited use of imported acquisitions and animation by CBeebies, the programme price impact in rivals is likely to be minimal. CBeebies commissioning of new UK animation is likely to increase the supply of quality UK material in the market place and keep the overall price of animation in the UK at lower levels than otherwise might be the case.

**d. The Likely Cash Flow Impact of CBBC**

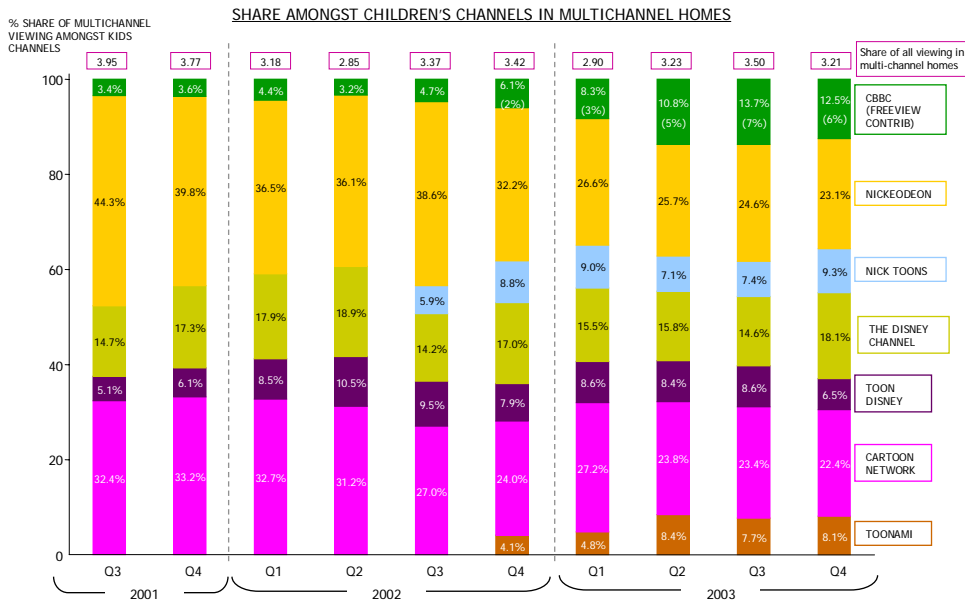
*Audience Share*

CBBC is likely to have taken 0.3 per cent share from other channels in multichannel homes since launch, having seen its audience rise to 0.4 per cent of all multichannel viewing compared with 0.1 per cent share for the children’s slot on BBC Choice. Much of the increase has come in incremental Freeview homes, which implies again that much of the audience share has come from relevant networks – probably BBC 1 and ITV.

Separate analysis of the ITV1 and BBC 1 children slot viewing over the period does show that the ITV children’s slots lost some share in all multichannel homes in 2002 and 2003, but it also shows a lower level of loss in Freeview homes. This is likely to suggest that commercial thematic children’s channels rather than the CBBC channel has caused the decline in ITV’s children’s slot.

We have therefore assumed that 0.1 percentage point was lost from BBC 1, 0.1 percentage point from ITV1 and 0.1 percentage point from other thematic channels.

Figure 42



*Advertising Revenue*

Converting the loss of share to ITV and commercial thematic channels into a loss of commercial impacts and applying the -1.7 elasticity, this converts to a £1.9 million per year revenue loss overall.

Treating the network and thematic advertising markets separately, the total impact rises slightly to £2m, with £1.2 million from networks – mainly ITV1, and £0.8 million from thematic channels, with the Disney Channel likely to have lost the most given its closer positioning to the CBBC audience.

Adjusting for the likely less elastic children's advertising market might suggest a smaller impact all round of just £1 million per year.

#### *Programmes Prices*

While the CBBC does use some acquired animation, its total share of the total acquisition market for such material in the UK is likely to be very small. At the same time its funding of UK animation is likely to increase the volume of material available in the future.

Once again, the fact that BBC archive is not available to other channels may make it more difficult for them to cost effectively compete for the BBC's audience, but within the area of children's programming there is so much other archive available – including ITV's which is used by Nickelodeon, that this is unlikely to have much of an impact.

#### **e. The Likely Combined Cash Flow Impact**

Figure 43 below summarises the estimated combined impact using all three types of methodology. Taking the lowest combination of impacts for all the channels and then the highest combinations for all the channels, an estimated range of £3.8m to £9.8m emerges.

Figure 43

IMPACT ON ADVERTISING REVENUE BY METHODOLOGY

	MAIN ASSUMPTIONS	BBC 3	BBC 4	CBBC	CBEEBIES	TOTAL
METHOD ONE	<ul style="list-style-type: none"> <li>• ALL VIEWING SHARE</li> <li>• SINGLE MARKET ELASTICITY @1.7</li> </ul>	• -£1.2 M	• -£0.9 M	• -£1.9 M	• -£1.2 M	• -£5.2 M
METHOD TWO	<ul style="list-style-type: none"> <li>• ALL VIEWING SHARE</li> <li>• SEPARATE NETWORK AND THEMATIC MARKET ELASTICITIES</li> </ul>	• -£1.4 M	• -£0.9 M	• -£2.0 M	• -£1.4 M	• -£5.7 M
METHOD THREE	<ul style="list-style-type: none"> <li>• DEMOGRAPHIC MARKET AUDIENCE SHARES</li> <li>• INPUTED DEMOGRAPHIC ELASTICITIES</li> </ul>	• -£4M	• -£2M	• -£1.0m	• -£0.7m	• -£7.7m
RANGE		• -£1.2M TO £4M	• £0.9M TO £2M	• £1.0M TO £2.0M	• £0.7M TO £1.4M	• -£3.8M TO £9.4M

It terms of the incidence of any harmful impact, it is likely that Channel 4 is the most impacted commercial channel, given the nature of the target audience of both BBC 3 and BBC 4, and the fact that both channels have picked up audience share in incremental Freeview homes, where there are few rival thematic channels. However, at the same time Channel 4 does seem to have increased its share in multichannel homes of both ABC1's and the under 40's, which suggests BBC 3 and BBC 4 might have prevented a greater gain in this area rather than a greater loss.

In terms of thematic channels, E4, Artsworld, the Disney Channel, and Nick Junior have probably been the most affected in terms of advertising revenue, but at the same time all these channels have probably become more valuable, not less valuable to pay TV platforms and have probably increased their leverage.

### 5. The Impact on the Creative Production Base

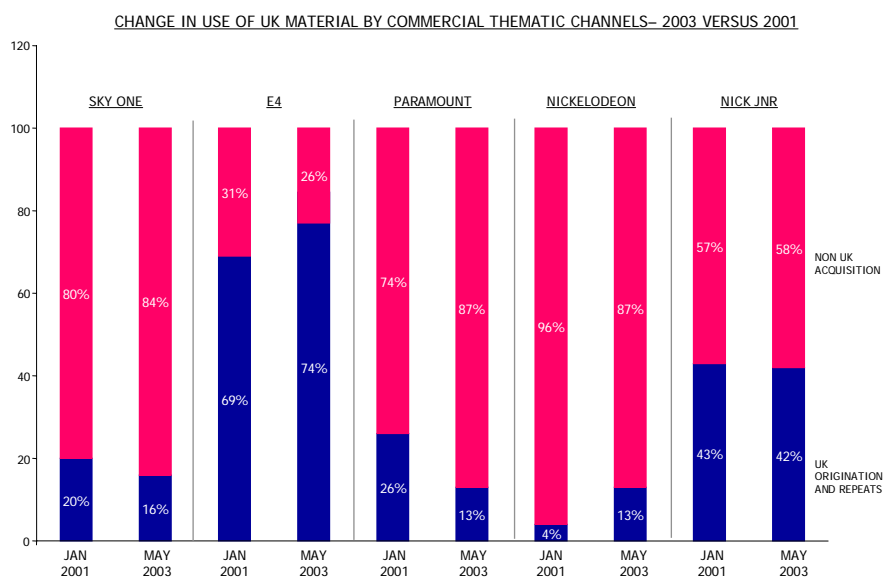
Given that the BBC channels combined programming spend was about £168 million a year for each channels initial launch year, and that about £150 million of this was on new programming or co-production, the channels have clearly made a major contribution to stimulating the production sector given this represents more than the entire annual spending of all non news and shopping basic thematic channels in the UK.

Beyond the headline numbers, about 33 per cent of all this origination spend has been with independents which is greater than the UK market average share for independents of 30 per cent. A significant proportion of this spend has also been outside London and the South East.

BBC 3 and BBC 4 have also brought new comedy and drama writing talent to the screen, while CBeebies has commissioned and developed UK animation. CBBC has also developed new comedy and drama formats and commissioned some animation.

However, none of the channels seems to have made extensive use of already established names – on and off screen – which would have bid up talent costs had they done so. Where channels have done this – most notably BBC 3, it seems to have been to give established stars new types of creative roles, and we would assume – although we do not have the evidence – that such non-pecuniary benefits for the key talent meant they did not demand or obtain large fees.

Figure 44



## 6. Overall Summary of Likely Market Impact Since 2001

Figure 45 below summarises the overall impact by channel and then – in cases where it makes sense to do so – across all channels. It reflects the conclusions from the preceding analysis, namely, that the BBC is providing a distinct portfolio of channels, that the direct impact on rivals is significant but not large and that the services have had a major role in driving digital penetration.

Figure 45

SUMMARY OF OVERALL MARKET IMPACT – 2001 to 2004

IMPACT	BBC 3	BBC 4	CBBC	CBEEBIES	OVERALL
DIGITAL TAKE-UP	MEDIUM	HIGH	MEDIUM/HIGH	HIGH/MEDIUM	HIGH/MEDIUM
DISTINCTIVENESS FROM COMMERCIAL MARKET	HIGH/MEDIUM	HIGH	HIGH/MEDIUM	HIGH/MEDIUM	HIGH/MEDIUM
IMPACT ON OVERALL COMMERCIAL MARKET (PLATFORM LEVEL)					SLIGHTLY NEGATIVE/ NEUTRAL (C4 worst hit)
DIRECT ADVERTISING CASH FLOW IMPACT ON RIVALCHANNELS PER YEAR	-£1.2M TO -£4M	-£0.9M TO -£2.0M	-£1.0M TO -£2.4M	-£0.7M TO -£1.4M	-£3.8M to £9.8M
MOST IMPACTED NETWORK	CHANNEL 4	BBC 2	BBC 1/ITV	BBC 1/ITV	CHANNEL 4
MOST IMPACTED COMMERCIAL DIGITAL CHANNEL	E4	ARTSWORLD	THE DISNEY CHANNEL	NICK JNR	
IMPACT ON PRODUCTION TALENT	POSITIVE (esp new talent in Drama and Comedy)	POSITIVE IN FACTUAL PROGRAMMING	SLIGHTLY POSITIVE (esp in drama and comedy)	POSITIVE (especially UK Animation)	POSITIVE
PROGRAMMING BUDGET 2002/03	£97M	£30M	£26M	£15M	£168M

## **E. A COMPARISON OF THE MARKET IMPACT WITH THAT PREDICTED IN 2001**

### **1. Broad Impact and Digital Take Up**

In terms of overall digital take-up and broad impact on the commercial market, the original study, was predicated on the continued existence of three pay TV platforms, and in particular the survival of ITV Digital. The BBC channels were seen as driving a certain amount of free to air digital penetration but also adding to the likely take up of pay TV, and in particular the relative fortunes of ITV Digital.

In fact, the BBC channels have probably turned out to have a larger role in driving digital penetration than envisaged back in 2001/2002 given the success of Freeview and their part in it.

In terms of the broad impact on commercial TV economics, the suggestion in the initial report that this is largely neutral or perhaps slightly positive still seems to make sense in terms of events over the last two years and research evidence. The platform based advertising impact of Freeview, however, was not foreseen in the previous study.

### **2. Direct Cash Impact**

The initial impact study in the Spring of 2001, predicted larger combined audience shares for the BBC channels -totalling 4 per cent of multichannel viewing in 2003 against outturn 2.7 percent. While the prediction for the children's channels combined was actually too low - at 1.5 per cent compared to the 1.8 per cent achieved – the forecast for BBC 4 was a lot higher at 1 per cent rather than achieved 0.2 per cent. The forecast for BBC 3 at 1.5 per cent was also quite a bit higher than the 0.7 per cent achieved.

The initial review has also not foreseen the polarisation in audience share by platform, where in Freeview homes the channels get about 5 per cent versus just 2 per cent in pay TV homes.

While the initial share forecasts were too high, the approach to elasticity in the initial review was too conservative. Back in 2001, with little independent research, we has assumed that elasticity was probably about -1 to -1.5, rather than the -1.6 to -2.5 range we have used in this review.

The net impact of an outturn lower audience share, but a high elasticity estimate has been fairly similar assessment of overall impact for the channels. Although only in the case of the BBC 3 review in 2002 did we provide a direct cash flow impact assessment last time of £4m. In the initial 2001 review we used a net present value impact approach which is difficult to compare precisely with this report.

## F. LIKELY FUTURE TRENDS IN THE UK TV MARKET TO 2007 AND LIKELY FUTURE IMPACT

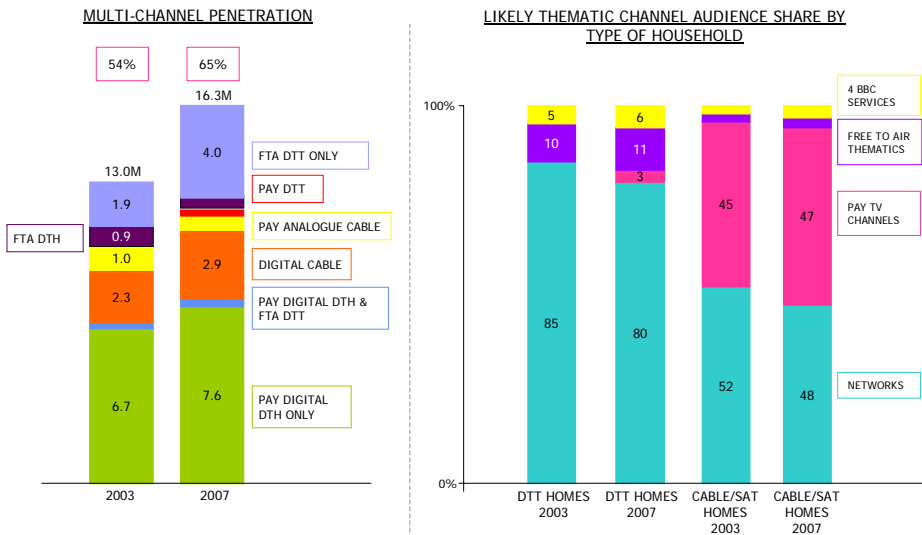
Set out below is a brief review of how trends over the next three years might modify the estimated impact provided above.

### 1. Digital Take Up

In terms of digital take up Freeview seems likely to continue to grow, and largely through incremental growth rather than substitution of pay TV homes. Indeed, the re-emergence of cable from administration, and the imminent launch of Top Up TV as an add on pay TV service for Freeview homes, would suggest that both pay TV and Freeview are likely to grow over the next three years.

The four BBC services are likely to continue to have a major role in driving Freeview and general digital take up.

Figure 46



## **2. Broad Market Impact**

The impact on sub fees is likely to remain neutral or even turn positive. While a few new Freeview homes may be substitutes for pay TV homes, the emergence of Top Up TV is likely to encourage more initial Freeview homes to eventually upgrade to pay TV. Freeview may therefore become more of a complementary platform.

At the same time, Freeview's impact on pay channel leverage with platforms is unlikely to become much less. While some more competition between pay TV platforms may emerge again in the next three years, it is more likely to be complementary to BSkyB rather than directly competitive. Meanwhile, increasing Freeview penetration will make the free to air alternative to pay TV even more viable, improving the leverage of channels with all pay TV platforms.

The broad Freeview related advertising impact should reduce and turn positive. As Freeview penetration increases the fixed cost of transmission for thematic channels on the platform becomes less of a burden. This should help tip the balance of advertising impacts from Freeview positive.

The disproportionately negative impact in Channel 4 should also reduce if, as it plans, it launches a new Freeview channel.

## **3. The Direct Cash Impact**

While audience share increases for CBBC and CBeebies are likely to level off, with most homes with children already having digital TV, the audience share of BBC 3 and BBC 4 might well improve – in both Freeview and pay TV homes – as they learn to improve their schedule mix and as some strands established in the first year or two become more established. BBC 3's share of all day multichannel viewing could rise to 1 per cent and BBC 4's to 0.4 per cent, yielding a total share of 3.2 per cent, a 0.5 percentage point gain on current share.

This is likely to result in a more or less proportionate increase in the direct cash impact in advertising revenue – with the £4m to £10m range moving to £6m to £15m – up by 50 per cent in both cases in today's prices.

With pay TV growth recovering slightly more of this impact might be on thematic channels than networks, but it is unlikely to represent more than 2 to 3.5 per cent of total thematic channel revenue.

## **4. Impact on the Production Base and Creative Content**

This factor might well improve in the next three years. Not only will BBC channel nurtured talent begin spread through the whole TV sector but near rival channels might at last begin to respond to the BBC services by commissioning more of their own UK output.

While sub fee and audience fragmentation pressures will remain, improving advertising income and channel ownership consolidation, might given the near rivals the resources to spend more on originated content in order to compete with the BBC.<sup>35</sup>

---

<sup>35</sup> This is one of the reasons for being conservative in the likely increases in share for the BBC channels.

