

**THE MARKET IMPACT OF THE BBC'S DIGITAL
RADIO SERVICES**

**(BBC 6 Music, BBC 1Xtra, BBC Asian Network,
BBC 7 and BBC Five Live Sports Extra)**

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

By Oliver & Ohlbaum Associates Ltd

March 2004



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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 five new digital radio services launched in 2002 – BBC 6 Music, BBC 1 Xtra, BBC 7, BBC Asian Network and BBC Five Live Sports Extra.
- This assessment has looked at the impact since launch, 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 creative community have been developed.
- 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 radio services – analogue and digital. 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 on the overall viability and prospects for commercial radio.
- Digital radio is a relatively new sector and RAJAR – the industry research body, has only recently started adding digital only stations to its survey. Even then, audience estimates for many of the lower reach digital services can only be viewed as rough estimates at the moment given the small sample sizes. This report has made the best use of the material available, while realising that measures of total digital listening and share by service within that total are simply broad and indicative numbers currently.
- In addition, a detailed and systematic independent comparative review of BBC and commercial digital service schedules was not possible in the time available – instead we have had to rely on the analysis done by the BBC and general channel descriptions and overviews provided by the commercial services.

- Despite these difficulties, the review has found that the BBC services are playing a vital role in driving digital penetration – especially but not limited to DAB distribution – and that this overall boost to digital has an unambiguous positive impact on the commercial sector as a whole, given commercial radio’s almost two thirds share of the radio choice facing every new digital household (compared with just 50 per cent of the FM choice currently). This positive impact has been estimated currently at £4.5m a year, but this is likely to rise substantially in the next few years as digital listening accelerates.
- Taken as a whole, the BBC services are offering something distinct from both the commercial market (analogue and digital) and from existing analogue BBC services. Where BBC services seem quite close to commercial rivals in terms of demographics and focus (such as BBC 6 Music) they still do much to differentiate themselves in terms of mix of output and commitment to UK talent and artists. Where new BBC services seem quite close to the output of current BBC services (such as BBC 7 and BBC Five Live Sports Extra) they do much to cater for different audiences at different times (such as children on BBC 7).
- O&O estimates that the five BBC digital services combined account for 0.6 per cent of all measured listening, and 16 per cent of all digital station measured listening. If commercial radio out of area analogue rebroadcasts are excluded (e.g. Xfm and Kiss FM outside of London and the Home Counties) from the total, the new BBC service share of digital station listening rises to 25 per cent.¹
- The BBC is spending nearly three times as much on content for its five new services as the commercial sector is spending on its 35 new services, and both BBC 1Xtra and BBC Asian Network are bringing new voices and production talent into the formal radio sector.
- However, the BBC services are probably taking some audience and advertising away from individual commercial services despite boosting the sector as a whole. O&O has estimated that perhaps £1.6m in advertising revenue is being lost by individual commercial radio services due to the existence of the BBC services – mostly from existing analogue services. This is also likely to rise in the coming years, but will remain much lower than the general and positive boost the BBC services give to the entire commercial radio sector.
- For a small number of commercial services the net impact of, on the one hand, a loss of revenue to a neighbouring BBC service and, on the other hand, the overall boost to the sector of the existence of BBC services, may still be negative. Such services might well include OneWord and some of the many services in the same market segment as BBC 6 Music.
- However, in no case is the existence of the BBC service likely to be the main determinant of the current and future success or failure of that commercial service.

¹ All these figures are based on Quarter 4, 2003 RAJAR data.

- Figure 1 summarises the findings of the report in terms of digital take-up, distinctiveness from commercial and BBC services, the broad positive impact on the commercial sector, the specific competitive impact on the revenue of specific services and the contribution to the production base and talent. It also summarises the listening hours and reach (of individuals with digital access) for each service. Overall, BBC 1Xtra and the BBC Asian Network probably gain the highest combined score.
- Looking forward over the next 3 years or so, the importance of BBC services to take-up should remain, while the positive broad impact on the commercial sector – as increased digital penetration helps increase its share of all listening – could rise to £20 million. While the competitive revenue substitution might also rise to £8m, this still leaves a £12m likely net benefit to the sector.

Figure 1

SUMMARY OF MARKET IMPACT											
	BBC 6 MUSIC		BBC 7		1XTRA		ASIAN NETWORK		SPORTS EXTRA		TOTAL/OVERALL
DIGITAL TAKE-UP AND EQUIPMENT MANUFACTURES	MEDIUM		HIGH		HIGH		MEDIUM		HIGH		HIGH
DISTINCTIVENESS FROM THE COMMERCIAL MARKET	MEDIUM		HIGH		MEDIUM		HIGH		MEDIUM		MEDIUM/HIGH
DISTINCTIVENESS FROM OTHER BBC SERVICES	HIGH		LOW		HIGH		HIGH		LOW		HIGH IN PLACES
IMPACT ON OVERALL COMMERCIAL DIGITAL ECONOMICS	SLIGHTLY POSITIVE +£750k		SLIGHTLY POSITIVE +£500k		VERY POSITIVE +£1m		POSITIVE +£750k		POSITIVE +£1.5m		POSITIVE +£4.5m
DIRECT CASH FLOW IMPACT ON RIVALS	-£300k		-£150k		-£500k		-£500k		-£150k		LIMITED -£1.6m
MOST AFFECTED ANALOGUE COMMERCIAL STATIONS	• VIRGIN		• CLASSIC FM • CENTURY		• GALAXY • KISS • CHOICE		• SUNRISE		• TALKSPORT • CENTURY • GOLD		
MOST AFFECTED DIGITAL ONLY COMMERCIAL STATION(S)	• PLANET ROCK • PASSION FOR THE PLANET • STORM		• ONEWORD • PRIMETIME • CAPITAL/DISNEY • ABRACADABRA		• URBAN CHOICE		• YAAR • ASIAN PLUS • PUNJAB RADIO		• EASY • THE LOUNGE		
PRODUCTION SPEND**	£4.2m		£4.5m		£6.1m		£4.3m		£1.7m		£20.8m
IMPACT ON PRODUCTION, CREATIVE SECTOR AND TALENT	MEDIUM/HIGH (EXPOSURE FOR NEW MUSIC)		MEDIUM/LOW		HIGH (NEW SOURCES OF TALENT)		HIGH (NEW SOURCES OF TALENT)		MEDIUM (NEW VOICES)		MEDIUM/HIGH
ANNUAL LISTENING HOURS /WEEKLY REACH OF DIGITAL LISTENERS*	30m	1.7%	56m	2.8%	54m	3.0%	112m	4.0%	24m	2.9%	276m

* Based on Quarter 4, 2003 RAJAR figures.

** Based on 2003/2004 budget projections

SECTION BY SECTION SUMMARY

MARKET TRENDS

- Terrestrial digital radio transmissions (commonly referred to as DAB) are now available in some form to 85 per cent of the UK population through DAB portable receivers, stand alone hi-fi systems and in-car radios.
- DAB consists of two national and a large number of regional and local multiplexes each of which carries between 7 and 12 stations (depending on the combination of stereo and mono services). The national multiplexes – one commercial and one controlled by the BBC, reach between 80 and 85 per cent of UK individuals while the regional/local multiplexes – all controlled by commercial groups – currently reach about 72 per cent of the UK population.
- Terrestrial digital radio (DAB) increases the listening choice for the average UK consumer from 14 stations to 33 stations. The largest proportionate increase in choice is outside London and the Home Counties. (Choice in London increases from 26 current analogue services to 46 from DAB i.e. less than double).
- The increased choice (in addition to the simulcast of the 14 analogue services) consists of 11 extra national services and 8 local and regional services. Some of these local and regional services are actually digital rebroadcasts of analogue services available elsewhere in the UK, and many of them are broadcast in several different regions.
- Digital radio services – retransmissions of DAB services and some extra services – are also available through digital satellite TV and cable TV receivers in the home, and they have also been added to the Freeview digital terrestrial TV system. The internet also provides access to DAB services and hundreds of other radio services from across the world.
- Commercial radio accounts for almost two thirds of the average terrestrial DAB choice across the country compared with half the analogue FM choice. It accounts for an even greater proportion of the radio choice on digital satellite and cable and almost all the choice on the internet.
- Digital radio, in some form, is now accessed by about 18 per cent of all UK listeners in an average month through DAB, internet and digital TV receivers.
- While cumulative DAB receiver sales (portable, in-car and hi-fi) now total about 435,000, the rapid initial penetration of digital radio services has also been due to their availability and increasing use on digital satellite, cable and Freeview digital terrestrial TV platforms and the internet.
- Early RAJAR results suggest that identified new digital services combined with out of area digital rebroadcasts of analogue local services now account for about 3.6 per cent of all listening in the UK.²

² Based on Quarter 4, 2003 RAJAR data.

- Commercial digital services currently generate little direct revenue. While the out of area analogue rebroadcast services (e.g. Jazz FM, Kiss etc) probably do earn some incremental advertising revenue from their expanded reach, and one or two of the leading digital only services such as the Hits and Smash Hits Radio might also earn some revenue, the remainder probably earn no revenue at all.

BBC SERVICE PERFORMANCE

- The five new BBC services (i.e. excluding World Service rebroadcasts) combined now generate 276 million listening hours a year, accounting for about 0.6 per cent of all radio listening and 16 per cent of all identified new DAB digital service listening in the UK.³ This share rises to 25 per cent if out of area analogue station rebroadcasts in digital are excluded (e.g. Xfm and Kiss FM outside London and the Home Counties).
- Each service seems to be succeeding in achieving its target demographic with BBC 7 reaching children as well as adults, BBC 6 Music reaching the 25 to 40 age group, the BBC Asian Network reaching the UK's younger Asian population, BBC 1Xtra reaching the urban under 25 year olds and BBC Five Live Sports Extra reaching the sports audience.

BROAD MARKET IMPACT OF BBC SERVICES

- Listening and survey evidence suggest that cross promotion and delivery of BBC digital radio services have made a clear and significant contribution to the take-up of digital radio in the UK – in particular but not limited to - terrestrial DAB reception.
- The BBC's development of the Freeview TV platform, its early moves to establish digital radio on digital satellite TV systems and the cross promotion of digital TV services in general have all made a significant contribution to the overall reach of digital radio through digital TV systems, which in turn has helped give digital radio an initial boost.
- BBC 7 and BBC Five Live Sports Extra and BBC 6 Music in particular have featured highly in consumers' reasons for getting digital radio. BBC 1Xtra and the BBC Asian Network while not featuring as highly in a UK context have probably helped persuade both the Asian community and the young urban – and to some extent Afro-Caribbean population – to upgrade to digital.
- By helping to drive overall digital penetration the BBC has conferred a general economic benefit on commercial radio which is likely to increase as digital radio becomes a more mature medium and one which advertisers become willing to use.
- As well as organically increasing commercial radio's share of listening by increasing its share of available choice, digital radio may also help commercial radio establish the quasi national network brands valued by advertisers. All this could provide a significant revenue uplift to the commercial sector.

³ Some listening on satellite and cable TV systems is to other digital services that have no UK DAB access

- In addition, the promotion of terrestrial DAB distribution in particular (as opposed to internet and digital TV system delivery) is likely to help preserve the leading position of UK radio providers versus low cost "juke box" style services that are likely to be available through alternative systems especially the internet.
- The direct financial value of this broad impact to commercial radio is currently worth about £4.5m a year, but will rise over the next few years to as much as £20m by 2007 as digital penetration accelerates.

THE SPECIFIC COMPETITIVE IMPACT

- While the direct financial value to commercial radio of this positive broad market impact has been relatively small so far – about £4.5m a year – it more than outweighs the estimated £1.6m in advertising revenue BBC services have potentially diverted from specific commercial analogue and digital services. This net benefit is likely to increase in the next few years from £2.9m to £12m a year.
- Indeed, the attributed contribution to the broad impact of each BBC service outweighs the specific competitive substitution of revenue. In no case does a BBC service take more from the commercial sector than it gives. This is likely to continue to be the case in the next few years.
- However, the net financial impact of these two effects on certain individual commercial digital services might well be negative in some cases – if still small. While the size of this net effect is negligible for affected established incumbent commercial analogue services – or digital rebroadcasts of these services – the impact on some digital only services may have been more significant. Although in no case has the presence of a BBC service been likely to be the only or even prime determinant of commercial success or failure.
- Both individually and taken together the BBC services represent a distinct offering to commercial radio. Those BBC services that operate in market segments already covered by commercial radio – such as BBC 6 Music and BBC 1Xtra – have a very distinct mix of music and programming types when compared to commercial counterparts. The BBC Asian Network has both a distinct schedule and a different target demographic to commercial counterparts.
- BBC 7 and BBC Five Live Sports Extra both provide an enhanced service to an existing BBC audience, with BBC 7 also achieving reasonable levels of reach to their target market of children, which is currently underserved by all radio.
- All the BBC services make a contribution to the production base, with BBC 1Xtra and BBC Asian Network in particular, helping to bring new production talent and presenters into mainstream radio, while BBC 6 Music makes an important contribution to live music performance and the promotion of lesser known artists in the more mainstream adult contemporary market.

CONTENTS

INTRODUCTION	9
A. AN ASSESSMENT FRAMEWORK	11
B. RECENT TRENDS IN THE UK RADIO MARKET	14
1. General Background	14
2. Competition, Market Structure and Ownership in Commercial Radio	15
3. Digital Platforms and Take Up	16
4. Radio Advertising	18
5. The Current Commercial Terrestrial DAB Proposition	21
6. The Economics of Commercial Digital Radio	27
7. Implications of the Market Analysis for the Potential Market Impact Analysis	28
C. THE BBC'S DIGITAL SERVICE OBJECTIVES AND PERFORMANCE SINCE LAUNCH	29
D. AN ASSESSMENT OF THE MARKET OF BBC DIGITAL SERVICES SINCE LAUNCH	33
1. Digital Take up	33
2. Distinctiveness	36
3. Competitor Viability	40
4. Production Base	45
E. AN COMPARISON OF THE MARKET IMPACT WITH THAT PREDICTED IN 2001	46
F. LIKELY UK RADIO MARKET TRENDS TO 2007	47
G. LIKELY FUTURE MARKET IMPACT	50

INTRODUCTION

In September 2003, the Secretary of State for Culture, Media and Sport announced a review of the BBC's digital radio services launched during 2002 – BBC 1Xtra, BBC Five Live Sports Extra, BBC 6 Music, BBC 7 and the BBC Asian Network. 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, back in the Spring of 2001. The framework and approach adopted by O&O for this review – and set out in the next section - is very similar to that initial review conducted in 2001⁴. However, the evidence and analysis used to reach an assessment of the market impact can now include a review of actual network performance and the evolution of the radio market over the last two to three years, as well as a projection for the next three to four years.

The report consists of 7 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 networks performance to date

- an historical impact analysis for each of the five services in turn, finished off with both a cross service comparison of impacts and a discussion of the likely cumulative impact of the five services taken as a whole.

- a comparison of the historical impact with that predicted in the Spring of 2001,

- an analysis of the likely market trends to 2007

- an assessment of the likely future impact of the BBC's digital radio services to 2007

O&O has drawn heavily on RAJAR data and market research into the take up of digital radio by the BBC and the Digital Radio Development Bureau (DRDB), and both BBC and some O&O research into the output of BBC digital services and their commercial counterparts. O&O has also looked in detail at the licensing of commercial digital services throughout the UK.

However, detailed assessment of the share, reach and demographic positioning of the BBC and rival services has not been possible given the paucity of detailed audience data on digital services, or indeed any systematic division between digital and analogue audiences to stations that have distribution in both markets.

⁴ 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 – rather than the Net Present Value measurement used in our initial report in Spring 2001

In addition, any assessment of the potential direct financial impact of new BBC services on specific commercial digital services has to take into account the fact that for many commercial services, digital reach makes little or no current revenue contribution.

In spite of these limitations, we have used the information that is available to make a reasonable assessment as to the direction and size of the impact of new BBC services taken as a whole on the commercial radio market, and the relative contribution and impact of each BBC service.

A. AN ASSESSMENT FRAMEWORK

The same framework is adopted as for the initial report in 2001. Our analysis has covered three broad questions. The overall aim is to assess whether:

- i. the **conversion to digital radio** in the UK is likely to be (or has been) more rapid
- ii. effective **consumer choice** is likely to be (or has been) improved
- 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 radio (and in particular DAB and Freeview delivery), and therefore the likely date of analogue radio switch off and release of scarce spectrum for alternative uses.

We also assess the general benefit to the UK consumer goods sector from the early and world leading development of digital radio in the UK.

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 digital services – which is included in the first dimension of competitor impact assessment described below.

2. The Impact on Consumer Choice

To analyse the second area of consumer choice, 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 networks and stations 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 on 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 and in particular, does the BBC make a greater use of relatively expensive speech radio than digital rivals – especially narrative speech programme forms such as dramatisation, comedy and factual documentary.

To determine some of these measures we have used a mixture of O&O analysis and externally commissioned BBC research.

Distinctiveness is assessed both with reference to the current analogue choice available to UK listeners and the potential commercial digital choice being offered. It is also reviewed against a background of highly variable choice – both in analogue and to a lesser extent in digital – in different parts of the UK. Given the regional variability of commercial radio a given BBC service can offer different levels of distinctiveness to different areas of the UK.

b. Competitor Viability

We have approached this analysis in two distinct dimensions. First, the broad impact the BBC services (individually and taken together) may have on digital platform take-up and market structure which in turn impacts all commercial stations' overall economics and prospects. In particular, the extent to which digital take up helps increase the commercial sector's share of overall listening and their revenue.

Second, we assess the specific impact of each BBC service on close "rival" station audience share, advertising revenue and programming costs which in turn affects short and medium term cash flow.

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

- audience share amongst relevant digitally enabled individuals,
- advertising revenue (through any reduced share and reach), and,
- programming cost inflation

Rivals assessed include both new (or expanded reach) digital stations covering the same genre and/or demographic as the BBC service, and existing analogue stations (local, regional and national) available to the average listener, where those services have particularly strong appeal to the target demographic or focus on the target genres of the BBC service.

The impact on audience share is assessed by first tracking the pattern of share, total audience and key demographics of each BBC service. An assessment is then made as to the proportion of the BBC's digital service audience taken from existing BBC services versus commercial services and the extent to which the BBC service might have grown total listening. We also try to estimate how much share may have been taken from incumbent analogue commercial services versus new digital commercial services.

The impact of rivals' share loss on their advertising revenue is assessed by reference to existing evidence on general elasticity of demand for radio advertising and any specific features of the advertising market for the demographic relevant to the affected service. Again, account is also taken of the likely impact on commercial digital services, many of which currently earn no incremental revenue, versus commercial analogue services.

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 archive material and presentation talent.

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 three services is greater than the sum of their parts.

3. The Impact on the Production Base

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

What are the BBC services likely contributions to new UK programme investment?

What is the value and worth of such investment?

What is the likely impact on commercial network 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 radio 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.

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 RADIO MARKET

Set out below is an outline of the main recent trends in UK radio. The main aim of this section is to provide an understanding of the current economics of UK commercial radio, the sustainability and objectives of its digital proposition and the macro level factors affecting growth and profitability over the last few years so as to better isolate the likely specific impact of BBC services on the market. The section also provides a general assessment of the BBC's current contribution to the whole sector, providing some context for an analysis of the BBC's specific role in digital radio later in the review.

The section covers six areas:

general background on the size, growth and flow of funds through the commercial sectors' supply chain;

an overview of the competitive structure of the UK radio market and the BBC's current role within it;

a review of the performance to date of digital radio in the UK;

an analysis of the UK radio advertising market and in particular how far revenue is related to changes in commercial audience share;

an overview of the current commercial digital radio proposition; and,

an assessment of the current economics of commercial digital radio.

1. General Background

Radio is an expanding medium with average listening per head rising 10 per cent over the last 5 years

Radio listening in the UK has expanded over the last 10 years while TV watching has stagnated. This growth has probably been fuelled by both an increasing range of services available - outlined in more detail below - and the general suitability of the medium to people's increasingly busy lives. Research suggests that people often listen to the radio while doing other things, and, of course, when travelling and commuting.

UK Radio is a £1 billion sector bringing the average listener in the UK 14 analogue services

UK radio broadcasting is a £1 billion sector, obtaining just over half its revenue from advertising and just under half through the BBC licence fee⁵. The number of analogue stations received varies across the country, with most individuals able to receive five national and one local BBC services and 3 national commercial services, but the number of local and regional commercial services ranges from only one in some rural areas to 18 in London and a similar number in the Home Counties.

⁵ O&O has estimated that about £460m of licence fee income goes to radio services. There is no separate radio figure in the BBC's accounts. We have calculated this figure by calculating the proportion of all programme spending by the BBC accounted for by BBC radio services (at £333m this represents about 17 per cent of programme spending) and applying this to the BBC's total licence fee income of £2.7 billion.

Across the UK the average listener has access to 14 analogue services – 6 from the BBC and eight from commercial radio.

Less Than Half This Revenue Currently Goes Into Programming Investment, With The Commercial Sector Recycling Just 30 Per Cent Of Advertising Revenue Into Programming

Analysis of BBC and commercial radio group accounts suggests that about £450m a year is spent on radio programming and broadcast rights, of which approximately two thirds is spent by the BBC, mostly on the intrinsically more expensive speech based networks – Radio 4, Radio 5 Live and local/national regional services.

The commercial sector spends only about £150m of its £500m net advertising revenue on programming. Commercial radio, being largely local and regional in structure, spends a significant amount on the administration costs associated with running a patchwork of over 250 stations. Commercial radio also spends a significant amount on marketing and promoting itself to listeners and it currently earns an average profit margin of 20 per cent. This all leaves relatively little money for programming which largely consists of DJ led music with occasional news and information bulletins.

Commercial Radio Currently Provides About 57 Per Cent Of The Analogue Radio Choice Available To The Average Listener, But Just 50 per cent of the better quality FM Analogue Radio Available. It Takes Just Under 50 Per Cent Of The Listening

Average commercial sector choice has grown rapidly over the last 15 years from 2 stations to eight, and with this expansion in the number of services listening share has grown from 36 per cent of all listening to 47 per cent. But listening share has not expanded as rapidly as share of available services, as the commercial radio market has tended to concentrate on the 20 to 40 year old music listening market, leaving much of the older and younger markets, and the significant market for speech radio, to the well funded BBC.

2. Competition, Market Structure and Ownership In Commercial Radio

Commercial Radio Ownership is Fairly Concentrated and is Being Permitted to Concentrate Further

The three leading local and regional station owning groups – Capital, EMAP and GWR – currently account for half the local commercial radio audience. Another 25 per cent of the commercial radio audience is taken by second tier commercial groups such as Chrysalis, TWG, Scottish Radio Holdings and the Scottish Media Group.

Changes to ownership limits in the 2003 Communications Act could leave the leading three groups in control of over 70 per cent of the local radio audience.

In Many Markets Direct Competition Between Rival Analogue Commercial Services Is Limited

Commercial radio licensing has in the past favoured a diversity of formats in any one locality or region, leaving each station with limited direct commercial competition for audiences. This tends to mean that there are low returns to large increases in programme spend by commercial radio stations as there is relatively little pressure to compete for audience with a number of rival local stations offering very different formats.

Even in markets where there is a greater degree of direct competition between commercial services – such as that between Heart and Capital in London - this tends to feed through to star presenter salaries and rewards and large marketing budgets rather than more complex and expensive programme formats.

Commercial Radio has Concentrated Primarily on the 15 to 45 year old Audience

Although each large radio market sustains a range of music types and formats with differing gender and music taste skews, nearly all of these are concentrated on age groups between 20 and 40, with little commercial analogue provision for the under 15s or over 45s. The exceptions being the national services such as Classic FM and TalkSport, the recent licences awarded to Saga radio and the regional mixed speech and music services of Century and Real Radio.

Commercial Speech Services are Limited to the Largest Markets and Tend to Focus on News, Phone-ins and Sport

Commercial radio tends to concentrate its speech output on the largest coverage areas – national, regional and London – and focuses on phone in, news and sport formats whose costs can be kept at £500 an hour or less. Stations such as LBC in London, Century Radio in the Midlands and the North and Real Radio in Scotland, either mix speech and music together, or concentrate on phone-ins, news bulletins and occasional live sports events.

The BBC Is Still The Leading Provider Of Narrative Speech Programming, Live Music Coverage And Services Catering To The Over 40s.

The BBC gains about two thirds of the listening of the over 40s through its main national speech services, Radio 2 and BBC local and national regional services.

The BBC is the only radio broadcaster with a significant commitment to new drama, comedy, entertainment and documentary programming and supports considerably more live concert and session music than its commercial counterparts. The costs per produced hour of such material can be £10K or more. Such levels of costs can not be sustained by the commercial sector given the audience and advertising revenue such programming would be likely to attract.⁶

3. Digital Platforms and Take Up

Almost 1 in 5 People in the UK Can and Do Access Digital Radio Through a Variety of Platforms

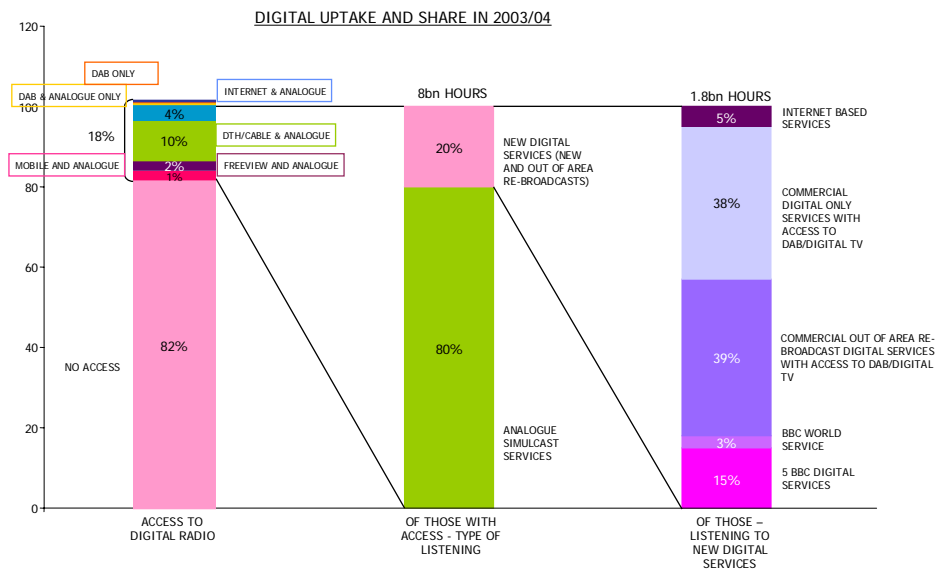
By the end of 2003, about 18 per cent of people in the UK were accessing digital radio services at least once a month (about 10 million). The majority listen to digital services using either their digital TV receiver (satellite, cable or digital terrestrial) or the internet, with only about 435,000 having DAB radio sets (portable, hi fi or in-car systems).

The leading digital radio service in the UK – *the Hits* - now has a weekly reach of 824,000 listeners across all the available platforms. Figure 2 breaks down the current

⁶ At an average price per listener hour of advertising of £1.30 across commercial radio, a £10K programme would have to have an audience of half a million just to break even and one million to make a decent target margin – this would only be possible if a commercial station covered a very large market and was able to achieve a very large share in that market – a 25 per cent share of listening in London at breakfast time might bring in that kind of audience, but even then greater margins can be made with cheaper forms of programming.

levels of digital access by distribution system and then breaks down the listening of those people with access between digital and analogue services, and between BBC and commercial digital services. These are estimates based on current available RAJAR data.

Figure 2



About 3.6 Per Cent Of All Radio Listening In The UK Could Be To Digital Services Not Previously Available In Analogue

Totalling up the listening reach and listening hours per person reached by the new digital stations, and adding an estimate for the extra digital listening obtained by local analogue services that then rebroadcast outside their region in digital ⁷, suggests that named digital services are gaining about 1.8 billion listening hours per year at the moment, that equates to about 3.6 per cent of current UK listening.⁸

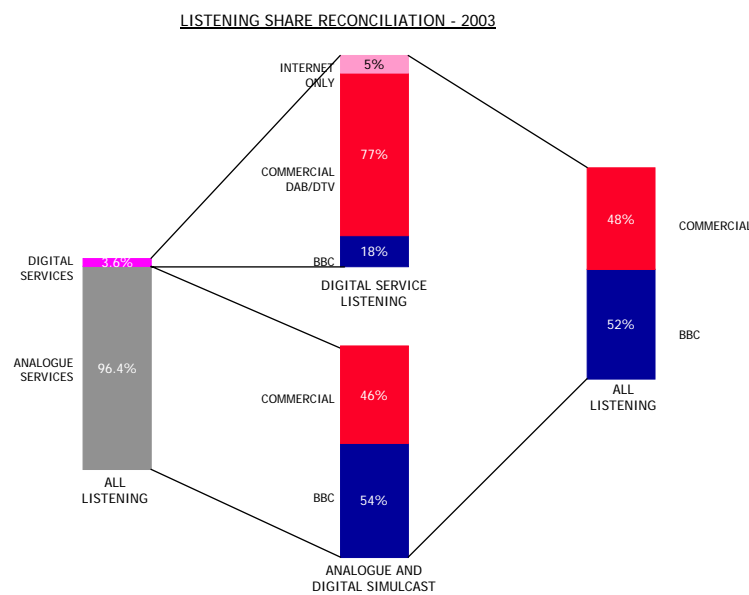
⁷ A key feature of commercial DAB as will be explained later in the report.

⁸ Obtaining actual digital listening figures for stations available in analogue in some parts of the UK but in digital over the rest – or large parts – of the UK, is difficult. Although RAJAR does estimate their total UK listening, which can be compared to their local analogue listening, to extract the implied digital listening in the rest of the UK, this total UK listening figure also captures “out of area” analogue listening. This could be a significant distortion. For instance, many London stations – where their analogue audience is officially measured, can also be heard over large parts of the home counties – where it is not. What appears to be significant digital listening could prove to be simply significant out of area analogue listening. We have adjusted for this in our analysis.

The same figure also suggests – if listeners with digital access listen to similar amounts of radio per week as the average UK listener – that those people with access to new digital services still spend 80 per cent of their time with the analogue services available to them – either in analogue or as a digital simulcast.

There is also no sign as yet that digital choice and availability is increasing listening, as average listening across the UK has been fairly flat in the last 12 months as digital listening has started to grow rapidly.⁹ Figure 3 below reconciles the commercial versus BBC share in digital, analogue only and then all homes at the end of 2003. This demonstrates that the existence of digital is helping the commercial sector to increase its share overall.

Figure 3



4. Radio Advertising

Radio Advertising Growth Slowed Considerably from 2000, with Recession and a Stagnating Commercial Audience

Radio advertising revenue grew by over 10 per cent a year in the 1990s driven by a robust economy and structural changes in commercial radio. The increasing number of commercial services available to any listener helped grow commercial audience share from 36 per cent to about 50 per cent and offered advertisers a more segmented and targeted audience. At the same time, the introduction of national commercial radio and multi region local station brands helped to bring in more national advertisers.

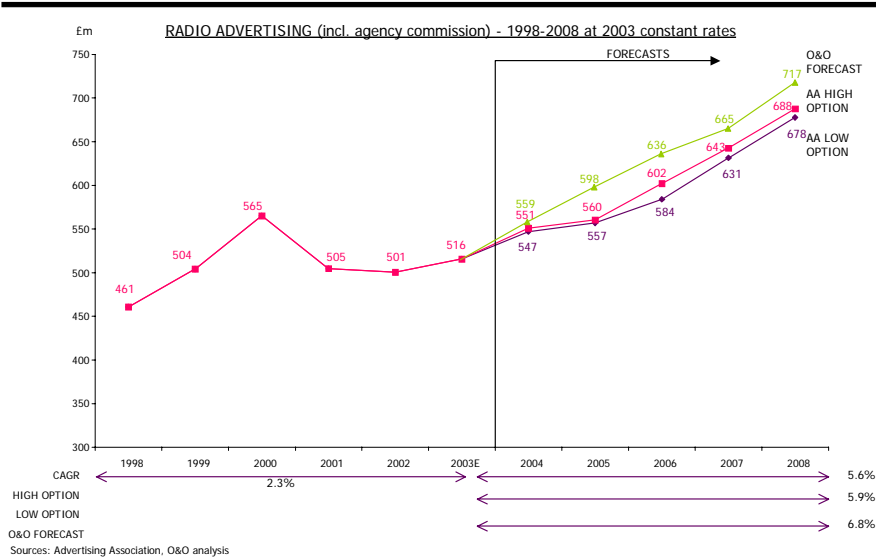
However, growth has slowed considerably over the last 4 years with a general advertising recession, and stagnant or declining commercial radio audience share

⁹ However, these are early days, and it could be possible that total listening will increase just as it did when analogue commercial radio expanded in the 1990s.

with only marginal increases in the number of commercial analogue stations available per listener. Figure 4 shows the trend since 1998.

While there are some signs that advertising growth is picking up again – latest figures suggest it rose by 6 per cent in 2003 – double figure growth is only likely if the commercial audience starts to expand again, or more effective demographically targeted national radio brands appear through consolidation, merger and digital distribution.

Figure 4



National Radio Advertising and Sponsorship Have Been the Main Areas of Growth Over the Last 10 years Although Local Advertising Has Proven More Recession Proof

National advertising accounts for about 70 per cent of all radio advertising and grew most rapidly in the 1990's when the arrival of national commercial radio, larger radio groups and multi-region station brands combined with weekly reach of over 50 per cent helped persuade national advertisers to switch money into radio.

Local radio advertising is still important, especially outside the main metropolitan areas, and because it is linked more to consumer spending than the profit margins of large advertisers, suffered much less from the recent recession.

Radio Advertising is Probably More "Elastic" Than TV Advertising, with Increases in Commercial Listening Hours Probably Helping to Expand the Market

Little bespoke published statistical work has been done to estimate the elasticity of demand for radio advertising in the UK (i.e. the response of price to changes in the volume of listening hour "impacts" offered).

On the one hand, the high growth in radio advertising was associated with a period of expansion in the commercial radio share of all listening and an expansion in overall listening suggesting quite elastic demand for radio advertising. On the other hand, from 1988 to 1990 the London market saw a rapid increase in market share for

commercial radio from 40 per cent to 60 per cent, yet advertising revenue grew by just 5 per cent.

It may well be that certain major structural changes in the UK radio sector, such as the introduction of national commercial radio and the increase from 2 to 8 commercial station choice to the average listener, had helped pull in money to radio from other media, while short term increases in share alone do not have the same impact.

O&O has performed its own regression analysis on radio advertising over the last 20 years in order to track the relative impact of the economy, the introduction of national outlets, increased segmentation of the audience and changes in overall commercial share.

This analysis suggests that increased segmentation and the availability of national outlets in the 1990s did make a considerable one off contribution to growth. It also suggests that the impact of a 10 per cent increase in commercial listening hours is about an 8 per cent increase in revenue – other things being equal. (This in turn suggests price drops by 2 per cent in response to a 10 per cent increase in impacts, which in turn implies an elasticity of demand of -5).

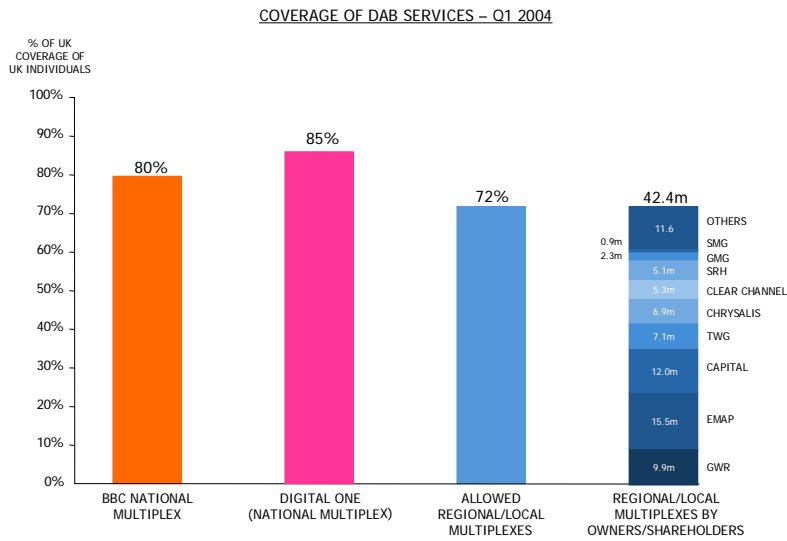
Of course, this covers the period from 1980 to 2002, when commercial radio expanded rapidly and broke through to become perceived as an important advertising media. Despite our efforts to capture this with a variety of structural variables, it may still be the case that elasticity has been over estimated.

A Recent Survey for the CRCA Suggests that Radio Advertising Has A Price Elasticity of -2.5

This is confirmed by a recent survey conducted on behalf of the Commercial Radio Companies Association (CRCA) which through a series of questionnaires to different types of advertiser about their likely response to increases of 5 to 10 per cent in the price of radio advertising, concluded that the volume of demand would drop by 12.5 per cent and 25 per cent respectively. This in turn suggests an elasticity of demand of -2.5 – i.e. a 10 per cent change in volume causes a 4 per cent change in price in the opposite direction, changing revenue by 6 per cent.

Within this study we have used an elasticity of -3.5, between that suggested by the regression analysis O&O has conducted, and the survey conducted for the CRCA by Independ. This would seem to be a fairly reasonable position to take given the evidence available.

Figure 5



5. The Current Commercial Terrestrial DAB Proposition

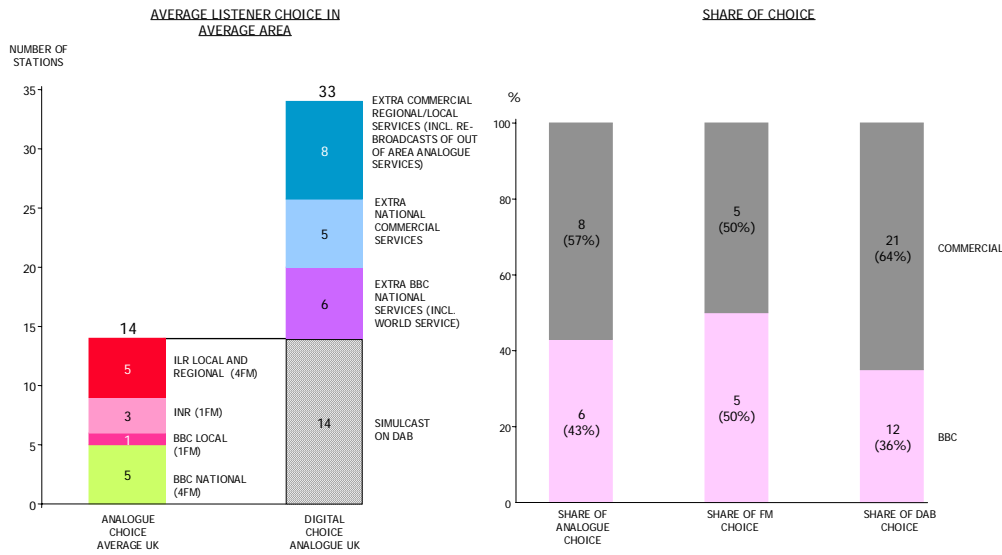
Commercial DAB now Offers 5 extra (non simulcast) national Multiplex Services to 80 per cent of the Population and an average of about 8 extra (non simulcast) Local Multiplex services to 70 per cent of the UK

The commercial DAB offering has expanded considerably over the last three years, with the national multiplex carrying 5 extra channels to the existing simulcast three national commercial services, now available to 85 per cent of the UK population, and a total of 224 non simulcast commercial services on local and regional multiplexes now covering 72 per cent of the UK population in total. Figure 5 summarises current coverage levels.

These local and regional multiplexes provide an average of 8 commercial services new to that area¹⁰ – an effective doubling of local choice – as shown in Figure 6.

¹⁰ While new commercial DAB services are often new to the area, many are rebroadcasts – with perhaps some local versioning – of services available in analogue in other parts of the UK.

Figure 6

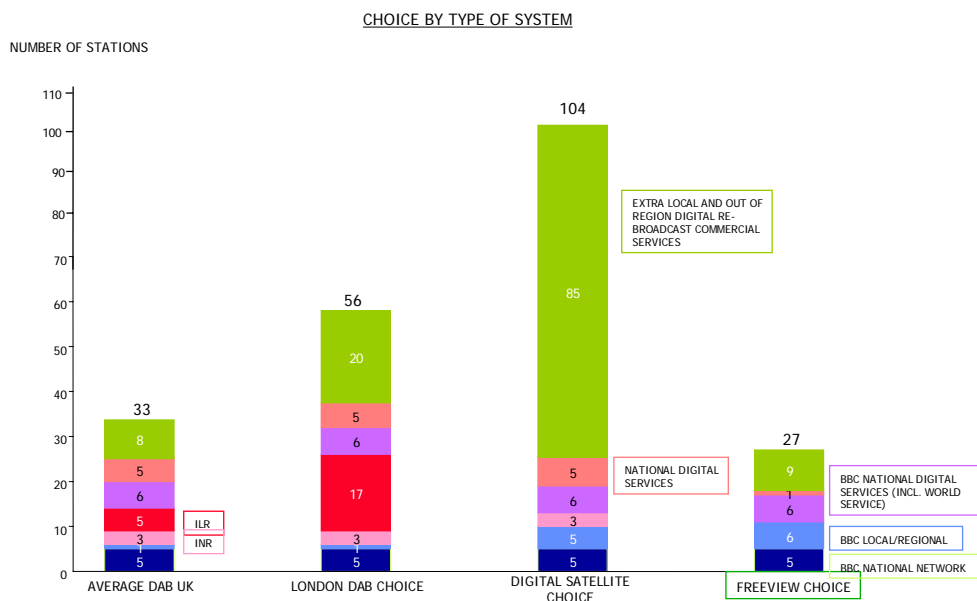


Commercial Radio Accounts for About Two Thirds of the DAB radio Choice Available to Listeners and an Even Greater Proportion on the Choice on Digital Television Systems and Through the Internet

With 13 extra commercial services to add to the 8 analogue commercial services available on average across the UK, this implies commercial radio is supplying about 21 out of an average 33 services available to the average DAB household, about 64 per cent – as shown in Figure 6.

With no effective capacity limits on digital satellite or cable, and unlimited access through the internet, commercial radio's share of services offered should increase dramatically with increased digital radio take up and usage. Figure 7 shows that choice on digital satellite is already much greater than average DAB choice across the country and even that in London, while Freeview is just short of average UK DAB choice. Freeview also offers a degree of regionality to transmissions.

Figure 7



The Commercial DAB Proposition is Still Primarily Music Format Led

Of the 229 non-simulcast digital service licences on commercial national, local and regional multiplexes, only about 30 involve significant amount of speech, and half of these are local access, hospital and student radio services. Of the 94 non-simulcast music service licences, 43 are modern rock formats, 30 dance/urban formats, 24 contemporary hits format and 19 adult contemporary.

Much of the Commercial DAB Proposition in Any One Region Consists of Repeated Analogue Services from Another Region

Almost half the non simulcast services on local and regional commercial multiplexes are rebroadcasts of analogue services that exist in another region. Of the remaining 95 local and regional services new to digital broadcasting in the UK, many are repeated across a number of multiplexes, yielding just 30 new digital only services on local and regional DAB multiplexes.

With the 5 new national DAB services, this yields a total of 35 new digital only services on UK commercial DAB radio of which 3 are modern rock, 4 contemporary hits radio, 3 easy listening, 3 adult contemporary music, 2 urban/soul stations and 2 country music stations. The remaining 17 stations consist of 3 Asian focused services, 6 access/student/hospital services and 4 news and talk based services.

Amongst the 35 new services it tends to be the music formats that obtain multiple local multiplex distribution – two formats having access to 17 individual multiplexes – while the speech, ethnic and access stations have distribution on only a handful of local multiplexes – with OneWord being the only national speech based new service.

Figure 8

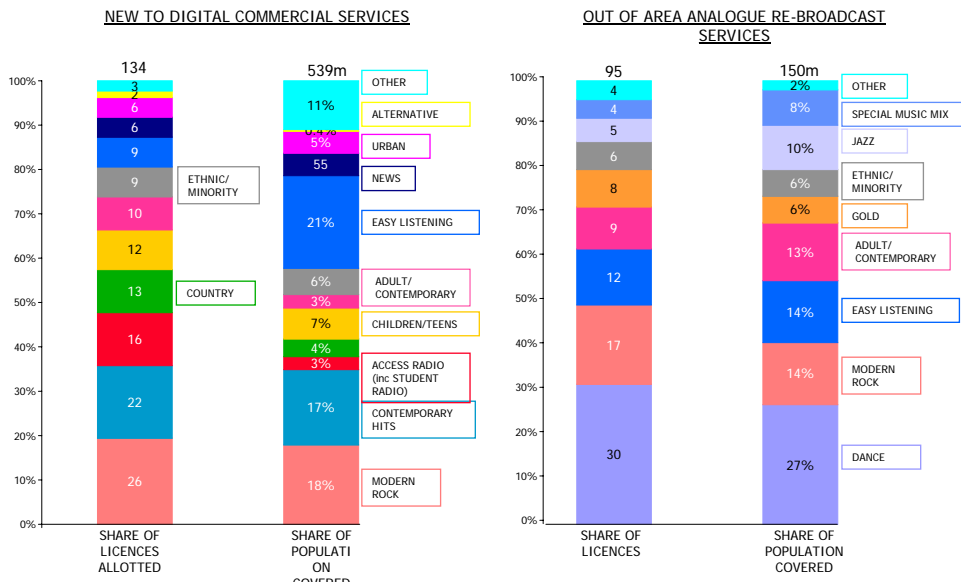


Figure 8 above summarises the licences issued by type of format, and then adjusts for the different levels of coverage of each licence to provide a comparative coverage for each type of format. New digital services concentrate on modern rock, contemporary hits and easy listening, while repeated out of area analogue rebroadcasts concentrate on dance, modern rock, easy listening, adult contemporary and jazz music formats.

Commercial Radio in the UK is Currently Spending About £30m a Year on Digital Radio – Over Half on Transmission

Four large UK radio groups report their digital radio revenues and expenditures separately while a fifth, EMAP, reports it together with its internet spending. These figures suggest that commercial radio spent about £30m on digital radio in 2002/2003, of which at least half was simply on DAB and satellite transmission, and internet streaming capacity. This left just £15m on all other areas of expenditure at most.

Figure 8

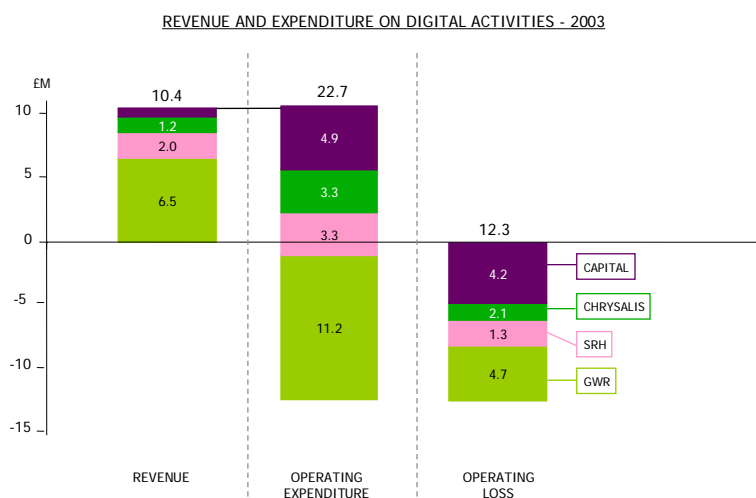


Figure 8 summarises the digital revenues and expenditures for the 4 main groups that report them. Almost all the income is actually from multiplex ownership – i.e. each service on a multiplex pays the owner for transmission and other technical services. This money is largely internal to the radio system – i.e. one large operator paying another large operator. GWR’s higher level of income reflects its greater level of ownership of multiplexes – including the national multiplex. In fact, the most significant external contributor to multiplex revenue is the BBC, which pays the local commercial multiplex owner for carriage of BBC local and national regional services.

O&O would estimate of the £10.4m in income of these four groups, about £8m to £9m is multiplex income, and only £2m of this is from outside inter trading between the groups. The £1m to £2m non multiplex income is probably all the advertising revenue the digital services run by these groups currently get. However, it is likely that incremental revenue from rebroadcast local analogue services is not included in these digital figures –so total digital advertising revenue might be higher than this £2 – perhaps about £4m.

Expenditure reflects both multiplex running costs, payments for transmission by broadcast services and spending on new programming. Of the £22.7m, only about £5m is probably on programming.

EMAP, which is not represented on this diagram, actually owns some of the most successful new and rebroadcast digital services in the UK. Adding them to the list might add another £1m to £2m to the advertising revenue of new digital services and £2m to £3m to incremental rebroadcast income.

Therefore, we would estimate that total advertising income to digital services – new and rebroadcast - is about £8m to £10m, compared to total industry expenditure of £30m.

The Average Programming Budget of a Uniquely Digital radio Service in DAB is probably only £200K a year – or less than £40 an Hour

On the assumption that at least £8m of the total £30m expenditure was spent on marketing and running costs across 35 new services and 229 non simulcast service licences, this leaves only £7m at most on programming to be shared across the 35 new services, or about £200K per service. That's less than £40 per hour – only enough to fund music play out and automated voice over speech.

Commercial Radio Stations Were Offered Licence Extensions to Their Analogue Services if they Started Local and Regional DAB Services

The heavy subsidy (or investment) into digital services by commercial radio across the UK is not surprising given that station operators were given the added incentive to roll out digital re-transmission of their services locally through an extension to their relevant local analogue licences. Only the national commercial multiplex offering – Digital One – started life as a genuine stand alone new business proposition.

Once the move into digital retransmission happened, the filling of the rest of the multiplex with new or out of area rebroadcast services was an obvious defensive strategy to maintain share of local commercial listening. The large number of out of area rebroadcast services also suggests that the costs of filling up capacity have been kept to a minimum.

Datacasting Is Also A Part of the Commercial Business Model for DAB

10 per cent of DAB capacity can be used for datacasting within the terms of current commercial licences. Most multiplex operators are looking at ways of combining with mobile phone operators to offer one way high data transmission capacity to the networks one to one communications infrastructure. This means that digital transmission investment is not driven solely by the prospects for the commercial radio services carried on the systems.

Commercial Radio in the UK Probably Accounts for about 80 per cent of all UK Digital Listening to non-Simulcast Service. Commercial Digital Services – New and Rebroadcast - probably Account for about 5 to 6 per cent of All Commercial Radio Listening.

Total listening hours of measured commercial digital services – new and rebroadcast-add up to about 25 million hours per week or about £1.25 billion a year, compared to just under 5 million a week for new BBC services. This means commercial services are getting at least 80 per cent of the listening to digital services, which equates to about 2.8 per cent of all listening time or 5 to 6 per cent of all commercial listening time (some of which comes from BBC share and some cannibalises commercial analogue share).

However, this is currently split between at least 20 main services with none getting much more than 0.3 per cent of all commercial listening.

Advertising Revenue for Digital Services is Negligible and Is Probably Confined to Where Digital Yields Incremental Distribution to Already Well Established Analogue Stations and A Couple of Leading National Services.

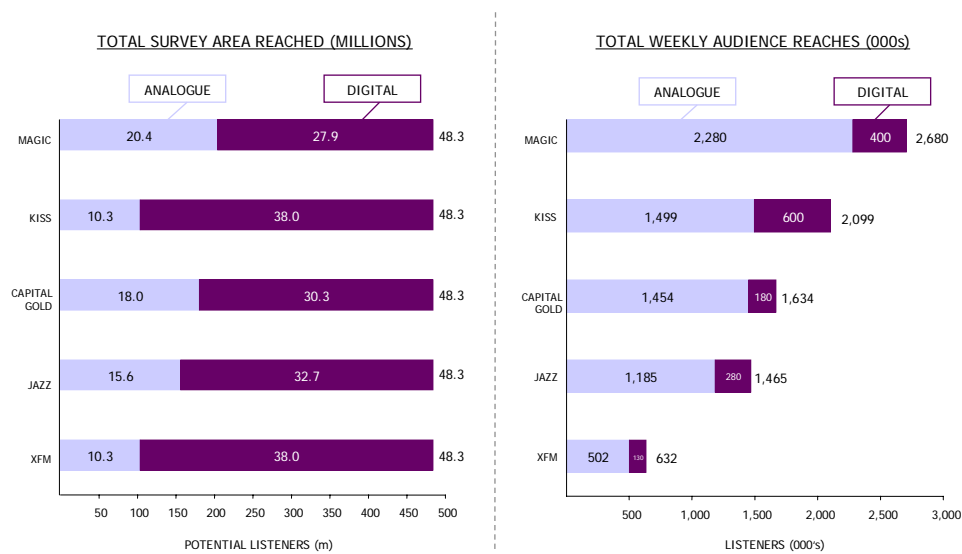
With such a fragmented digital market at the moment, only those new commercial digital services reaching 200,000 to 300,000 listeners per week, or those providing

significant incremental reach to existing local analogue formats are likely to be generating any incremental advertising revenue at the moment.

Although new and rebroadcast commercial digital radio accounts for 5 to 6 per cent of all commercial listening, it is unlikely to account for much more than 2 per cent of all radio advertising – or £10m a year, and no one service is likely to be generating more than £0.5m a year.

Figure 8a shows how incremental digital reach for established networks can be an important revenue enhancing addition.

Figure 8a



Sources: RAJAR, DRDB, O&O analysis

6. The Economics of Commercial Digital Radio

The preceding analysis suggests that there are certain essential requirements for a commercial digital service to have a chance of becoming successful in the medium term.

Commercial Digital Radio Needs Multiple Digital Platform Distribution To Be Economic

Successful commercial digital services will need access to all digital platforms in order to gain sufficient reach and revenue to sustain a reasonable quality of service and, therefore, reasonable audience share. No one platform by itself is likely to achieve breakeven.

Successful DAB Distribution is Necessary if Not Sufficient, for the Commercial Success of UK Digital Radio Services

DAB – although not the only platform – is likely to play a vital role in commercial digital station viability. It provides the main way of reaching the growing in car market, and is the only distribution system where market entry from overseas services and music “ juke box” type services can be restricted.

DAB therefore represents the only route for commercial digital radio to gain high reach, and the only platform within which established UK commercial radio stations and owners can prevent rapid share loss to low cost new entrants.

Terrestrial DAB distribution is therefore necessary, if not sufficient, for commercial digital radio to succeed.

Commercial DAB needs Multiple Multiplex Distribution to Be Economic

Within the DAB market, commercial services need some degree of multiple local and regional multiplex access in order to gain sufficient reach to generate enough revenue to become viable. Although this multiple multiplex reach may eventually take the form of a number of affiliated local stations sharing the same brand and programming spine, in the early stages of digital it is likely to consist of the same programming output overlaid with automated voiceover tracking – which indeed seems to have proven to be the case on many multiplexes.

7. Implications of the Market Analysis for the Potential Market Impact Analysis

The preceding analysis of the UK radio market over the last three years has some specific implications for the impact analysis below.

First, digital radio – and especially DAB reception – is still a developing platform, probably yet to enter its crucial high growth stage. Although almost 20 per cent of people do access such services every month, many do so only occasionally through their digital TV and using the internet. If BBC services are helping to drive digital penetration, then they are still needed for strong future adoption.

Second, new digital service listening share is still very small, even those homes that access digital regularly spend a great deal of time listening to simulcasts of their favourite analogue station. Listening to digital only services and the out of region re-broadcasts of local analogue services probably only currently account for 3.6 per cent of listening. Any impact of BBC digital services on the whole ecology of commercial radio is, therefore, likely to be small at this stage.

Third, with such limited listening, attributable advertising revenue to new digital services is likely to be very small, and commercial digital radio is still likely to be in its initial loss making stage. Commercial service entry and exit to the market at this stage is just as likely to be a sign of the industry being in its development phase, as being a sign of any harmful impact of the BBC's services.

Fourth, commercial digital radio – even when it is more fully developed - is unlikely to support many speech formats, and those it does are likely to be around news, phone-ins and sport. Only a non-commercial broadcaster such as the BBC can afford to commit to expensive drama, comedy and magazine programming.

Fifth, any loss of advertising share by commercial services as a result of BBC service success, is likely to be less than their proportionate loss in share given an elasticity of demand for advertising of between -2.5 and -5.

Sixth, while the commercial digital proposition is seeing an expansion in the number and range of services supplied to the average digital listener, with such limited funds, the proposition is still likely to be DJ led music, or voiceover track music, or even music without voiceovers – and concentrate on the 20 to 40 year old music tastes, where the bulk of advertising money is spent.

Seventh, with commercial radio having two thirds of the DAB choice growth in digital is likely to increase its share versus the BBC and therefore confer a general benefit.

C. THE BBC'S DIGITAL SERVICE OBJECTIVES AND PERFORMANCE SINCE LAUNCH

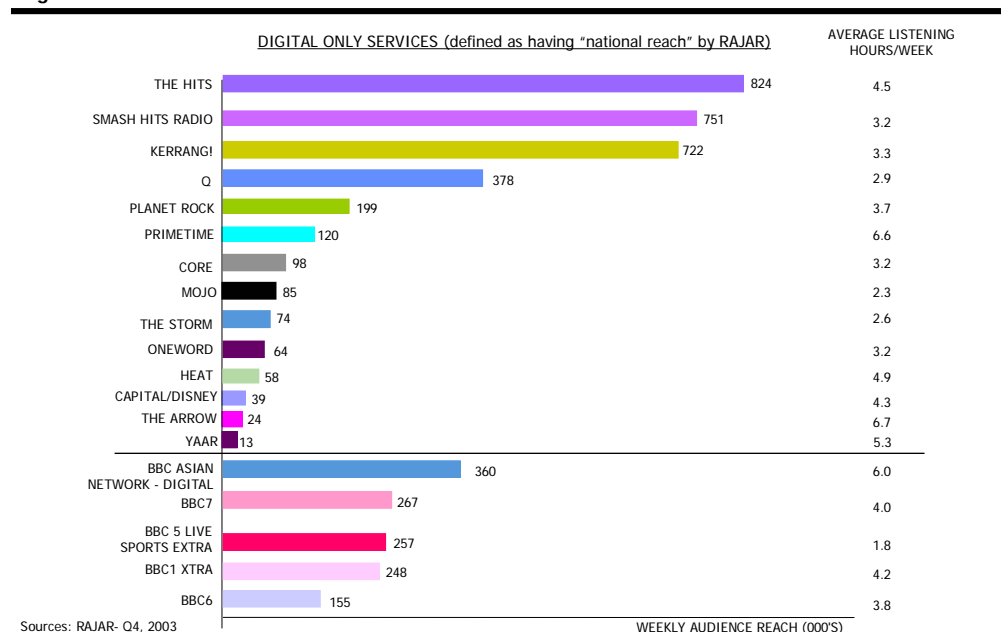
The BBC's main objectives in developing its portfolio of digital services are:

- to provide services to audience groups currently underserved by the BBC's portfolio of analogue services;
- to add to the overall choice likely to be offered by commercial digital radio especially in the provision of speech radio programming
- to help drive take up of digital radio – and in particular – terrestrial DAB (mostly as a consequence of the above two objectives).

Each of the five separate services aimed to fulfil each of these three objectives to a greater or lesser extent.

Overall the five services now generate about 276 million listening hours per year and gain about 0.6 per cent of all radio listening, and about 16 per cent of all measured new digital radio service listening¹¹ (or 25 per cent if out of area digital rebroadcasts of commercial analogue services are excluded from the total).¹² Figure 8b shows the weekly reach and average listening time per listener reached of each BBC service and leading commercial services for the last quarter of 2003.

Figure 8b



¹¹ Based on Quarter 4, 2003 RAJAR data.

¹² With the retransmission of the BBC World service on DAB etc, the BBC probably accounts for about 18 per cent of all new digital station listening.

1. BBC 6 Music

BBC 6 Music was launched in March 2002 and has an annual budget in 2003/04 of £4.2m¹³. BBC 6 Music was designed both as a service that would get to the 25 to 40 year old music loving audience currently under reached by the BBC's analogue services, but also to broaden the likely range of music and perspectives that might be offered by the commercial sector to this market, and to provide a significant element of relatively costly speech output, and cover live music events and lesser known UK artists. These factors in turn would then help drive digital radio penetration within the 25 to 40 age group.

BBC 6 Music now achieves a weekly reach of 155,000 listeners spending on average 3.8 hours a week listening to the service, providing a total of 30 million listening hours annually, equivalent to about 0.06 per cent of all radio listening, and about 2.1 per cent of all new digital service listening.¹⁴

Its peak audience share is in the 25 to 34 year age group, with a strong share of the 35 to 44 age group as well. Its audience is quite heavily skewed ABC1 and is 60 per cent male.¹⁵ 8 per cent of all UK radio listeners were aware of BBC 6 Music in 2003.¹⁶

2. BBC 1Xtra

BBC 1 Xtra was launched in August 2002, and has an annual budget of £6.1m. BBC 1Xtra was designed as a service that would serve more fully - than the BBC could do within the broader remit Radio 1 - the urban music loving population into R&B, hip hop, dance and rap music - and in particular, but not limited to, the Afro-Caribbean population of the UK. It was also aimed at addressing the social issues and interests of the young Afro-Caribbean population in the UK with targeted and appropriate speech and discussion programming. Again these factors, it was felt, would help encourage digital take up amongst this important group especially outside the major urban conurbations - where commercial R&B and hip hop stations tend to be based.

BBC 1Xtra now has a weekly reach of 248,000 listeners each listening for 4.2 hours a week on average, a total of 54 million listening hours a year. This represents about 0.1 per cent of all radio listening and 3.8 per cent of new digital radio service listening.

Its audience skews heavily to the 16 to 25 age group with a relatively strong share among under 15s, and a slight ABC1 bias. Limited evidence available suggests, however, that only about one quarter of the audience is black - well above national average of about 7 per cent, but perhaps comparatively low for a station targeting that group.

7.3 per cent of all UK listeners were aware of BBC 1 Xtra in 2003.

3. BBC Asian Network

¹³ All budget numbers used in this section are projections for the 2003/2004 financial year.

¹⁴ In this case new digital service listening includes digital services only, and national or multiregional digital rebroadcasts of existing local and regional analogue services.

¹⁵ All demographic profile figures in this section are from Quarter 3, 2003 RAJAR data.

¹⁶ The Pan BBC Tracker Survey, October 2003

The BBC Asian Network was launched in October 2002 and has a £4.3 million programming budget in 2003/2004. This represents a £3m increase on the budget of the pre-existing analogue medium wave service in the Midlands.

The BBC Asian Network was similarly aimed at serving more fully, a group underserved by the BBC – outside of the Midlands where an analogue local Asian service has been provided by the BBC since the early 1990s. Again the focus is on providing a mix of music and speech output and aiming to extend the commercial offering to this market beyond a few core regions, and to reach parts of the Asian ethnic population currently not reached by targeted commercial services – most notably the young and Asian market.

The service now has a weekly digital reach of 300,000 listeners with an average 5 hours of listening per person reached – representing 78 million listening hours a year, accounting for 0.14 per cent of all listening and 5.5 per cent of new digital service listening in the UK.

Over 80 per cent of the audience is Asian with a heavy skew to the under 35s, women and ABC1s.

19.3 per cent of UK listeners were aware of the BBC Asian Network in 2003.

4. BBC 7

BBC 7 was, in contrast, aimed more at enhancing the service proposition to the BBC's loyal radio comedy and drama audience – who tend to be over 40 ABC1s, helping to encourage them to switch to digital. However, BBC7 has also targeted a group currently underserved both by the BBC's analogue services and the commercial market – children – with the kind of speech based radio the commercial sector would find it uneconomic to provide.

The service was launched in December 2002, and has a budget of £4.5m, and now reaches 267,000 listeners each week, listening for an average of 4 hours a week – a total of 55 million listening hours. This represents 0.1 per cent of all radio listening and 3.9 per cent of all new digital service listening.

It has a heavy skew towards over 40 year old ABC1s amongst adults, but the under 15s also account for 32 per cent of its total audience. 6.2 per cent of all UK listeners were aware of BBC 7 in 2003.

5. BBC Five Live Sports Extra

BBC Five Live Sports Extra was similarly aimed at enhancing the service already provided to sports enthusiasts by Radio Five Live, especially on days where different sporting events take place simultaneously across the UK. The service was focused on providing extra and complementary coverage of events already covered by the BBC on Radio 5 Live, and was expressly prohibited from bidding separately for new events.

The service launched in February 2002 and now reaches 257,000 listeners each week, listening for an average of just 1.8 hours per week¹⁷. This represents a total of 24 million listening hours which accounts for 0.04 per cent of all radio listening and 1.7 per cent of all new digital service listening.

¹⁷ Five Live Sports Extra is an intermittent service only broadcasting when extra event coverage is available and no time is available on Five Live itself – it is not therefore surprising that average weekly listening hours are relatively low.

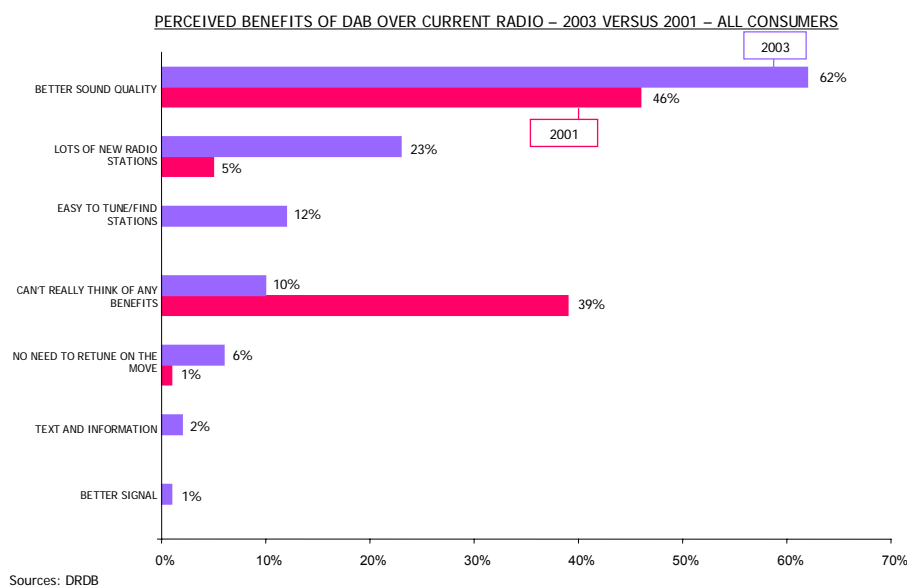
The service tends to skew towards the 45 to 54 age group, and almost 80 per cent of the audience is male. 26.7 per cent of UK listeners were aware of BBC Five Live Sports Extra in 2003.

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

1. Digital Take Up

Consumers have consistently cited both improved sound quality and the availability of a large number of new radio stations as by far the strongest two reasons for thinking about getting digital radio. Over the last two years the second of these two main reasons has tended to strengthen as consumers gained greater understanding of the services available and such services were increasingly cross promoted by the BBC and others. This is shown in Figure 9 below.

Figure 9

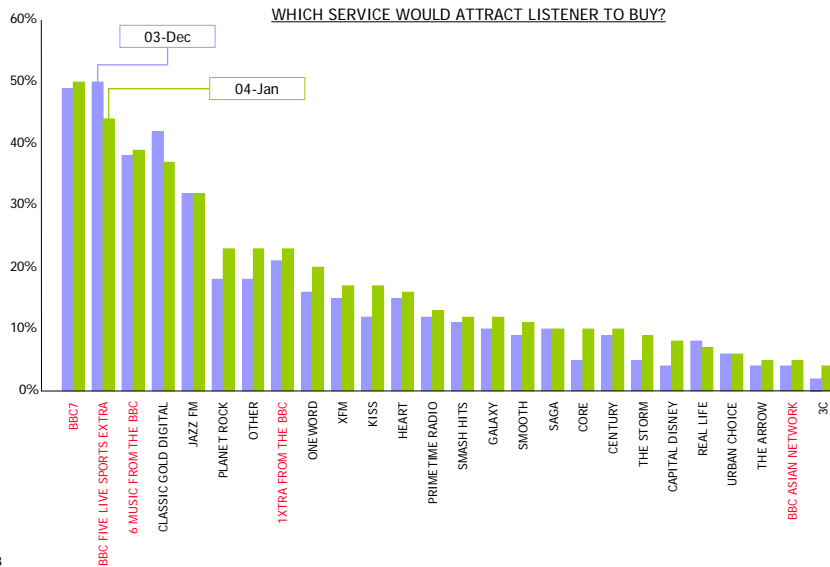


In fact, other research in 2003 showed that among those who have recently purchased DAB receivers, the majority were now buying to receive more radio services. BBC services featured among those cited as a reason for buying DAB with BBC 7, Five Live Sports Extra and BBC 6 Music featuring particularly strongly.¹⁸

Surveys of people likely to buy in the near future showed an even greater tendency to rate BBC services highly as shown in Figure 10 below.

¹⁸ Surveys back in 2000 suggested that a new adult contemporary music service was the type of new service most desired from digital.

Figure 10



Source: DRDB

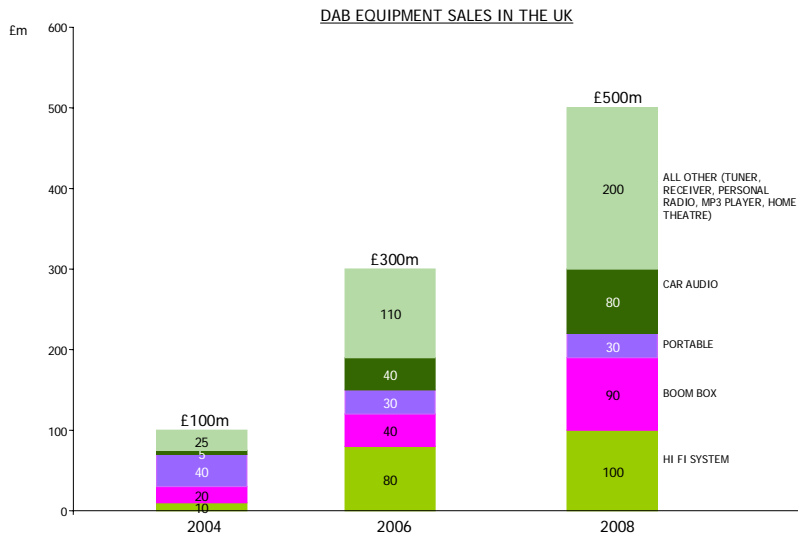
BBC cross promotion of its services also seems to have had a more general effect on take up of digital radio, with the TV promotion being the main means by which people found out about DAB radio (the BBC is the only organisation promoting digital radio on TV).

The BBC's promotion of the Freeview TV platform since late 2002, which carries the main national BBC and commercial digital services, and its promotion of the availability of digital radio services on satellite and cable have also probably contributed to the overall reach of digital radio in the UK.

BBC co-operation with commercial DAB providers and their joint co-ordination with DAB set manufactures probably made a significant contribution to the launch and growth of the platform. DAB receiving equipment is set to generate £100m or so in revenue in 2004, rising to £500m by 2006. Digital portable sets are already outselling analogue portable radio sets in the main high street retailers.

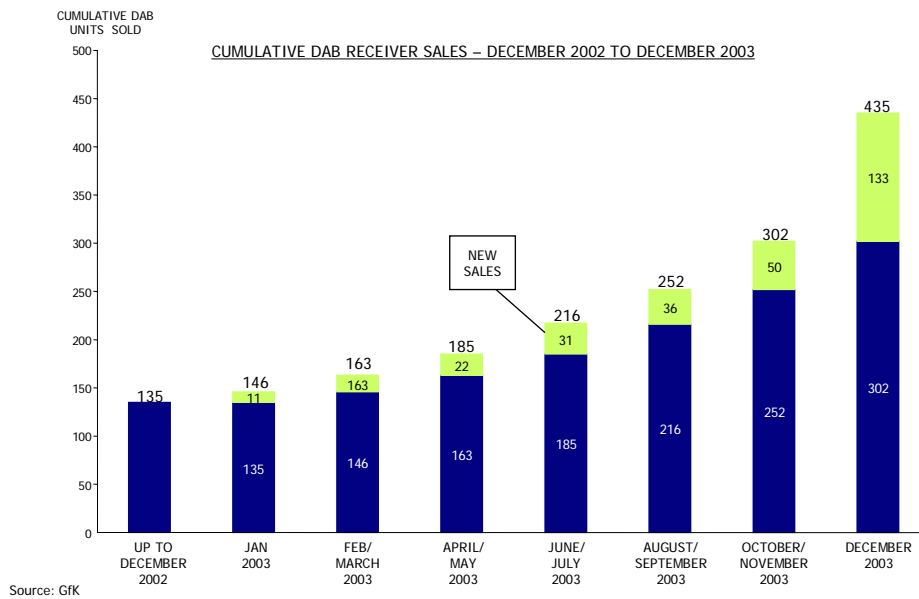
Perhaps most importantly, UK set manufacturers and chip and software designers feature strongly in the DAB market where the UK is a world leader.

Figure 11



These figures reflect the fact that the high growth phase has yet to come to DAB, with initial digital listening growth coming through the internet and digital TV. But recent DAB sales figures for the Christmas 2003 period suggest that DAB set sales are about to take off – helped in part by the availability of the services on these other platforms – which in turn promote the services to the listener. Figure 12 shows the recent sales history.

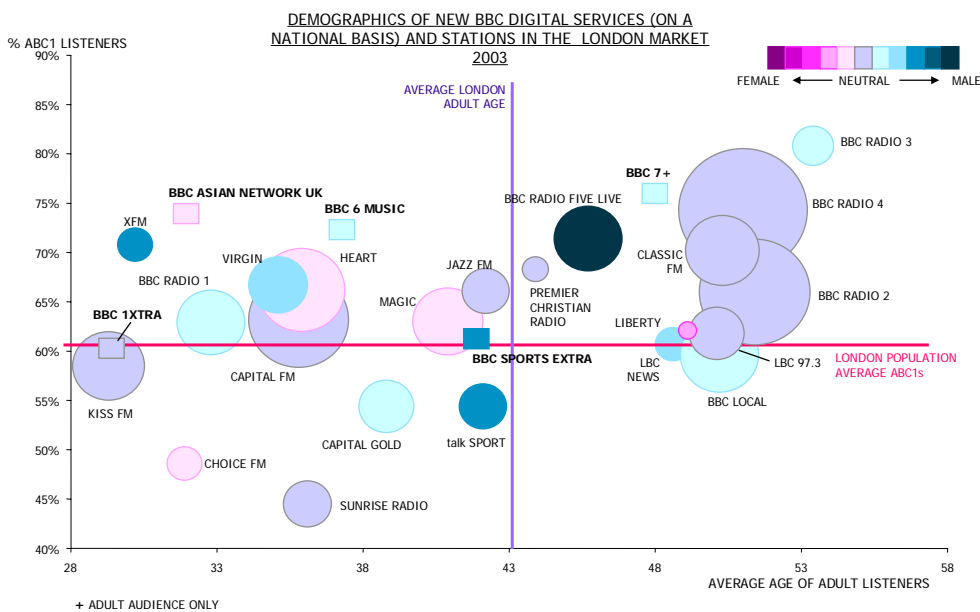
Figure 12



2. Distinctiveness

Taken as a whole the BBC's services commitment to speech broadcasting, to new programming, live music and to a broad play list within its DJ led music programming do amount to a distinctive proposition in today's digital radio market. For the most part the new services also take a distinctive demographic positioning to existing commercial and BBC services. Figure 13 maps the demographics of the new BBC services against services in London, the UK's most developed analogue market and, and therefore, a fairly good predictor of the digital radio market across the UK in the future.

Figure 13



a. BBC 6 Music

BBC 6's demographic and overall genre format positioning is within the adult contemporary category of radio stations with music from the 70s, 80s and 90s mixed with some contemporary mostly rock and indie music tracks, and is targeted at the 25 to 40 year age group.

This particular demographic and music type is already seemingly well covered by the analogue commercial radio sector in the UK, with Virgin AM operating nationally and with most reasonably sized radio markets having a regional or local adult contemporary service on offer.

Digital commercial radio not only offers the rebroadcast of *Virgin* on the national multiplex, but also the *Planet Rock* service available on national DAB, the rebroadcasting of *Xfm* across most of the UK through local and regional multiplex distribution, and *the Arrow*, *the Storm* and *Passion for the Planet* all potentially available to over 15 million homes through local and regional multiplex access. In addition, *Planet Rock*, *the Arrow*, *Xfm* and *the Storm* are all available to the UK's 6.8 million digital satellite homes, with *Planet Rock* available to both digital cable and Freeview TV households as well.

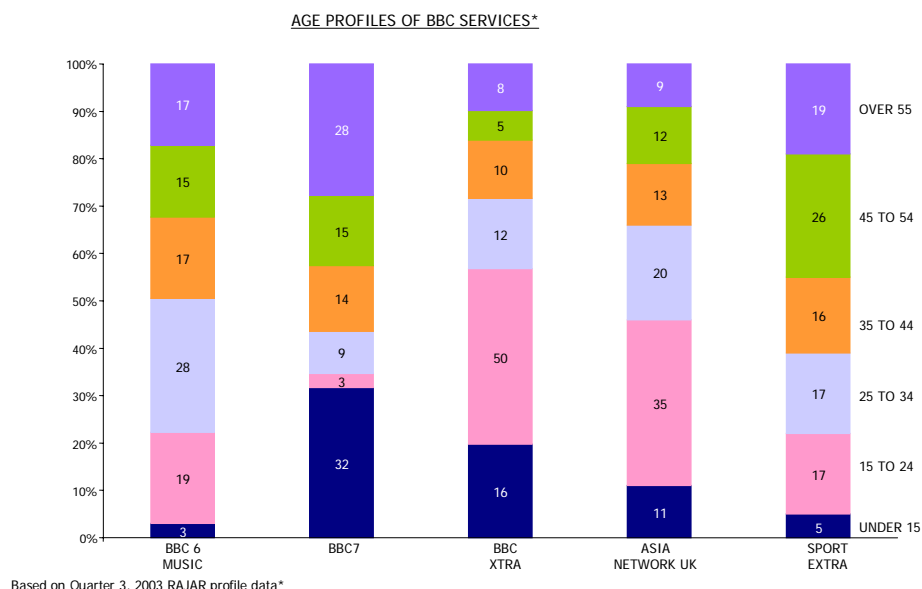
However, a closer review of BBC 6 Music’s music policy and schedule mix does suggest a very different approach to commercial analogue services and a different approach and a richer schedule mix than digital services offering similar broad types of music and targeting a similar demographic. Indeed, some evidence also suggests that BBC 6 Music’s achieved demographic may be a bit older and more ABC1 than most of the current commercial offerings in the radio market.

BBC 6’s play list seems to be far wider and less hit driven than commercial rivals in a similar market positioning. Research commissioned by the BBC from Market Research UK limited suggests that BBC 6 Music airs 1,500 different tracks and 900 different artists per week, this is twice the level of *Xfm* and three times the level of *Virgin*. Those tracks chosen tend to be album tracks rather than hit singles, with about one third never making even the top 75 hit list.

BBC 6 also seems to show a disproportionate commitment to UK artists and new live performances, with 54 per cent of all tracks played from UK artists and 58 per cent of its 280 new live sessions a year being with UK artists – many of whom are unsigned by record labels at the time of their sessions.

The commitment of the network to music documentaries, social action campaigns and regular music industry news bulletins make it a very different station to all commercial analogue and digital rivals. Indeed, only *Xfm* amongst its commercial rivals has a commitment to live and new music even approaching that of BBC 6 Music, and this service targets a younger age group and still seems to fall well short of the levels provided by BBC 6 Music.

FIGURE 14



b. BBC 1Xtra

BBC 1 Xtra focuses on urban hip hop, R&B, Drum and Base, Garage and rap music aimed at the under 25 audience with a particular focus on the interests and issues affecting the UK's young Afro Caribbean population. With urban music being amongst the most dynamic and high growth areas in the UK's youth culture today, it's a service which is also likely to appeal to many young non Afro Caribbean listeners.

The UK already has a number of local and regional commercial analogue ILR stations focusing to a greater or lesser extent on urban music such as *Kiss FM* and *Choice FM* in London, *Galaxy FM* in the North of England and the Midlands, and the *Vibe* in the West of England and Scotland. The new digital services include the *Urban Choice* service technically available through 4 multiplexes to 14 million UK listeners.

The overall demographic positioning of the service – under 25, urban and slightly ABC1 – is also similar to services such as *Kiss FM*.

However, most of the commercial services mix a narrow range of urban music styles with more mainstream soul and dance music, and none have a commitment to live music, UK artists, and speech and features programming aimed at the young Afro-Caribbean population. In addition, many parts of the UK have no official terrestrial urban music service on either analogue or digital – with pirate radio often filling the gap left by the official commercial sector.

1Xtra carried about 12 hours of news, documentary and social action programming original to the network per week in 2002/2003 and since August 2003 has expanded its flagship current affair show *TX Unlimited* from one hour every weekday early evening to 2 hours. 53 per cent of 1Xtra's play list made up of UK artists, and it broadcasts 250 hours of live music events per year from 68 locations around the UK and from major international festivals.

c. BBC Asian Network UK

The BBC's Asian network achieves high relative levels of reach to the younger, ABC1 Asian population in the UK. It provides a mix of news, speech, music and sports programming for the UK's Asians. It broadcasts in English during the day, and in five different Asian languages in the evening.

While a number of local radio markets have an analogue commercial Asian service in the UK, most have more Asian language programming, and are based mainly on music and phone-ins. Commercial DAB also provides a couple of new Asian services, but these are only available on a few local multiplexes.

The most distinctive features of the Asian network when compared to commercial services is its high volume of news and current affairs output, the fact that 58 per cent of its output is speech and its focus in the young Asian population. The music output that is on the channel contains a strong commitment to new and live Asian music output.

d. BBC 7

BBC 7's focus on drama and comedy programming originally broadcast on Radio 4 or from the BBC's programme archive naturally means its focus is generally quite close to the traditional Radio 4 demographic of over 40s, ABC1s. However, its key children's strands of *Big Toe* and *Little Toe* do attract an under 15 audience, a

listening group traditionally underserved by all of UK radio, particularly in speech programming.

Only the digital service OneWord in the commercial sector provides narrative speech programming – drama and comedy – for adults and children as part of the national commercial digital multiplex. While a number of commercial pop music focused stations do attract children from 10 to 15, and Capital and Disney do run a children’s service on some local digital multiplexes which is also available over the internet and digital TV platforms, none of these more music based services offers a regular output of speech based entertainment and factual programming for children.

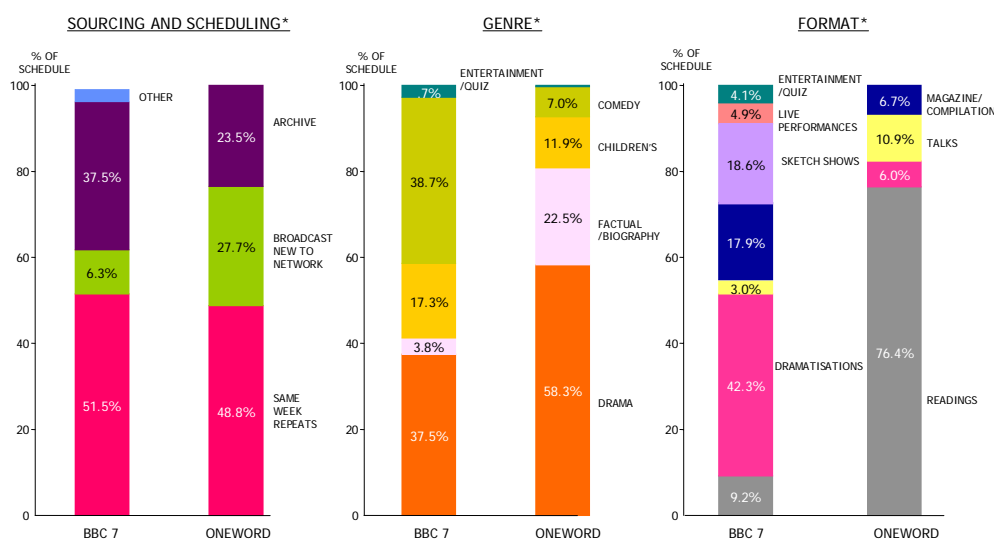
A review of recent output by O&O (see Figure 15 below) suggests that BBC 7’s broad output sourcing strategy is not dissimilar to OneWord – the commercial national speech service - with a mix of same week repeats, archive and original broadcasts.

BBC 7 programmes are repeated at least once and many twice within twenty four hours , with about one eighth within any one week being original to BBC7 . About 75% of programming in any week is taken from BBC Radio 4 archives , the rest from other BBC networks and the World Service.

Both services also offer a varied mix of programme genres, but with BBC 7 more focused on Children’s and comedy, and OneWord more focused on drama and biography. BBC 7 Children’s output accounts for the vast majority of programming especially commissioned for the network.

However, three quarters of OneWord’s output is made up of readings – unabridged spoken word recordings often already published – of novels and autobiographies. Over 40 per cent of BBC 7’s output in contrast is full dramatisations of plays and adapted novels, with a further 28 per cent being sketch shows, live performances and game shows. Of the remaining 30 per cent just 10 percent is readings, with the other 20 per cent being talk and magazine shows.

Figure 15



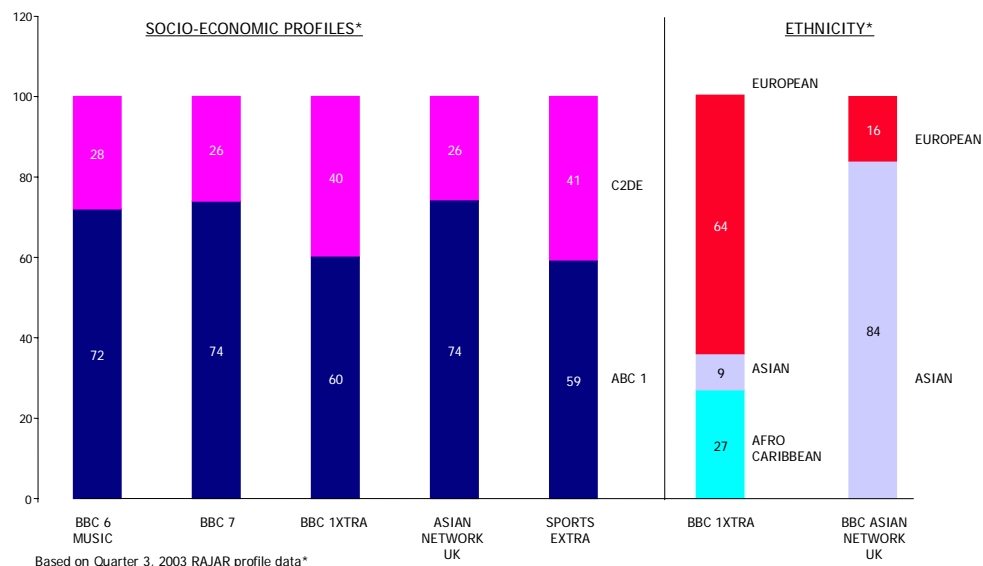
* Based on one week samples – January 2004

e. BBC Five Live Sports Extra

The main aim of this service is to offer choice of sporting event and a choice of commentary. It helps the BBC deal with “bottlenecks” in the sporting calendar when certain events clash or when multiple games within a tournament are being played simultaneously. It therefore allows the BBC to cater for a wider variety of sporting tastes and interests, and gives sports more exposure.

The main distinctive features of its programming formats are the uninterrupted commentary, and the access to airwaves of new commentating talent. The service has no sports news or programming other than commentaries.

Figure 16



3. Competitor Viability

a. Broad Impact on Commercial Radio Economics

i. The Assessment Framework

There is a significant amount of evidence that the development of a portfolio of digital BBC services and the cross promotion of their availability on BBC traditional TV and radio has made a significant contribution to the take up of DAB and digital radio in general – as described in the previous section.

This in turn has a generally positive impact on the economics of commercial radio in the UK, given that commercial radio has a far higher share of the digital services on offer in the UK to their share of analogue services (they provide about 65 per cent of digital services to the average UK listener versus 50 per cent of analogue FM services).

Digital also offers commercial radio the opportunity to establish quasi-national network brands – something they are already starting to do - which evidence suggests will further enhance their revenue prospects.

The specific boost to the take up of DAB terrestrial distribution provided by the BBC – as opposed to internet and digital satellite and cable TV distribution – will also help protect and enhance the economics of UK commercial radio services from excessive market entry from low cost – mostly imported – rivals.

By reducing significant audience erosion from the likes of music “juke box” style services and imported radio services from the USA – both of which are available on the internet and could become available on digital satellite and cable TV given their transmission capacity – the BBC’s significant support for DAB terrestrial transmission is helping to bolster the prospects of commercial digital radio services in the UK.

The exact impact of each individual BBC service on commercial digital radio prospects in general in the UK is more difficult to pinpoint. However, those BBC services that bring in a distinct demographic to digital radio from the commercial offering – such as BBC 7, or perhaps significantly enhance the service to a group that otherwise might be slow to get digital radio – such as 1Xtra – probably make the greatest comparative contribution.

ii. An Estimated Impact

To estimate the impact several stages of analysis are needed. First, an estimate of the increased share for commercial radio in total brought about by the conversion to digital access. Second, how that share gain translates into a revenue gain – using the price elasticity analysis covered already – but taking into account the more limited ability to generate revenue from low reach digital services at the moment.

Third, an assessment of how much of the increased digital penetration, and therefore, of the increased commercial share, could be attributed to the BBC’s involvement in digital radio.

Fourth, an analysis of any additional benefits to commercial radio over and above the pure share impact – such as the emergence of national brands etc. Fifth, a review of the likely comparative contribution to the calculated impact of each BBC service.

On the first of these areas, the RAJAR evidence suggests that in home with digital access, the commercial sector obtains about 80 per cent of the audience to new services, and that 20 per cent of listening is to all new services. This makes a contribution of 16 percentage points to each digital listeners share (i.e. 80 per cent multiplied by 20 per cent).

If we assume that within the 80 per cent of listening to analogue radio (in analogue or simulcast) the share between commercial radio and the BBC breaks down 47 per cent to 53 per cent, as it has done recently, then commercial stations get a 38 percentage contribution to share from analogue station listening by a digital listener.

This implies that with a digital listener, commercial share moves from 47 per cent to 54 per cent (16 percentage points plus 38 percentage points), an increase of 7 percentage points.

With about 9 to 10 million digital access listeners in the UK, this 7 per cent extra, equates to about a 2.9 per cent increase in total commercial impacts. With a price

elasticity of -3.5 this converts to a 2.1 per cent revenue increase, which would be about £11m extra. With this share gain being for digital services rather than analogue services – where only the leading services and the rebroadcast services probably get incremental revenue, this £11m might fall to £9m.

Finding a way to attribute a portion of this £9m to the BBC's overall involvement in digital directly is more difficult. But with so many BBC services being key purchase drivers for digital take up, and with the BBC's cross promotion being important for awareness, the BBC's contribution is going to be much greater than its 18 per cent of digital service listening. 50 per cent might be a reasonable contribution factor at this stage in the development of digital radio. This would yield a £4.5m benefit.

The impact of the BBC's promotion of DAB and Freeview platforms in particular, which helps protect commercial radio from further market entry by low cost music "juke box" type services might enhance this value – but this is so difficult to quantify and is likely to be a very long term effect. This leaves £4.5m as the estimated benefit.

In terms of dividing this impact between specific BBC services, the evidence suggests that BBC 6 Music, BBC7 and Five Live Sports Extra had the most impact on take up, while the kinds of audience brought to digital by 1Xtra and the BBC Asian Network probably offer commercial radio the best prospects of future share gains against BBC services in the future. (Commercial radio is still likely to find it difficult to make significant inroads to the BBC 7 type audience demographic – especially its adult audience, while it already obtains the vast majority of listening by the BBC 6 Music type demographic – in both cases the likely future gains to commercial radio are probably lower than with other services).

This implies the largest impact for 5 Live Sports extra (£2m), a significant impact of BBC 6 Music (£0.75m), 1Xtra (£1m) and BBC Asian Network UK (£0.75m), and a more modest impact of BBC 7 (£0.5m).

b. Cash Flow Impact

The stages of analysis used to estimate the direct competitive impact of individual BBC services are similar to those adopted in the broad impact analysis above. First, it is necessary to estimate the likely audience taken by the relevant BBC service from other BBC services versus commercial services. Second, the impact of this share loss on revenue loss needs to be calculated. Third, account needs to be taken of the current low level of saleability of digital airtime for some services. Fourth, and related to the third point, an assessment needs to be made of the likely substitution of share from commercial analogue versus digital services. Lastly, some assessment of any cost inflation from competition for key talent and rights needs to be assessed.

i. BBC 6 Music

BBC 6 Music obtained an average weekly audience reach of 155,000 listeners in the fourth quarter of 2003, with each of those listeners spending an average of 3.8 hours listening to the network.

While the cross promotion of the service by the BBC on TV and radio might be thought to imply a considerable number of its listeners are taken from existing BBC services, its demographic positioning suggests that a disproportionate number of listeners – when compared with other new BBC services – probably come from commercial analogue and digital services.

About 75 per cent of the 30 million listening hours generated by BBC 6 Music radio could come from commercial services – or about 23 million listening hours. At an average current industry advertising price per thousand per 30 second slot of around £1.30 across the UK, this would equate to about £530,000 in advertising revenue in 2003/04. However, digital radio is generally not selling at anywhere near average cost per thousands for radio, so if the audience was taken from digital services, it would be unlikely to represent much more than 50 per cent or £260,000 of lost advertising revenue.

If, on the other hand, the airtime was selling at full analogue type prices, then an elasticity of demand for radio advertising of -3.5 might suggest that any share taken by the BBC service would also cause a rise in the market price for the relevant airtime market. If the relevant market was all radio advertising then the resultant market price increase would reduce the total loss in revenue from £530,000 to about £340,000.

Therefore the annual revenue loss could be somewhere between £260,000 and £340,000 depending on how much of the share was taken from analogue versus digital services and how far these digital services were able to sell their airtime at analogue prices.

On the assumption that most the share is lost to existing analogue services, then the overall revenue loss might be as much as £320,000, with the greatest relative impact on *Virgin* and *Xfm* who might lose £100K a piece. Total loss to all digital services would be unlikely to exceed £120K in total. The main digital services to suffer would be the Storm, Planet Rock and Passion for the Planet.

There is unlikely to be a significant impact on costs, with BBC 6 Music not competing directly for top DJ talent and with much of its live session and concert recordings being to artists and events of little interest to commercial rivals.

ii. BBC 1Xtra

BBC 1Xtra is obtaining an average weekly audience of 248,000 each listening to 4.2 hours a week. This equates to 54 million listening hours a year in total.

While BBC 1Xtra is probably taking audience from commercial services, it is probably also taking audience from Radio 1, and is also likely to be generating new listening to legitimate radio services (as opposed to the pirate R&B and Hip Hop stations that operate across the UK) or more listening per head among the Afro-Caribbean population.

Therefore, it might be reasonable to assume that about 70 per cent of its listening comes from other commercial stations – or about 38 million listening hours per year. At a market price of commercial airtime of about £1.30 per thirty second slot per thousand impacts that would equate to about £880,000 of lost advertising revenue. But with an elasticity of demand of -3.5 , the loss of revenue is likely to be about £560,000 after price adjustments. Again some of the loss may be from digital stations who would be selling at much lower prices than analogue commercial stations. This would put the loss at between £440,000 and £560,000.

Again with a number of analogue stations likely to lose out, an estimate of £500,000 is probably reasonable, with the largest losses likely to be from stations such as Kiss, Galaxy and Choice FM. Digital stations effected are likely to be Urban Choice and Mojo.

Cost inflation for commercial networks is very unlikely. Indeed, in so far as 1Xtra is bringing in and training new talent to the industry, it might start to lower the effective costs for commercial services in the same segment.

iii. BBC Asian Network

The BBC Asian Network UK obtains an estimated digital weekly audience (as opposed to its local analogue audience in the Midlands) of 360,000 (Based in quarter 4, 2003 RAJAR data). Some of this listening is likely to be extra listening to radio by Asian listeners. While it might be expected that the ABC1 orientation of the audience could mean much of any share substitution will come from the BBC, the relatively youthful nature of the audience might suggest more comes from commercial radio services.

Given this evidence it might be safest to assume that about 40 per cent of the audience comes from commercial radio or 45 million listening hours a year. At the average cost per thousand in the UK, this would be worth £1 million, but with an elasticity of -3.5, this converts to a revenue loss of £670,000. Given that some of the loss would be to digital channels, this might come down to about £500,000.

Again there are unlikely to be significant increases in costs, while new talent is likely to be brought into the radio industry and trained.

The impact on analogue services is likely to be spread across a number of services, with a particular impact on local commercial Asian services such as Sunrise. Although Sunrise's demographics suggest this might not be that harmful.

Digital services such as Yaar Radio, which are targeting the Asian community are likely to be the most affected.

iv. BBC7

BBC 7 obtained an audience of 267,000 at the end of 2003. A large proportion of this audience is likely to be new listening – especially children's listening, or from heavy Radio 4 and Radio 2 listeners. Therefore, only about 30 per cent of this audience is likely to come from the commercial sector, or 17 million listening hours a year.

At market prices this equates to £390,000 a year in lost advertising, but with the general price adjustment, this might fall to £250,000. With digital commercial services – and fairly low reach ones at that – being among the stations likely to suffer a share loss, the total might actually fall to £150,000 despite the quality of the adult audience being quite good.

Analogue commercial stations that might suffer include Classic FM (due to its demographic) and Century Radio – given its demographic and speech mix. Digital stations that would suffer include OneWord which has a similar mix of speech based drama and comedy – albeit almost exclusively unabridged spoken word recordings – and Capital/Disney and Abracadabra – both focused on children.

The impact on costs is slightly less clear cut. If BBC 7's use of archive BBC material is leading to its unavailability to OneWord, then this could be said to increase OneWord's costs.¹⁹

¹⁹ Lack of archive supply might be more to do with protection of the general BBC brand, and in particular Radio 4's brand, in which case any cost increase can not be directly attributable to BBC7's existence, even though it may be a fact.

v. BBC Five Live Sports Extra

Sports Extra reached 257,000 listeners at the end of 2003, and generated 24 million listening hours on an annualised basis. The sports audience in the UK is closer to the core commercial market than most BBC services, so despite the obvious cross promotion to regular Radio 5 listeners, about half this audience and 12 million listening hours a year could be coming from commercial radio.

At market prices, this is worth £280,000 a year, which once elasticity of -3.5 is taken into account yields an income loss of £180,000. But with analogue services such as Century Radio, Capital Gold and Talksport likely to be the main losers, the actual loss is likely to be £150,000 or more.

Digital service that could suffer might be Easy and the Lounge , with similar demographics.

With Radio 5 Live Extra only permitted to cover extra output from sports rights covered mainly on Radio 5 Live itself, the impact on sports rights prices should be minimal, although the ability of the BBC to air more of any event might force other commercial bidders to have to offer more for any given right where those rights holders value exposure more than radio rights income.

4. Production Base

The BBC is currently investing £21m a year on programming for its five new national digital services versus about £8m spread across the commercial sectors 35 new digital services and some re-versioning of re-broadcasts of existing analogue services for different regions and markets in digital. This represents over 70 per cent of all the digital programming investment in the UK.

In addition, services such as BBC 1Xtra and BBC Asian Network UK are bringing new talent into the production sector, while both these services and BBC 6 Music are giving an outlet to new and lesser known performers and artists. BBC 1Xtra in particular has given a national outlet to new UK R&B, hip hop and garage music and has probably played a role in developing UK artists in a growing global music trend dominated by the USA.

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

The outturn impact assessed in the previous section is summarised below and differs from the initial prediction in the review O&O conducted in the spring of 2001 in four main ways.

Figure 17

SUMMARY OF MARKET IMPACT						
	BBC 6 MUSIC	BBC 7	1XTRA	ASIAN NETWORK	SPORTS EXTRA	TOTAL/ OVERALL
DIGITAL TAKE-UP AND EQUIPMENT MANUFACTURES	MEDIUM	HIGH	HIGH	MEDIUM	HIGH	HIGH
DISTINCTIVENESS FROM THE COMMERCIAL MARKET	MEDIUM	HIGH	MEDIUM	HIGH	MEDIUM	MEDIUM/ HIGH
DISTINCTIVENESS FROM OTHER BBC SERVICES	HIGH	LOW	HIGH	HIGH	LOW	HIGH IN PLACES
IMPACT ON OVERALL COMMERCIAL DIGITAL ECONOMICS	SLIGHTLY POSITIVE +£750k	SLIGHTLY POSITIVE +£500k	VERY POSITIVE +£1m	POSITIVE +£750k	POSITIVE +£1.5m	POSITIVE +£4.5m
DIRECT CASH FLOW IMPACT ON RIVALS	-£300k	-£150k	-£500k	-£500k	-£150k	LIMITED -£1.6m
MOST AFFECTED ANALOGUE COMMERCIAL STATIONS	• VIRGIN	• CLASSIC FM • CENTURY	• GALAXY • KISS • CHOICE	• SUNRISE	• TALKSPORT • CENTURY • GOLD	
MOST AFFECTED DIGITAL ONLY COMMERCIAL STATION (S)	• PLANET ROCK • PLANET FOR THE PLANET • STORM	• ONEWORD • PRIME TIME • CAPTAL/DISNEY • AMBACADABRA	• URBAN CHOICE	• VIKI • ASIAN PLUS • PUNJAB RADIO	• EASY • THE LOUNGE	
PRODUCTION SPEND**	£4.2m	£4.5m	£6.1m	£4.3m	£1.7m	£20.8m
IMPACT ON PRODUCTION, CREATIVE SECTOR AND TALENT	MEDIUM/HIGH (EXPOSURE FOR NEW MUSIC)	MEDIUM/LOW	HIGH (NEW SOURCES OF TALENT)	HIGH (NEW SOURCES OF TALENT)	MEDIUM (NEW VOICES)	MEDIUM/ HIGH
ANNUAL LISTENING HOURS /WEEKLY REACH OF DIGITAL LISTENERS*	30m 1.7%	56m 2.8%	54m 3.0%	112m 4.0%	24m 2.9%	276m

* Based on Quarter 4, 2003 RAJAR figures. ** Based on 2003/2004 budget projections

First, the analysis did not foresee the extensive use of digital radio in digital TV platforms which has helped digital radio achieve quite rapid access to a number of people despite DAB sales themselves being still under 500,000 (a level which is in line with the original prediction).

Second, the elasticity of demand for advertising that we have used in this review at – 3.5, is higher than that assumed in our initial report where we had very little quantitative evidence to use.

Third, the commercial DAB sector has proven more reliant on the rebroadcasting of local analogue services to other regions – something which has made the economics of commercial digital radio more robust (we pointed out last time that the commercial sector could not sustain a large number of new digital only services).

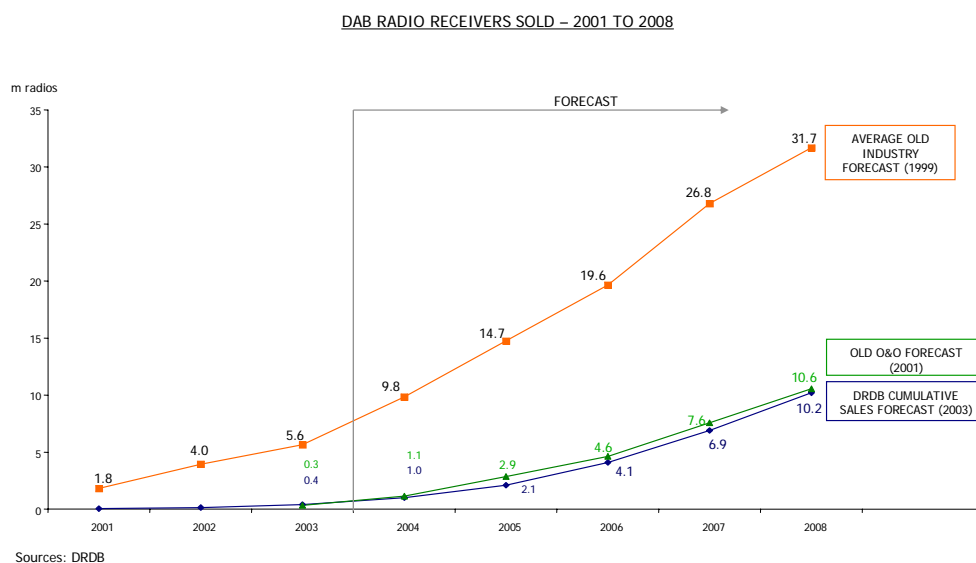
Fourth, our total predicted share for all the five BBC services of new digital service listening was lower – at about 8 per cent, compared with outturn of 16 per cent – especially for BBC 1Xtra and the Asian Network. This coupled with the distribution on digital TV systems means that the total reach and listening hours of BBC services are greater than we expected.

However, the initial analysis was correct in assessing that the economics of commercial digital radio are likely to remain fairly thin for some time, that commercial digital radio would still concentrate largely on music formats and be dominated by the large ownership groups.

The overall impact of these differences on the conclusions is limited, In our initial review we set out a case for believing that the BBC services' ability to drive digital penetration, and the beneficial impact this would have on general commercial radio share and economics would outweigh any specific impact of lost share for individual commercial services, still holds true.

Lastly, the initial report pointed out the vulnerability of services such as OneWord – even with its national distribution, and this is still the case.

Figure 18

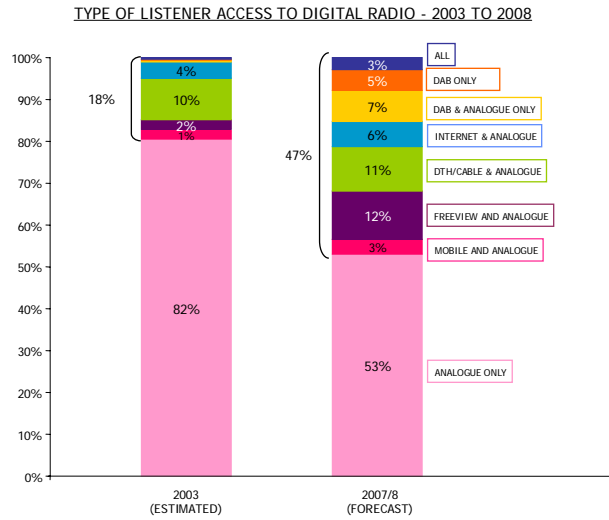


F. LIKELY UK RADIO MARKET TRENDS TO 2007

DAB radio is probably about to enter its more rapid growth phase, building on the initial penetration through digital TV and the internet. Industry forecasts – which have become more realistic in recent times, suggest that perhaps 7 to 10 million DAB receivers will have been sold by 2007/08. Some of these receivers will represent multiple sales to the same people, so this might equate to about 7 million unique individual sales, or about 15 per cent of the adult population.

Increased Freeview penetration should help bring more non DAB terrestrial reception and listening, while new moves to put DAB chips into mobile phones for both DAB radio reception and datacasting should help increase penetration still further. By 2007/08 just under half the UK population is likely to be accessing digital radio signals in some form or other.

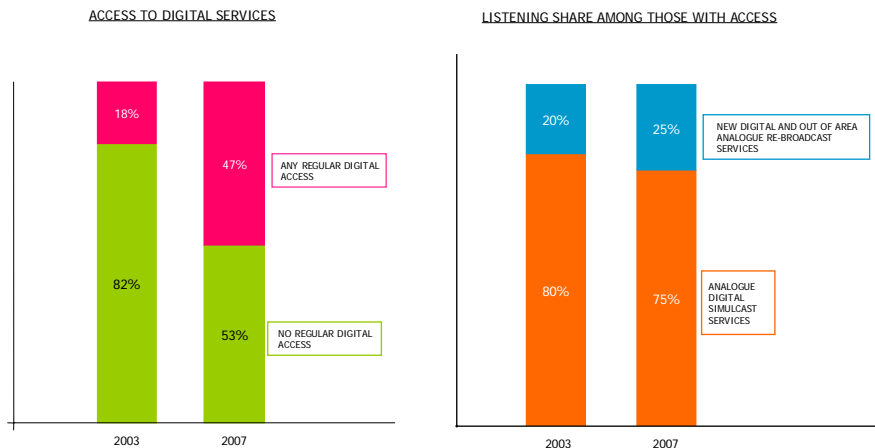
Figure 19



Sources: RAJAR, DRDB, O&O analysis

The share of listening taken by digital only and rebroadcast services from those individuals with digital access is likely to increase as some individuals have more than one set and as the service proposition improves slightly (although the economics of commercial DAB are probably not going to allow for much more programming investment in the next 3 years). Figure 20 shows the likely changes.

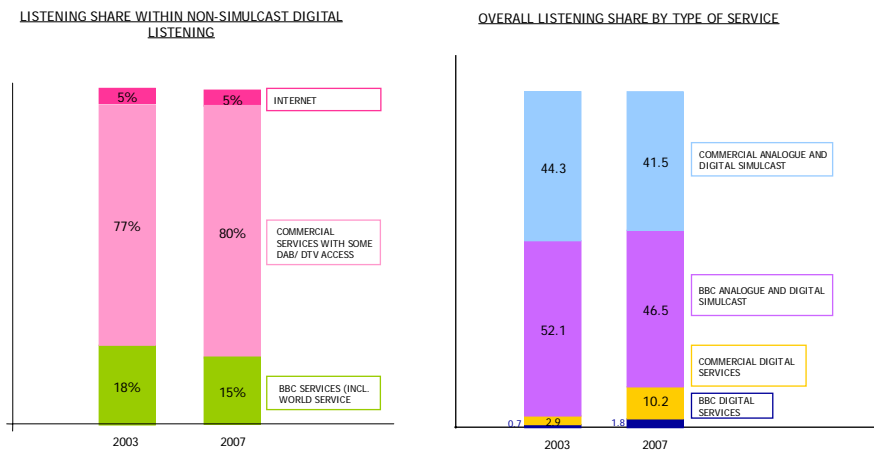
Figure 20



The slightly improved commercial proposition should help the commercial services take a slightly higher share of all new digital service listening. This combined with increased levels of penetration, and the existing high level of share taken by

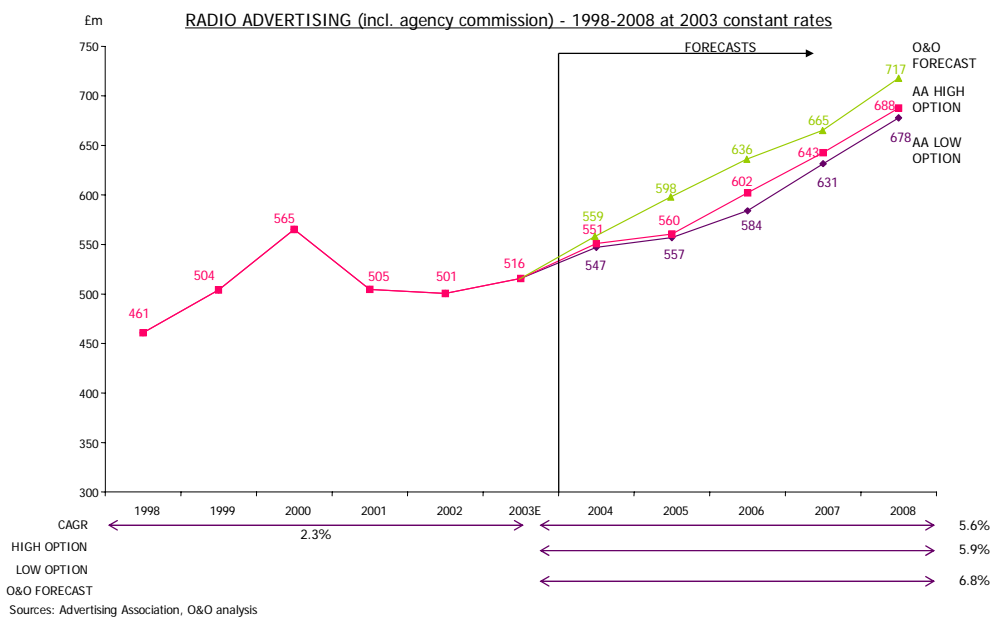
commercial services of digital listening, should help push digital service listening to 12 per cent, from 3.6 per cent by the end of 2007, and commercial services should be taking 10.2 percentage points versus the digital BBC service's 1.8 per cent. Overall, this will help increase commercial share of all listening to almost 52 per cent.

Figure 21



This increased commercial share, plus a recovering UK advertising market should combine to bring healthy advertising growth rates back to commercial radio. The ability of digital distribution to establish quasi national network brands across the UK should also aid advertising growth.

Figure 22



G. LIKELY FUTURE MARKET IMPACT

With DAB about to enter its growth phase and evidence suggesting that BBC services and cross promotion are key drivers of this growth, it is likely that the BBC's contribution to the take up of digital radio will continue to be vital. Add to this the likely continued lack of substantial investment by commercial radio in new digital programming and the likely BBC promoted growth of Freeview radio reception, and the role of the BBC services in the next few years is likely to increase not decrease.

In terms of the broad benefit to the commercial sector, with commercial radio share likely to rise to 52 per cent overall, and to about 56 per cent in a digital access home, the overall advertising benefit is likely to rise from £4.5m a year to about £20 million a year – especially as digital listening becomes easier to sell to advertisers.

The impact on specific competitors will also grow with the digital market from the £1.6m this year to about £8m by 2007. But this implies the net financial impact on the commercial sector will grow from a positive £2.9m (£4.5m less £1.6m) to £12m (£20m less £8m).

The BBC services' distinctiveness from the commercial market and within its own portfolio, and their comparative contribution to the production base, are also likely to remain positive.