Out of the Box

The Programme Supply Market in the Digital Age

A Report for the Department for Culture Media and Sport

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When old words die out on the tongue, new melodies break forth from the heart; and when old tracks are lost, new country is revealed with its wonders.

Sir Rabindranath Tagore

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1.1 Introduction

1.1.1 This report has been commissioned by the Department for Culture, Media and Sport [DCMS] to address the outstanding issues from Phase I of Creative Industries Task Force Television Inquiry and, mindful of the impending publication of the Communications White Paper, to conduct a wider examination of the television programme supply market and the relationships between broadcasters, producers, distributors and creative talent.

1.1.2 The full terms of reference set out by the Secretary of State were to: "*investigate and report on how the UK television programme supply market could best be adapted to realise the potential of UK creative talent to satisfy the growing audio-visual economy*."

1.1.3 In particular, we have been asked to consider:

- The economic relationships in the television industry with emphasis on the different elements of the value chain, i.e. broadcasters, production and distribution companies and creative talent.
- The likely impact of new content platforms, including international channels.
- The likely impact of the changing television economy on the volumes and diversity of original content production, including the terms of the existing Independent Production Order.
- The ability of the industry to exploit fully all revenue streams including programme sponsorship (e.g. masthead programming) and merchandising.
- The negotiation and development of talent rights agreements, such as those with writers, composers, performers and musicians, with a view to identifying and making use of best practice agreements.
- The allocation and retention of programme rights.

1.1.4 To this end, the Inquiry team has examined the economics of the programme supply chain and conducted over sixty interviews with senior industry figures, including broadcasters, producers, distributors, on- and off- screen talent, agents, advertisers, financiers, new media companies and regulators.

1.2 Key Observations

From Channel Scarcity to Abundance

1.2.1 To date the growth in available channels has been limited to an expanding minority of homes—currently around 40% for all multichannel homes and 20% for digital homes. Nonetheless, by September this year more than 23 million individuals aged four or over had access to some form of multichannel television.

1.2.2 The growth in channel availability has resulted primarily in a redistribution of viewing between channels rather than an increase in overall time spent viewing.

1.2.3 While in August 2000 the terrestrial channels still attracted 81.5% of viewing across the country as a whole, in multichannel homes the figure fell to 57.1%. In digital homes, the combined share of the terrestrial channels stood at just 50.2% However, the fact that a sizeable proportion of the population has so far shown little inclination to pay for television programming beyond the licence fee makes the exact rate of digital take up difficult to predict with confidence.

1.2.4 Increased competition has not reduced the revenues available to the individual broadcasters. In fact, with total revenue to the commercial channels growing from £2.6bn in 1994 to £4.9bn in 1999, the opposite has been the case. Net advertising revenue remains the dominant source of revenue, but subscription revenue has been growing at a much faster rate.

1.2.5 The growth of the new cable and satellite market has been fuelled primarily by encouraging people to pay more for television services rather than reducing the advertising spend on the existing channels. As total viewing has decreased over the same period, it would appear that people are paying for increased functionality and choice rather than a greater volume of viewing—emphasising the extent to which television has been underpriced historically in the UK.

1.2.6 There is unease in the advertising industry about the potential impact of personal video recorders, such as TiVo and ReplayTV, on the traditional spot funding model of commercial television—with reports suggesting that 88% of advertisements are not watched by system users. However, the manufacturers are working closely with the advertising industry to exploit other attributes of the technology, such as its ability to allow advertisers to target niche audiences and to integrate banners, cross-promotions and sponsorships into the system. On balance, we suspect that the net long-term impact of the new technologies will be to increase the revenue flowing into the television industry—though from the UK perspective, this outcome will be contingent to some extent on the willingness of the UK regulators to allow channels and advertisers greater freedom to experiment with new forms of advertising.

Competition in Production

1.2.7 Two decades ago almost all original production of television programmes was carried by the in-house production arms of the UK broadcasters. While the majority of UK production continues to be produced in-house, DGA estimates that the independent production sector produced just under 6,300 hours of network production for the terrestrial channels, and a further 5,000 or so hours of programmes for the non-terrestrial channels in 1999.

1.2.8 The independent production sector remains extremely unconcentrated and very few companies have real freedom in the market place. 563 independent companies produced programmes for the terrestrial network channels in 1999. Of these, 56% produced at least one programme for Channel 4 across the course of the year, 26% for BBC2, 17% for ITV and BBC1, and 15% for Channel 5—highlighting the continuing importance of Channel 4 to the sector. 79% of the companies produced only one network programme during the year, 14% produced two programmes, 4% produced three programmes and only 2% produced four or more programmes. Only 14 independent production companies produced programmes for 4 or more channels in 1999.

1.2.9 Despite the growth of the independent production sector the UK production industry as a whole remains heavily concentrated. The BBC's in-house production arm continues to enjoy a total share of the original production market of just under 40%, and the top 12 production companies account for just over 80% of the market. Of these, only Chrysalis, in ninth position (1.8%), and Celador Productions, in eleventh position (1.5%), retain their independent status at the time of writing.

1.2.10 First-run commissioned programmes (including news programming) accounted for an estimated 50% of all transmissions across the terrestrial networks in 1999. The broadcaster-owned production teams produced two-thirds of all commissioned programmes in 1999 against one third from the independent sector. Excluding news, the two sectors produced 56% and 44% respectively.

1.2.11 Digital convergence will bring a substantial increase in demand for audiovisual production from which UK producers (both in-house and independent) will undoubtedly benefit. Many UK producers are beginning to experiment with the possibilities of the emerging new media and are engaged in detailed discussions with a novel range of potential content buyers beyond the traditional broadcasters. This expanding pool of well-financed buyers should eventually act to strengthen the negotiating position of the production sector. However, the new technologies also bring greater complexity to the negotiation of certain types of programme rights, and the competition authorities need to remain alert to attempts by any of the parties to abuse market power to distort the outcomes of negotiations.

Increased Competition Abroad: More Second Chances at Home

1.2.12 Although the UK is second only behind the US in the international programme sales, it continues to operate a balance of trade deficit. The deficit, which is heavily influenced by the purchase of rights to show US films on UK television, increased from -£36m to -£160m between 1994 and 1998 despite the fact that total receipts rose from £200m to £348 over the same period.

1.2.13 Figures produced by the British Television Distributors Association [BTDA] show UK exports increasing from $504m to $532m between 1998 and 1999. Programme sales fell from $379m (75%) to $338m (64%), but this decline was more than offset by the growth in Licensing, Formats & Local Productions from $56m (11%) to $111m (21%).

1.2.14 The statistics reflect the difficult international market for traditional programme sales as the major channels in most territories expand their commitments to original production. This trend has hit UK programme sales even in countries where few UK programmes have traditionally been shown on the major channels; as the increased original production on the major channels has made more high-quality US imports available (at more competitive prices) to the secondary channels which may have bought UK programming in the past. Hence, even where sales of UK programmes have been achieved, lower prices have been secured—with some distributors suggesting that prices may have fallen by as much as 20% over the last eighteen months.

1.2.15 Senior industry sources indicate that currently approximately 25% of UK originated programming has genuine overseas sales potential, with the most valuable programme exports tending to be those aimed at up-market or young audiences and/or which have a substantial quality premium. There is some evidence that deficit financing—where the primary licence fee paid by the broadcaster does not cover the full costs of production—is being employed more often now in the production of these "exportable" types of programme, with typical deficits ranging from, for example, £15,000–20,000 per hour for a sit-com to £100,000–130,000 per hour for a high profile natural history series.

1.2.16 The growth of multichannel homes in the UK has allowed an increasing number of international channels (such as Discovery, Nickelodeon, and MTV) to establish a commercial footing in the UK. The international channels have offered new choice to British viewers, raised previously untapped revenues, provided a competitive stimulus for the traditional terrestrial channels in genres in which previously there had been little pressure to innovate, increased the pressure on the UK balance of trade, and created a small, but gradually expanding, market for UK producers.

1.2.17 The UK broadcasting industry as a whole has been comparatively slow—relative to the US—to exploit the opportunities to develop its own international channels; partly, in the case of the commercial sector, as an unintended consequence of the federal ITV system. However the development of international channels now represents a significant strand of the BBC's international strategy, with BBC Prime and BBC America and joint-venture channels like Animal Planet (with Discovery) making BBC Worldwide the most substantial international channel operator based outside the US.

1.2.18 To some degree the pursuit of international channels entails sacrificing short-term revenue from traditional programme sales in the expectation of greater long term reward, and there is little doubt that the BBC has experienced more of the former than the latter to date; though the joint venture with Discovery now appears to be beginning to pay dividends. The longer-term benefits of the BBC's international channels include the fact that they provide a way of raising the profile of and promoting UK talent and programmes overseas and that they are more readily able to accommodate the UK production industry's internationally eccentric episode and series lengths.

1.2.19 The emergence of dynamic competitive secondary markets in the UK—on cable, satellite and digital terrestrial television—has gone some way to easing the competitive pressures that UK distributors face in the international markets. Breakthroughs in talent agreements, which have facilitated a shift from residuals to a royalty based payment system, and the belated enthusiasm on the part of the terrestrial broadcasters for the financial returns from re-cycling existing programme inventories in new market windows, have stimulated substantial growth in the UK secondary market. We estimate that the value of the secondary market for UK-originated programming now exceeds £100m, and the market should continue to expand rapidly as the total number of channels grows and the primary UK channels respond to the increasing need to generate revenue across the full range of available windows.

Talent: Finding its Market Value

1.2.20 Intensifying competition between channels is encouraging broadcasters to pay higher prices to secure unique “must-have” talent. The reverse is also true, with the broadcasters seeking to pay lower prices for “readily-substitutable” talent.

1.2.21 While all parties to the various talent rights agreements are continually looking for opportunities to advance their own interests in negotiations, the switch from a residuals-based to royalty-based system appears to be working well for all concerned. Directors, however, remain aggrieved at their exclusion from the secondary payments’ system.

Economics of the Programme Supply Chain

1.2.22 Total net inflows into the TV industry have grown around 50% from £4.5bn in 1994/95 to around £6.7bn in 1999. Over the same period, total expenditure on programming has risen from £2bn to just over £3bn for the terrestrial channels, with the non-terrestrial channels adding a further £800-£900m. The terrestrial channels still account for 77% of total expenditure on programming in the UK—broadly in line with their overall share of viewing (81.5%)—with the BBC responsible for over 40% of the expenditure in 1999.

1.2.23 The programming spend on the independent production sector has grown substantially from £550 million to £750 million between 1994/95 and 1999, but at a slower rate than the overall growth in programme expenditure (37% versus 50%). The proportion of programme expenditure on acquired programming has declined from around 15% in 1994/95 to 10% in 1999.

1.2.24 Total broadcast hours across the terrestrial networks have increased by 47% from 26,500 to 39,000 hours since 1994/95, due to the universal move to 24 hour broadcasting and the advent of Channel 5. First run originated production, which has increased from 13,000 to 19,300 hours, accounts for 49.7% of transmissions (versus 49.1% in 1994/95). Within this figure, independent production has grown 38% to just under 6,300 hours while the broadcasters own in-house production has grown 41% to just under 11,000 hours.

1.2.25 While hours of output have increased from all sources, the terrestrial broadcasters have increased their share of output and their use of repeats at the expense of acquired programmes. With the exception of Channel 4, independent producers are ceding share of output to the broadcasters’ production units. However, while the sector’s share of total transmissions is declining, the overall growth of the market has, thus far, more than offset this—so that the total volume of hours being produced by the independent sector has continued to expand.

1.2.26 Overall, the “balance of power” appears to have shifted slightly towards programme producers—particularly those with access to valuable talent, ideas or formats—who are consequently able to capture what might be thought of as a fairer return for their risks and effort.

1.2.27 The genre mix across the cable and satellite channels as a whole is significantly different from that of the terrestrial channels, partly reflecting the disparity in positive programming requirements between the channels. The mix is skewed towards the more obviously commercial end of the spectrum—to such a degree that, for example, there were fewer hours of religious programming shown across all the analogue cable and satellite channels analysed than across the five main terrestrial channels in 1999.

1.2.28 Five years ago we found that the terrestrial broadcasters relied on acquired programmes, mainly films, for their "profits". With less competition from satellite and cable channels (and Channel 5) at that time, acquired programmes were less expensive and delivered larger audiences. Since then there has been a reduced reliance by the terrestrial broadcasters on the "profits" of acquired programming; however, acquired programming still account for almost 50% of the global contribution to the terrestrial channels. Broadcaster-produced programming contributes 33% and independent produced programmes about 5%—although the latter figure is distorted by the fact that the independent hours are concentrated on channels with relatively low overall contributions.

1.2.29 Total transmissions across all the terrestrial channels generated a net positive contribution to overheads of approximately £1.5bn in 1999. About half of the total figure was accounted for by films and soaps, with the sports and documentary genres also generating healthy "profits". Education and current affairs were the only genres to incur significant negative contributions, although when originated programmes alone are analysed this list expands to include religion and arts programming. Broadly, the least profitable genres of programming for the commercial channels are those that the channels are required to transmit as part of their public service responsibilities.

1.3 Key Themes

1.3.1 The UK programme supply industry is already one of the strongest in the world, but the global industry is changing too rapidly to allow the UK to rest on its past achievements. Digital convergence offers the chance to build on the bequest of the existing regulatory framework, but only if all players in the industry, including the regulators, are prepared to accept the new freedoms and disciplines that the new world promises and entails.

1.3.2 The interviews suggest that there is tremendous enthusiasm for these changes and, in particular, for the more self-determined and self-determining approach to commercial and public policy goals that digital convergence makes possible—that the future of the industry can, and should, be shaped via a process of dynamic exploration and discovery along a multitude of individually-chosen paths. Channel this energy effectively and the UK programme supply industry will flourish for the public good at home and abroad: frustrate or diffuse it and a great opportunity will be lost.

1.3.3 Three key themes have emerged from the research:

a. Contrary to the conventional wisdom, channel growth and audience fragmentation do not lead to a "thinning out" of programme quality—at least not until the growth exceeds subscribers', viewers' and advertisers' willingness to pay. Thus far the predominant trend has been one of substantial growth in output, programme spend and choice, and, ultimately, competition increases rather than diminishes the imperative to produce programmes that people love to watch.

b. Public service obligations have a "cost", and particularly so in primetime where the alchemy of entertainment occurs and creative ideas are transformed into much-loved programmes and valuable intellectual property. The increasing competition for viewers' attention is making it harder—particularly for the commercial channels—to cross-subsidise programmes that are not inherently attractive to viewers; as viewers have more available options and competitors are quick to spot and target vulnerable points in the schedules. This is not to say that all public service programmes are relatively unattractive to viewers, and it does not imply that public service goals should be abandoned. Instead, there is a pressing need for clearer definitions of the objectives, an overview of the costs and benefits and more explicit performance measures to check that the chosen means are producing the desired results and are doing so as efficiently and effectively as possible.

c. The full realisation of the value of UK intellectual property rights coincides with the long-term interests of the creative economy and its consumers and is most likely to occur in a market characterised by competition across and within every level in the programme supply chain. Such a market is also likely to produce the fairest allocation of reward. However, greater reliance on competition to achieve commercial and public policy objectives depends crucially on the presence of a vigilant and effective regulatory authority with appropriate expertise to understand the peculiar sectors and divisions of the programme supply market and the ability to address the industry as a whole.

1.3.4 While the individual recommendations set out below impact in different ways on the various functions in the supply chain, taken together, and coupled with the extraordinary opportunities presented by the digital convergence, they point to a competitively demanding, but creatively and financially rewarding, future for <u>all</u> the players in the industry.

1.4 Recommendations

1.4.1 Lack of competition between buyers of programmes and of choice between programmes for the majority of viewers remain the biggest inhibitors on the full realisation of the value of UK creative talent. Current market trends are starting to correct both issues, but not quickly enough if the UK programme supply industry is to seize fully the opportunities presented by digital convergence. Accordingly, and most importantly, we recommend that **the Government should seek to accelerate the completion of the digital switchover**. The Government has set an indicative timescale for the digital switchover between 2006 and 2010. While we recognise that there are other substantive considerations for the Government to take into account, from the perspective of the programme supply industry we believe that the switchover should take place as soon as practicable. Such a move—which we believe could be accomplished ahead of the Government's indicative timescale and in a way that does not unduly favour any of the competing digital platforms—would accelerate the production of digital-related programmes and services by UK creative talent, hasten the end of channel scarcity, enhance the opportunities for competition between programmes and make it easier for all programme rights to find their true value.

1.4.2 However the anticipated benefits from intensified competition in the programme supply industry post the digital switchover are to some extent contingent on the ability of the regulatory framework to facilitate their release. In our view, in addition to being transparent, unambiguous, free from political interference and regulatory capture, technologically neutral and as consistent and fair as possible between competing organisations and platforms, the key characteristics of a regulatory framework that will enable a competitive programme supply industry to achieve its potential are:

a. **A lighter, more flexible regulatory system that enables greater self-determination** on the part of the broadcasters—particularly Channel Four and ITV—to negotiate new ways of fulfilling their public service roles **within an overarching framework that encompasses the BBC**.

b. **A clearer definition of the concept of public service broadcasting**. In part, this will require **the ability to quantify the costs and benefits of certain types of public service programmes and objectives**, and a willingness to experiment with novel ways of achieving some of these, where a more efficient and effective means of doing so can be identified. Such an approach could, for example, help to facilitate the emergence of mutually favourable outcomes in any negotiations over the future roles of ITV, Channel 4 and Channel 5.

c. The detailed industry knowledge required to identify different relevant markets in a range of complex cases and to act effectively on the basis of those market assessments.

1.4.3 We believe that the independent quota should be regarded as a temporary market intervention that can and should be removed when the long-term competitive conditions in the industry make its role obsolete. That point has not been reached yet. However, as we believe the destination to be a realistic one, we have identified various measures to hasten the journey. Of these, the accelerated digital switchover and supporting regulatory framework are by far the most significant, building on competitive trends that are already apparent in the industry. In brief, the remaining measures, which are primarily intended to promote the growth of better capitalised production companies and which are described in greater detail elsewhere, are:

a. **Making it a condition of qualifying status for the independent quota calculations that all programmes that have not been fully-funded by a broadcaster should have a free choice of distributor**.

b. **Raising the maximum permissible investment by a broadcaster in a "qualifying" independent company (or by an independent producer**

in a broadcaster) to 49%—with the rider that any cross-holding between a broadcaster and a producer would prevent any programmes made by the producer for that broadcaster from counting as an independent production for the quota calculations.

c. **Domestic or overseas broadcasters with a total share of UK viewing that remains beneath 1%, should be allowed to own fully (or be fully-owned by) independent production companies without compromising the independent status of the production company**—with the rider, again, that any cross-holding between a broadcaster and a producer would prevent any programmes made by the producer for that broadcaster from counting as an independent production.

d. **Broadcasters should be allowed a two year period of grace—calculated from the date of commissioning (or recommissioning) when the producer of an independent programme loses its independent status due a change in ownership of the company.** However, the period of grace should not apply to any programmes that a company acquired by a broadcaster produces for the acquiring broadcaster.

e. **A broadcaster should be free to choose, if it so desires, for the independent production quota to be applied globally across its fully-owned channels and for the rules on the range and diversity of productions to be relaxed to allow for specialisation on the part of its in-house production division**—provided that, in doing so, it can demonstrate that it is not reducing its spend on independent production below 25% of its original programming budget.

f. **The organisational arrangements for monitoring and enforcing the implementation of the 25% independent production quota and the European original and independent production quotas should be streamlined and harmonised.** In the absence of a new overarching regulatory authority, an individual broadcaster's compliance with the 25% quota and the European quotas should be monitored and enforced by the same regulatory authority, and the responsibility for monitoring and enforcing all of the non-licence fee funded channels' compliance with the 25% and European quotas should lie with a single regulatory authority.

1.4.4 We recognise that the ability of the UK Government to modify the legislative framework relating to independent production is to some extent contingent on agreement with the European Commission and the other Member States advising in the Contact Committee and that this has already been the subject of some discussion. It would appear that the exact legal position remains ambiguous, and may be further complicated by the pending review of the *Television Without Frontiers Directive*. In view of this, we recommend that the Government considers the amendments suggested above and, where it is minded to act, further clarifies its latitude to do so with the European Commission as soon as practicable.

1.4.5 We have refrained from making definite recommendations about the future organisational structures of the broadcasters, principally because doing so would be inconsistent with our belief that the main industry players should be given greater freedom to shape their own futures. However, given that the twin imperatives for a successful creative industry are for small creative units and deep investment pockets, and the independent sector remains fragmented, we see scope for flexibility in allowing a miscellany of arrangements between broadcasters and producers, perhaps along the US studio model, to emerge. With this in mind, from the perspective of the programme supply industry as a whole we see no overriding objections, for example, to Channel 4 moving to establish closer longer-term relationships with chosen producers if it wishes to do so, or of BBC Worldwide taking equity stakes in existing independent production companies and/or in new companies formed as offshoots from BBC in-house production teams—in the latter case, perhaps, following a model similar to that of a university science park.

1.4.6 The current Fiscal Investment arrangements for Film Production have begun to inject an important new element of finance in the UK television production sector, helping to counteract one of the sector's long term structural weaknesses. The positive effects include affording production companies greater scope for retaining certain programme rights (if they wish to do so) and encouraging some investors who have benefited from the scheme to consider more speculative direct investments in production. Accordingly, we suggest that **the Treasury should be asked to consider extending the current fiscal arrangements for Film and TV Production beyond the current cut-off point in July 2002**.

1.4.7 In view of the anomalies arising from the application of different regulatory frameworks to converging media, the imminent need of broadcasters to experiment with a broader range of advertising models as technology challenges the traditional spot model and opens up new interactive possibilities, and, with digital switchover, the increasing freedom of viewers to choose away from forms of advertising or sponsorship that disturb or displease them, we recommend that **the rules governing television advertising and sponsorship should move broadly into line with those governing print media and the internet**.

1.4.8 Finally, we believe that market forces, appropriately overseen by the competition authorities, should continue to be the fundamental determinant of talent rights agreements, and that it is not for the Government to intervene in individual negotiations. However, the Government does have a role to play in establishing and maintaining the legal framework within which the negotiations occur, and it should **continue to press overseas collecting agencies to respect and, where appropriate commit to, international agreements on the transfer of payments between territories** to ensure that UK talent receives its due reward for overseas transmissions of UK-produced programming.

2 Background to the Report

2.1 The Creative Industries Task Force Television Inquiry

2.1.1 This report was commissioned by the DCMS to follow up Phase I of the *Creative Industries Task Force Television Inquiry,*[1] which was launched in response to the findings of *Building a Global Audience*.[2]

2.1.2 Phase I examined how the UK industry's export performance could be improved via better support for export efforts, reducing barriers to investment, and reviewing the nature of the UK's television product. While noting that the UK was performing well in television exports—with a market share of 9% "three times that of our next closet rivals, after the US"—and that international demands "rightfully take second place" to the demands of the UK audience, the Inquiry concluded that "greater investment in exportable television programmes depends on the entrepreneurial sprit of creators and investors." In this context, it recommended that the UK's international position could be strengthened via:

- A stronger, more effective and better funded British Television Distributors Association.
- More consistent support for UK exports from British Trade International.
- An expanded role for the British Film Office in Los Angeles, supporting UK television export efforts in the US market.
- A more flexible tax incentive structure to benefit co-production activity.
- The production of regular and accurate Government statistics for UK television imports and exports.
- A rights fund to encourage UK animation production.
- Some relaxation of the rules governing programme-related merchandising.
- A UK producers' training scheme.
- A coherent Government strategy on rights developments and on international laws relating to talent rights.
- Better funding for productions designed for the international market.

2.1.3 The recommendations have been addressed by the Government in an *Action Plan*[3] published in July this year, and specific action points are being pursued with the support of the British Television Distributors Association, the Office for National Statistics, Trade Partners UK, the Film Council, the Creative Industries Export

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[1] UK Television Exports Inquiry—The Report of the Creative Industries Task Force Inquiry into Television Exports, DCMS Creative Industries Programme: London, 1999.

[2] *Building a Global Audience—British Television in Overseas Markets*, David Graham & Associates, DCMS Broadcasting Policy Division; London, 1999

[3] Available on the DCMS website: http://www.culture.gov.uk/pdf/tv_exports_action.pdf

Promotion Advisory Group, the Inland Revenue, the Independent Television Commission, and the Audio Visual Industries Training Group.

2.1.4 This report has been asked to address the outstanding issues from, and the industry's responses to, Phase I; and, beyond this, mindful of the impending publication of the Communications White Paper, to conduct a wider examination of the television programme supply market and the relationships between broadcasters, producers, distributors and creative talent.

2.2 Structure of the Report

2.2.1 In seeking to gauge the current state of the programme supply industry, we have employed two complementary methods of analysis. First, we have sought to gain a broad quantitative overview of the economics of the programme supply chain and the trends emerging within it over the last five years. The results of this analysis, which draws on and refers to previous work carried out in this area,[4] are set out in Chapters 3 and 4 of the report (p.20 ff.).

2.2.2 Second, we have conducted over sixty interviews with senior figures from each element within the programme supply chain. The range of interviewees has encompassed broadcasters (analogue, digital, terrestrial, cable, satellite, national and international), producers (in-house and independent, national and international), distributors (UK based and overseas), on- and off- screen talent (actors, writers, musicians and directors), agents, advertisers, financiers, new media companies and regulators. The themes, hopes and concerns emerging from the interviews are discussed in Chapter 5 (p.92 ff.).

2.2.3 The final chapter of the report (Chapter 6, p.117 ff.) draws together both sets of analysis and sets out the recommendations that we believe will help to establish the conditions necessary to enable UK creative talent to realise its full potential to satisfy the growing audio-visual economy.

2.3 Programmes—The Lifeblood of the Creative Economy

2.3.1 We have been asked to look at the programme supply industry. What does that mean?

2.3.2 A programme industry develops or acquires, produces and exploits ideas, scripts and formats. It thrives where there is open and vigorous competition within and across all programming revenue windows, where the appropriate structures are in place to support and reward risk bearers, and when the value of each intellectual property right is maximised and all contributions are rewarded fairly—in the face of uncertainty about the value of those rights and contributions when the agreements are forged.

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[4] *The Economics of the TV Programme Supply Chain*, A Research Study for the Department of National Heritage, by Chris Goodall & Co and David Graham & Associates, Department of National Heritage, April 1996.

2.3.3 The industry depends on efficiency, of course—but that's only the start. Success depends on the ability to invest in development: the better the development resources, the better the chances of a first class product. And, in turn, this flow of money into development—either from the creative companies themselves or their partners and associates—depends critically on the extent to which successful projects are able to attract high rewards.

2.3.4 A successful programme supply industry is relentlessly innovation driven—because there are no fixed formulae for success; no one can ever be absolutely certain in advance what will capture the public imagination and attention. Innovation and excellence seem to flow most readily from small, competitive and focused teams—a scale of production often at odds with the risks attached to investment in development. These twin imperatives for small creative units and deep investment pockets underpin the assorted relationships of big and small units that characterise creative industries around the world.

2.3.5 The inquiry has presented an exacting challenge—both in terms of its scope and the need to report in time for its findings to inform deliberations over the White Paper. It is a vital challenge though; for the strength of the UK programme supply market will be a critical determinant of the success and speed of development of the UK communications industry as a whole as the digital age unfolds.

2.3.6 The inquiry team have been grateful therefore for the prompt support and intellectual input from a cross-selection of senior industry figures who contributed to the Inquiry[5]. The candid insights offered have played an important role in shaping the recommendations set out on page 119 ff. As ever, all errors and omissions remain our own.

2.3.7 The terms of the inquiry have required us to identify the measures that will advance the UK programme supply chain—and thereby the audiovisual sector—as a whole. The research conducted for the inquiry has underlined that this is not a zero-win game. While individual recommendations impact differently on the various functions in the supply chain, we believe that, taken together, and coupled with the extraordinary opportunities presented by digital convergence, the recommendations point to a competitively demanding, but creatively and financially rewarding, future for all sectors in the programme supply chain.

[5] A full list is included in the Acknowledgements at the end of the report (p.132).

3 The Market for UK TV Programmes

3.1 Introduction

3.1.1 After an extraordinarily long period of industrial stability grounded in the regulatory response to spectrum scarcity, the UK broadcasting industry is now in the midst of an extraordinarily intense period of change.

3.1.2 The most profound impacts of this change have yet to be felt; but as more homes shift to new digital platforms and as the full potential for the delivery and manipulation of digital content unfolds, the programme supply industry as a whole will have to adjust to new disciplines, opportunities and threats.

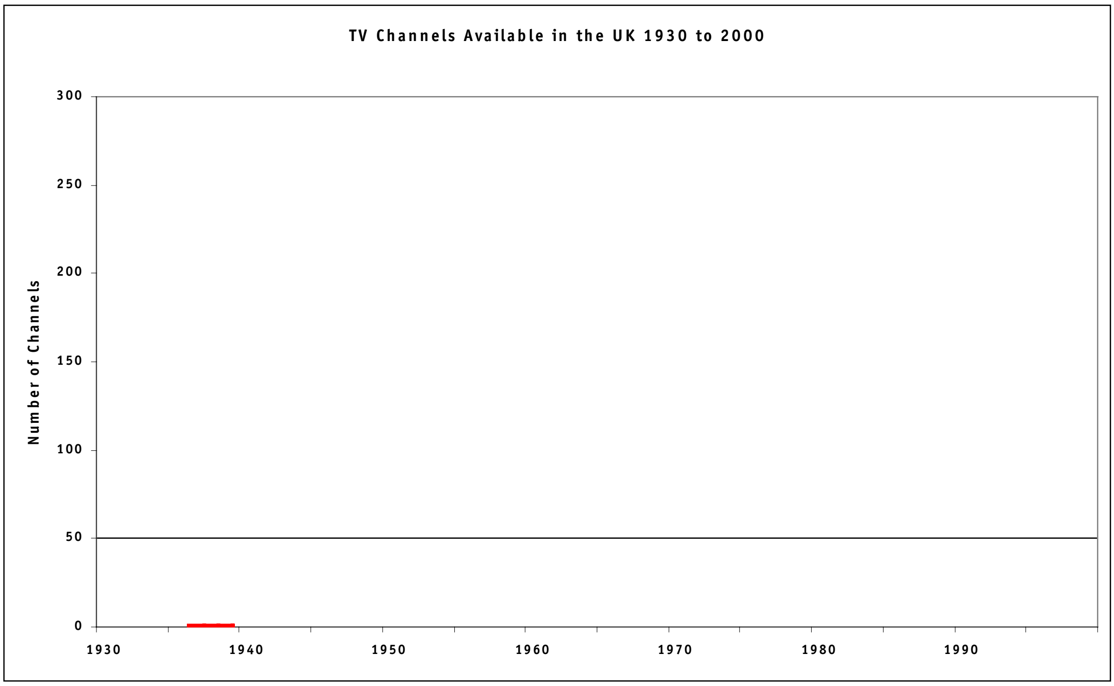
3.1.3 This chapter aims to map the current state of, and trends in, the industry as it prepares to face these changes.

3.2 From Channel Scarcity to Abundance

Channel Availability

3.2.1 The magnitude and rapidity of the growth in channel availability in the UK, particularly since the launch of digital satellite television in 1998, is shown in Figure 1 below.

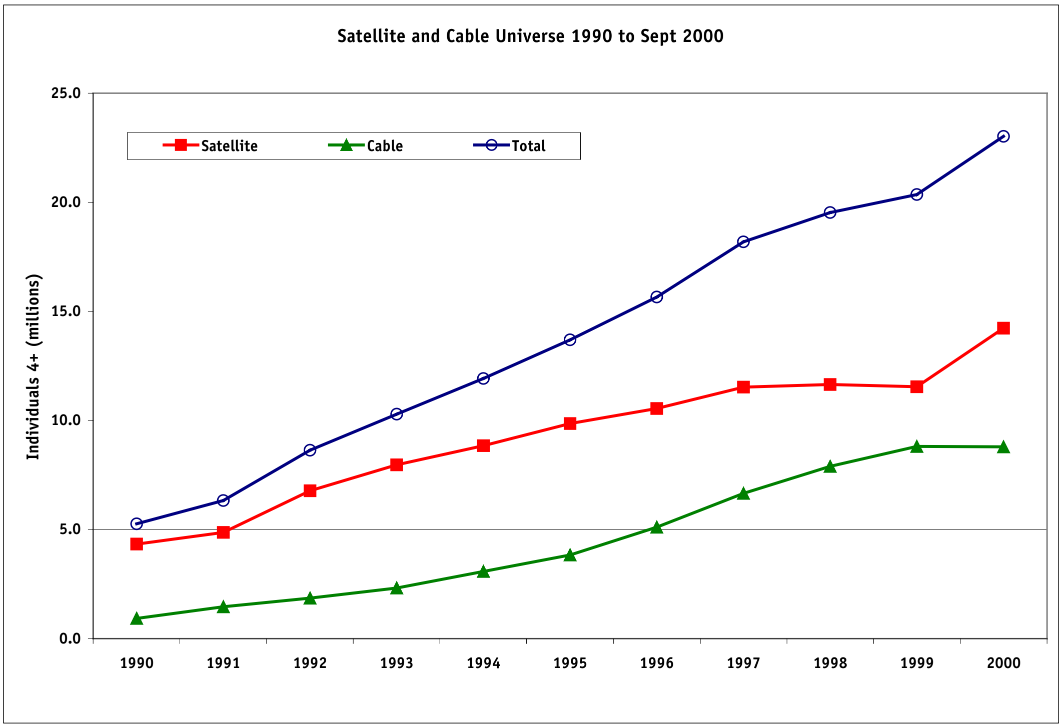
Figure 1: Available TV Channels in the UK 1930 to 2000



Source: DGA

3.2.2 To date the growth in available channels has been limited to an expanding minority of homes—currently around 40% for all multichannel homes and 20% for digital homes. At the time of writing, more than 23 million individuals aged four or over have access to some form of multichannel television, with satellite remaining the dominant platform.

Figure 2: The Multichannel Universe—Growth in Individual Access 1990 to September 2000[6]



Source: DGA Analysis of BARB Data

Impact on Viewing Patterns

3.2.3 Average time spent viewing has fallen since 1992, despite the increase in channel availability (Figure 3 overleaf).[7] Hence, the audience share won by the new channels has been at the expense of the traditional terrestrial channels (Figure 4 overleaf).

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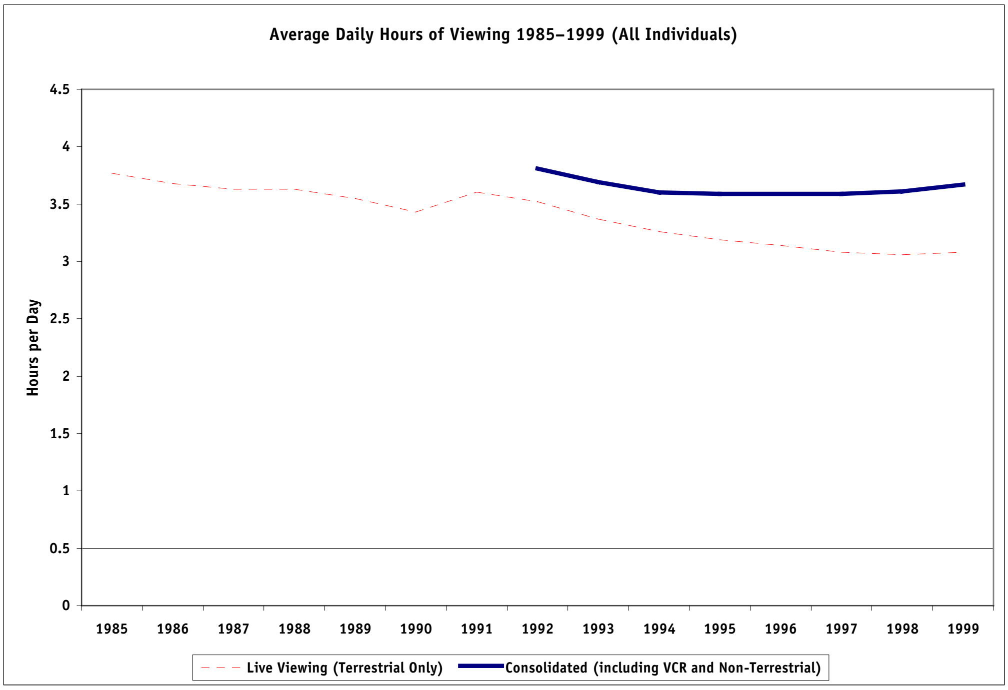
[6] Note the figure for 2000 is taken from the week ending 17 September 2000. The figures shown for the cable and satellite universes in 1999 and 2000 probably understate the real growth pattern due to the difficulties BARB has experienced in responding to the rapid uptake of digital services, and the delays in reporting digital terrestrial and digital cable viewing. A recent survey from OFTEL suggested that the current digital market shares are approximately: Sky Digital (80%), OnDigital (16%) and Cable (4%). *Consumers' Use of Digital TV*, Summary of OFTEL Residential Survey—Q1 July 2000, OFTEL August 2000.

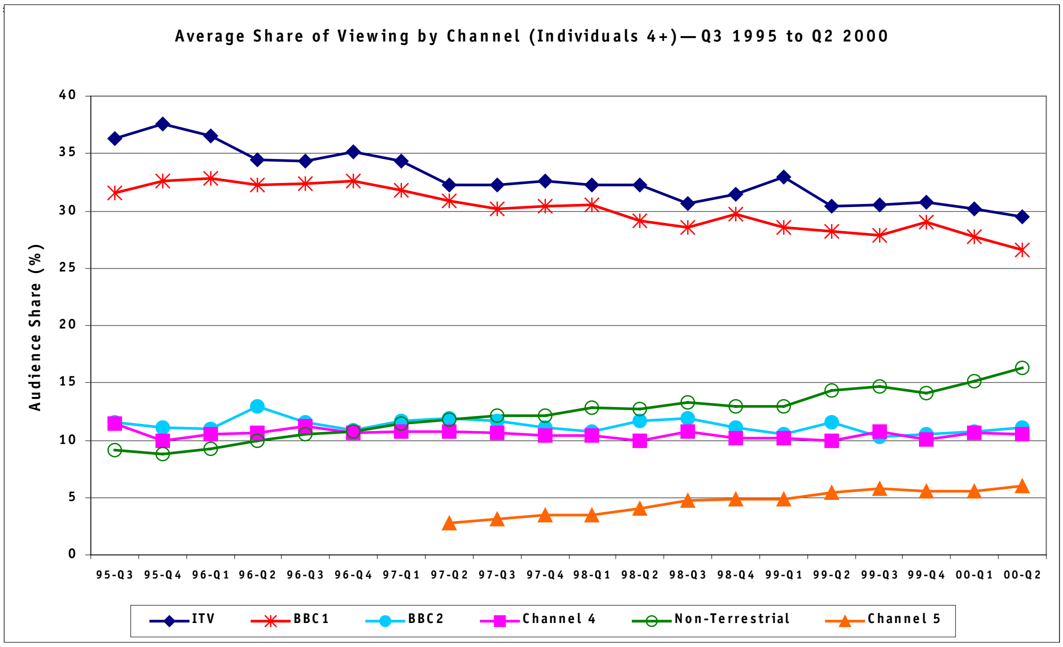
[7] There appears to have been a slight reverse in the long-term decline since 1997, but it is too early to conclude whether this reflects a genuine long-term response to increased choice and, with the launch of digital television, functionality in multichannel homes. The trend draws some support from the US, where the average time spent watching TV in US households has recently increased to more than 50 hours per week. *NetTV Market Forecast and Analysis 1999-2004*, IDC 2000, Framingham, MA.

Figure 3: Average Hours of Daily Viewing 1985–99[8]



Source: IPA Trends in Television

Figure 4: Average Share of Viewing by Channel



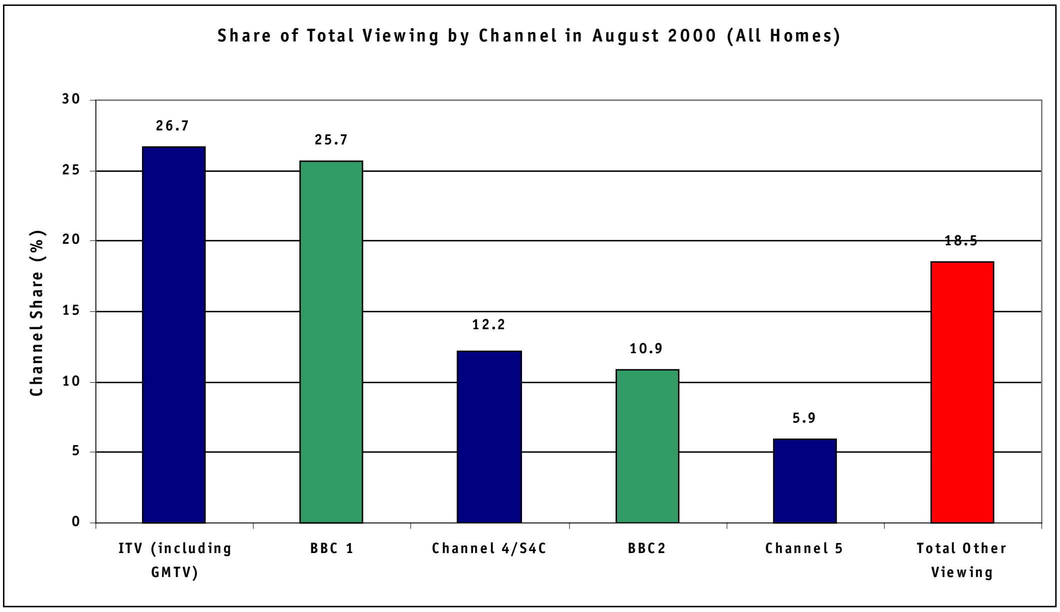
Source: IPA Trends in Television

3.2.4 While in August 2000 the terrestrial channels still attracted 81.5% of viewing across the country as a whole (Figure 5), in multichannel homes the figure fell to 57.1% (Figure 6). Across the two-week period in August analysed for the

[8] The divergence between the red line (live terrestrial viewing) and the blue line depicting consolidated viewing (which includes live terrestrial viewing, proximate viewing of programmes taped off air and viewing to non-terrestrial channels) reflects the increased viewing of non-terrestrial channels and, to a lesser extent, the increased use of VCRs. The "kink" in the red (broken) line between '90 and '91 is explained by introduction of a new audience measurement system.

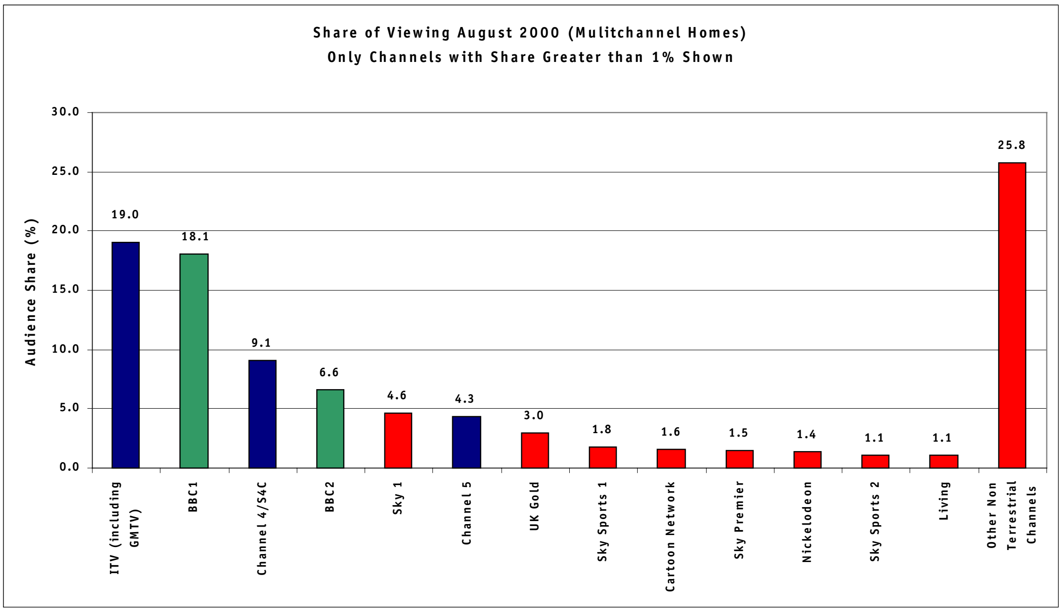
report, the combined share of the terrestrial channels in digital homes stood at just 50.2% (Figure 7), with ITV and BBC1 accounting for 16.8% and 15.7% respectively.

Figure 5: Share of Viewing August 2000 (All Homes)



Source: DGA Analysis of BARB Data

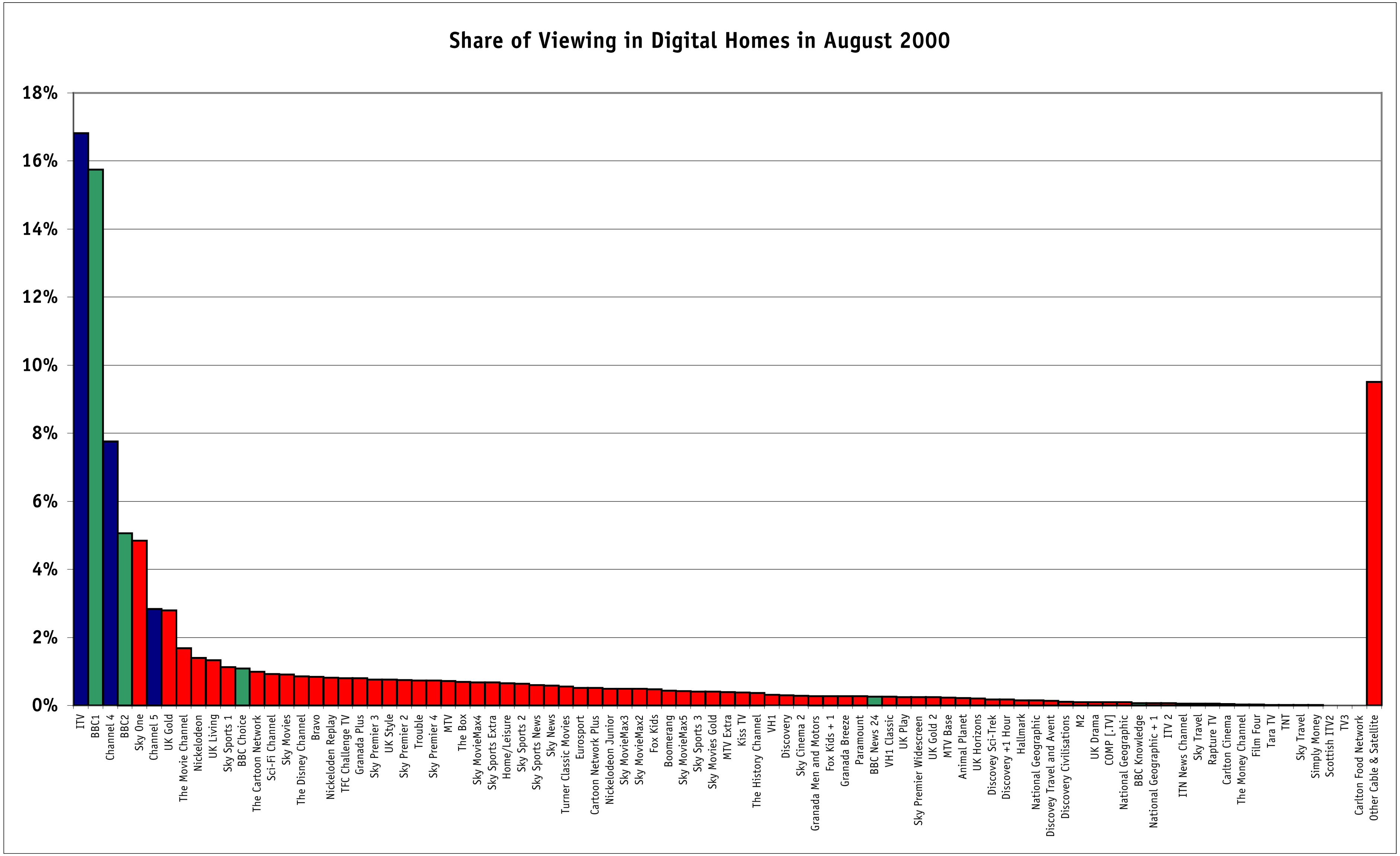
Figure 6: Share of Viewing August 2000 (Multichannel Homes)



Source: DGA Analysis of BARB Data

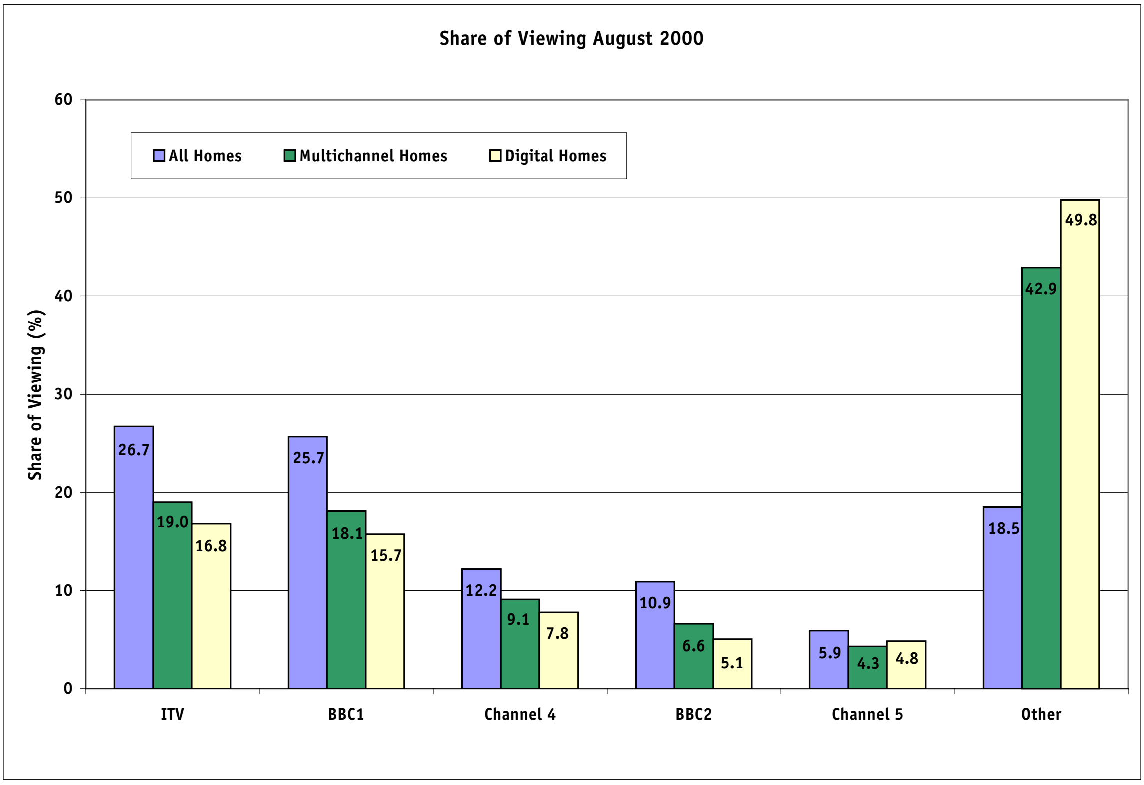
3.2.5 It does not follow automatically that if all homes switched immediately to digital platforms the shares of the traditional terrestrial channels would fall to the current levels in existing digital homes. It is a plausible, though not indisputable, assumption, that the viewing patterns of the population of viewers who have not

Figure 7: Share of Viewing in Digital Homes Across a Two Week Period in August 2000—**Source:** DGA Analysis of BARB Data



yet embraced multichannel homes would continue to exhibit for a prolonged period a greater tendency to watch the traditional channels in the digital environment than those of the current early adopters.[9]

Figure 8: Shares of Viewing August 2000 by Type of Home[10]



Source: DGA Analysis of BARB Data

3.2.6 Similarly, the fact that a sizeable proportion of the population has so far shown little inclination to pay for television programming beyond the licence fee makes the exact rate of digital take up difficult to predict with confidence. A recent market survey conducted on behalf of OFTEL found that around 1 in 3 digital customers claimed to be new to pay TV services, suggesting that digital television is succeeding in attracting a substantial number of new viewers to the multichannel universe.[11] However, a report prepared for the BBC by *.econ*[12] at the end of last year suggested that 30–40% of households may well be content to retain their existing 4 or 5 analogue television channels for the foreseeable future, and have no interest in subscribing to digital pay-TV packages. The British Radio and Electronic Equipment Manufacturers' Association [BREMA] has also expressed scepticism that the

[9] In this context it is interesting to note that the terrestrial channels as a whole recorded their first ever year on year increase in market share in multichannel homes in 1999. *Screen Digest*, February 2000, p.61.

[10] Channel 5's share is greater in digital as opposed to analogue multichannel homes because access is boosted by its carriage on the Sky Digital platform. An attraction of the digital switchover from Channel 5's perspective is that it could allow the channel to move significantly closer to universal access; this would also bring a substantial fillip for competition in the programme supply industry.

[11] *Consumers' Use of Digital TV*, Summary of OFTEL Residential Survey—Q1 July 2000, OFTEL August 2000.

[12] *BBC Digital Services and the Take-Up of Digital Television*, a report prepared for the BBC by *.econ*, December 1999.

Government's conditions for digital switchover will be met fully by 2010 without some form of intervention on the part of the Government to accelerate the switchover. [13]

3.2.7 Nevertheless, it seems reasonable to conclude that as TV-set replacement and the competitive evolution of new digital platforms (satellite, cable, terrestrial, ADSL, and broadband webcasting), channels and interactive services drive up the penetration of digital television over the coming months and years, overall shares of viewing are likely to spread more thinly across the traditional terrestrial channels. At the very least, even if, in practice, the terrestrial channels succeed in buttressing their viewing shares—and/or retaining overall shares by launching new channels themselves—the competition between broadcasters for audiences will become increasingly intense.

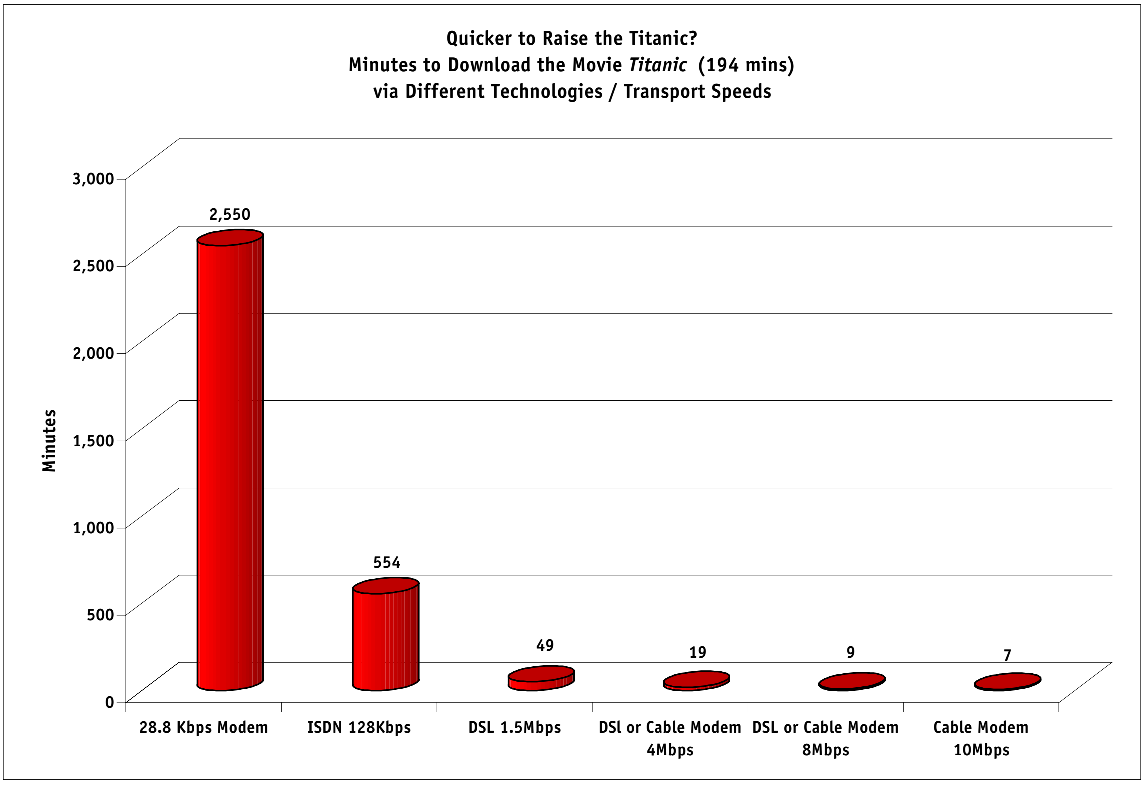
3.2.8 Moreover, the market position of the traditional broadcasters faces a further challenge from emerging technologies such as video on demand—from Video Networks, Kingston Communications, Yes Television, Diva and BT[14]—and personal television recorders—from TiVo, NDS, ReplayTV, UlitmateTV and the integrated digital TV manufacturers—which, in potential at least, have the ability to dissolve schedules and eclipse the luminance of channel brands. The latter effect is visible already to some extent in the use of electronic programme guides in digital homes to select programmes by genre rather than channel.

3.2.9 The balance between audiovisual quality and download times remains the biggest obstacle to the use of video on the internet, but as existing broadband technologies improve and become more widely distributed, the user experience offered will, in many respects, become equivalent to watching television (Figure 9 overleaf).

[13] The President of BREMA, Lord McNally, recently commented that: "*The Catch 22 is the prediction that digital Pay-TV will reach saturation at 60% (optimistically two-thirds) of UK households, whilst the remaining 40% to one-third will resist the move to digital because they only want Free-To-Air services, do not wish to pay a subscription and are not enthused by the digital programming or the need to purchase digital receiver equipment. Such households will need to be persuaded to move to digital.*" Reported on www.dtg.org.uk, October 2000.

[14] The prolonged exclusion of BT from the broadcasting market has almost certainly delayed the development of ADSL in the UK, and blocked the entry of a potentially large source of external finance into the programme supply market. BT will be free to become a broadcaster from 1st January 2001, although its position as a potential new entrant is not as strong now as it might have been before.

Figure 9: Quicker to Raise the Titanic?



Source: United States Internet Council, State of the Internet 2000 / Center for the New West.

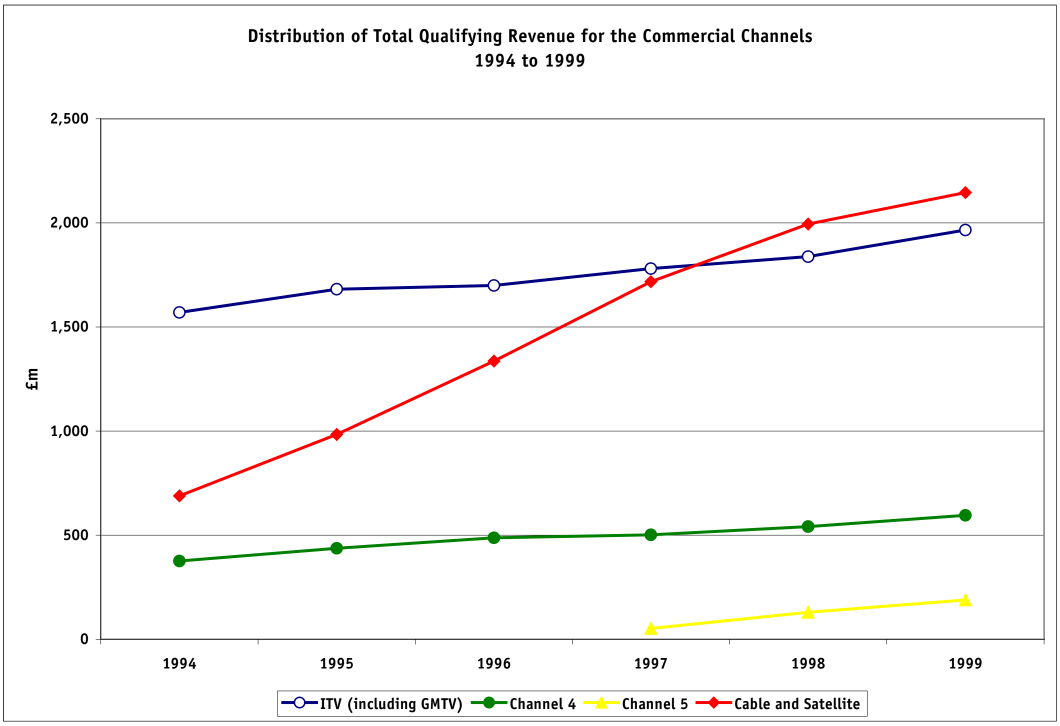
3.2.10 Again, the exact speed and magnitude of the impact of all of these technologies is difficult to gauge with any great confidence—not all of them may evolve into proven mass-consumer products like television itself—but the launch of such services, and those that will follow in their wake, clearly heralds the emergence of a different relationship between programme viewers and providers; in which a multitude of individual viewing choices—as opposed to a centralised few—increasingly determine what programmes are being watched at any given point in time.

3.2.11 In this context, some transfer of market power from content aggregators to the creators of "must-view" (as opposed to "might-view") content seems inevitable. Indeed, as we shall see later, this process is already starting to unfold.

Impact on Commercial Revenue

3.2.12 Despite the intensifying competition, the revenues accruing to the commercial broadcasters have increased substantially from £2.6bn in 1994 to £4.9bn in 1999 (Figure 10 overleaf).

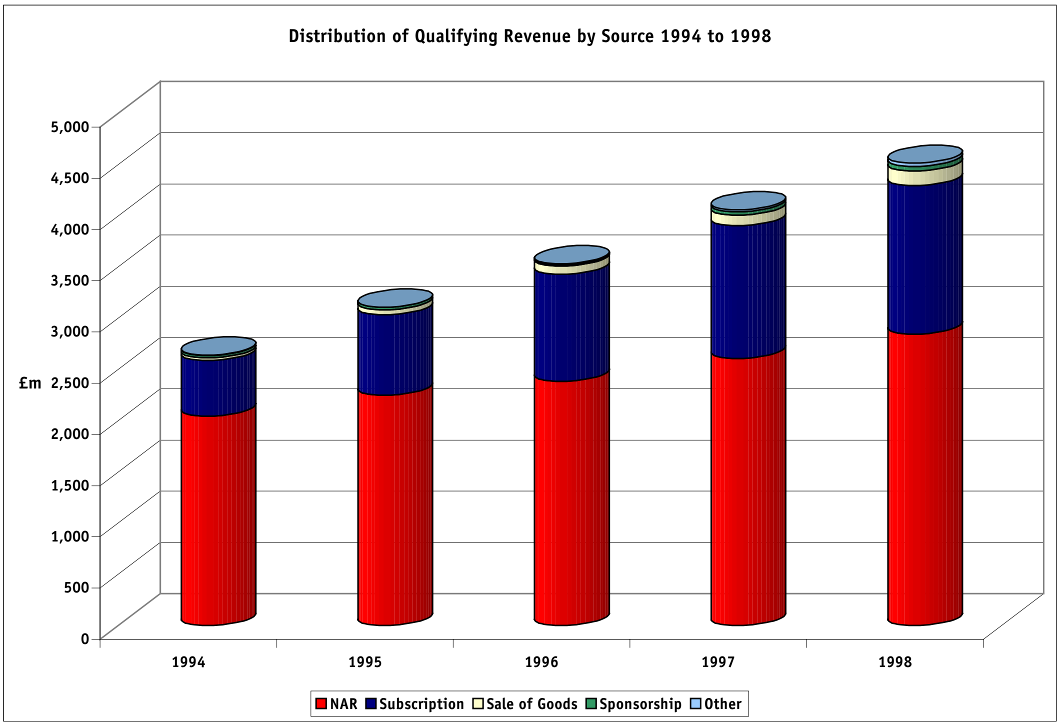
Figure 10: Growth in Commercial Channel Revenue 1994-99



Source: ITC

3.2.13 Figure 11 shows how the various income streams have contributed to the overall growth in revenue to the commercial channels since 1994. Although advertising remains the dominant source of revenue for the commercial channels as a whole, subscription revenue has grown at a much faster rate—supporting the claim that, historically, television viewing has been underpriced in the UK.

Figure 11: Distribution of Qualifying Revenue by Source 1994 to 1998



Source: ITC

3.2.14 BSkyB accounted for 82% of all subscription revenue in 1998. In total, 84% of BSkyB's revenue came from subscriptions—both from individual DTH subscribers (86%) and cable licensees paying for the right to broadcast BSkyB's programming (14%). Only 14% of its revenue was derived from advertising. The growth in the sale of goods (shown in Figure 11) is attributable primarily to sales from home shopping channels. Sponsorship revenue, which reached £52 million in 1999, continues to generate a relatively small fraction (1%) of the commercial channels' overall income.

3.2.15 There is considerable unease in the advertising industry at the moment about the impact that personal video recorders (such as TiVo and ReplayTV) may have on the traditional spot-funding model of commercial television. The relative ease with which such systems enable viewers to skip commercial breaks is reportedly resulting in 88% of advertisements remaining unwatched by system users.[15]

3.2.16 However, the equipment manufacturers are working closely with the advertising industry, as evidenced by TiVo's recent joint venture with Omnicom, one of the top three advertising agencies in the world, to experiment with different forms of advertising that exploit other attributes of the technology—such as its ability to allow advertisers to target specific niche audiences far more precisely than before. ReplayTV has also begun to test ways of integrating banners, cross-promotions and sponsorships into the system with the backing of companies such as Universal Pictures and Coca-Cola.

3.2.17 Thus, although the technology is in the early stages of development—and despite concerns in the UK and US about declining advertising revenue in the fourth quarter of this year—we are inclined to agree with the findings of a recent report from Forrester Research, that the net long-term impact of all the new technologies will be to increase rather than decrease the revenue flowing into the television industry.[16] Though, from the UK perspective, this outcome will be contingent to some extent on the willingness of the UK regulators to allow channels and advertisers greater freedom to experiment with novel (and, indeed, some currently excluded) forms of advertising.

[15] *Box of Tricks*, Michael Lewis, in the *Media Guardian,*28 August 2000, p.3.

[16] Forrester Research predicts that traditional advertising revenues will fall by $18 billion by 2005, but that the introduction of smarter, interactive TV technologies will generate $25 billion in new revenue within the same time frame. *Smarter Television*, Forrester Research, July 2000.

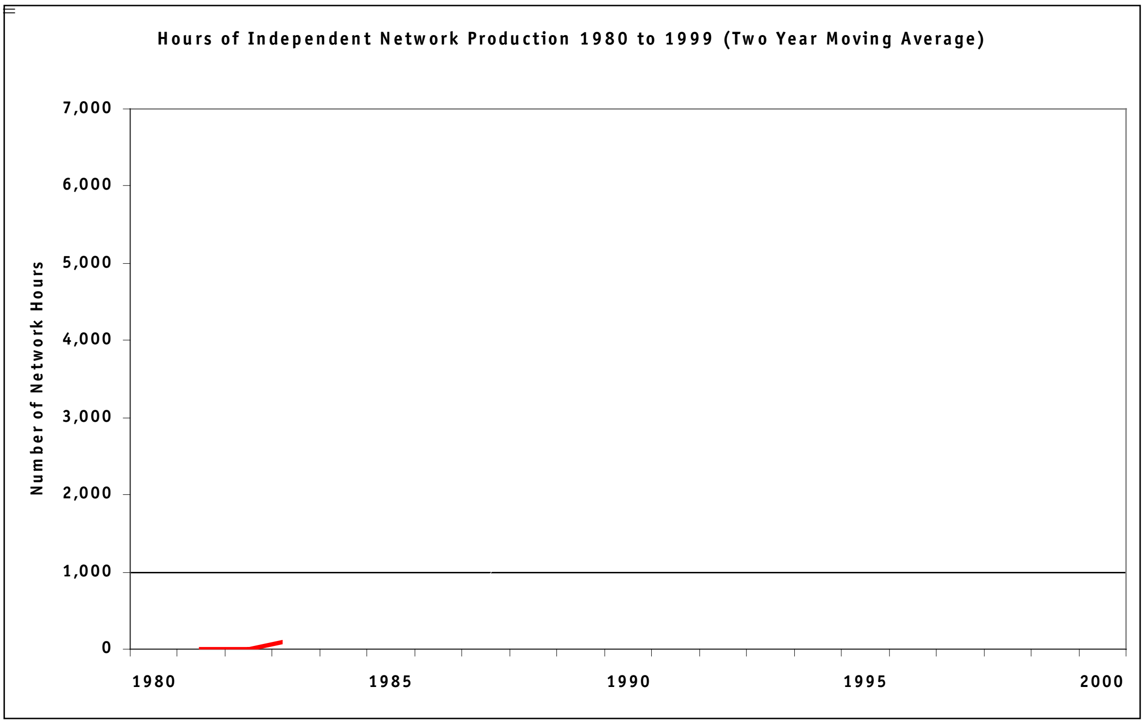
3.3 Competition in Production

Vertical Integration and Beyond

3.3.1 As the number of available channels increases, competition between the broadcasters intensifies, and the funding and rewards from programme making begin to depend to a greater degree on the exploitation of a range of distribution windows and payment opportunities than on the primary broadcast licence alone, the centre of gravity of the industry will begin to shift from broadcasting to production—be it in-house or independent.

3.3.2 Two decades ago almost all original production of television programmes was carried out by the vertically-integrated production houses of the UK broadcasters. However, the launches of Channel 4 and Channel 5, the introduction of the 10% and 25% European and UK Independent Production Quotas and the ITV Network Arrangements have promoted the growth of a substantial independent production sector (illustrated in Figure 12 below). Over the same time period, there has also been a significant growth in production by the ITV in-house teams for other broadcasters—for example, *The Royle Family* by Granada for the BBC.

Figure 12: The Growth of the UK Independent Production Sector 1980 to 1999



Source: DGA

3.3.3 Table 1 (overleaf) shows that first-run commissioned programmes (including News) accounted for an estimated 50% of all transmissions across the terrestrial networks in 1999. Vertically integrated production by in-house teams took the largest share of this (28%), followed by independent producers (16%) and production by one broadcaster's in-house production team for another channel. If News is excluded from the calculations, the shares of total transmission hours achieved by each production sector were 20%, 18% and 3% respectively.

Table 1: Share of Total Terrestrial Network Transmissions by Source of Production in 1999

Source of Total Terrestrial Network Transmissions in 1999	Independent	Broadcaster	Other Broadcaster	Total Broadcaster	Repeat	Acquired
Share of Hours (Excluding News)	18%	20%	3%	23%	17%	41%
Share of Hours (Including News)	16%	28%	5%	33%	15%	36%

Source: DGA

3.3.4 In total, broadcaster-owned production teams produced two-thirds of all commissioned programmes in 1999 against one third from the independent sector (Table 2 below). Excluding News again, the two sectors produced 56% and 44% respectively.

Table 2: Share of Commissioned Hours by Source of Production—Terrestrial Network Programmes 1999

Source of Terrestrial Network First Run Production in 1999	Independent	Broadcaster	Other Broadcaster	Total Broadcaster
Share of Commissioned Hours (Excluding News)	44%	47%	8%	56%
Share of Commissioned Hours (Including News)	33%	56%	11%	67%

Source: DGA

Market Shares of First-Run Production

3.3.5 Despite the increasing volume of programmes commissioned beyond the vertically-integrated production units, the production sector remains highly concentrated (Table 3 overleaf).[17] The BBC's in-house production division retains a total share of the market for original production across all channels of 38% in 1999, and, together, the top 12 production companies accounted for just over 80% of the market.

3.3.6 Granada's strategy of acquiring ITV licensees that have relatively strong in-house production divisions and of maintaining the distinct identities of the acquired divisions has buttressed its position as the second largest production house in the UK. The recent acquisition of United's production arm will push Granada's market share towards 20% in 2000 (18.6% combined in 1999).

[17] There are several options for measuring market share in this context, including volume of hours and overall value of production. We have adopted the share of viewer hours achieved by all originated production here because it reflects both the total volume of production in terms of hours and, via the size of the audience secured, also provides a reasonable proxy for the relative value of the production to the broadcaster. The *Viewer Hours* measure is calculated by multiplying the average audience number of viewers for a programme by its duration—and is often informally referred to as "eyeball hours". A more detailed discussion of the advantages and disadvantages of the various methods of calculating market shares can be found in, for example, *Methods of Measuring Media Concentration*, Media, Culture and Society, October 1997, Iosifides, and *Markets and the Media, Concentration, Regulation and the Interests of Consumer*, M. E. Beesley (Ed) IEA: London, 1996.

Table 3: Estimated Market Share of Terrestrial Network and Multichannel First-Run Commissioned Programming by Production Co*mpany in 1999

Rank	Holding company	Share of Total Viewer Hours (%)	Cumulative Share (%)
1	BBC	37.69	37.69
2	Granada	16.66	54.36
3	Pearson	4.53	58.89
4	ITN	4.37	63.26
5	Carlton	4.30	67.56
6	GMG Endemol	2.69	70.25
7	British Sky Broadcasting	2.64	72.89
8	United Film & Television	1.91	74.80
9	Chrysalis	1.79	76.60
10	GMTV	1.75	78.34
11	Celador Productions	1.52	79.87
12	TransWorld International	1.12	80.99
13	Independent Sports Network	1.00	81.99
14	Scottish Media Group	0.87	82.86
15	The Mersey Television Group	0.79	83.65
16	Sunset & Vine	0.78	84.42
17	Zenith Entertainment	0.68	85.10
18	Mentorn Barraclough Carey	0.62	85.73
19	Tiger Aspect Productions	0.55	86.28
20	Independent Image	0.51	86.78
21	Talkback Productions	0.50	87.29
22	Highflyer Productions	0.49	87.78
23	MTV	0.41	88.19
24	Hat Trick Productions	0.37	88.56
25	Lion Television	0.36	88.93
26	VH1	0.28	89.21
27	Wall To Wall Television	0.26	89.47
28	International Weather Productions	0.26	89.74
29	Reuters Television	0.26	90.00
30	World Productions	0.26	90.26
31	Topical Television	0.23	90.49
32	Two Four Productions	0.21	90.69
33	Valentine Productions	0.20	90.89
34	Shed Productions	0.18	91.08
35	Diplomat Films	0.18	91.25
36	RDF	0.17	91.42
37	Catalyst Television	0.16	91.58
38	Action Time	0.16	91.74
39	Hewland International	0.15	91.89
40	Union Pictures	0.15	92.04
	Others	7.96	100.00

Source: DGA

3.3.7 Other companies are pursuing a strategy of growth through acquisition as well; for example, Pearson/RTL (3rd in the table) acquiring Talkback (21st) and the Television Corporation bringing together Sunset & Vine (16th) and Mentorn Barraclough Carey (18th). Telefonica's recent acquisition of Dutch company Endemol (GMG-Endemol: 6th) and the agglomeration of companies under the RTL banner both illustrate the increasing desire on the part of broadcasters/distributors to secure guaranteed access to content and for content providers to secure access to broadcasting/distribution channels.

3.3.8 However, many large and medium-sized UK independents have considered options for consolidation and concluded that, for the time being at least, the advantages (typically identified to us as access to central corporate administrative and financial resources) do not outweigh the disadvantages (typically identified as the dilution of creative control). The breakthroughs achieved by Celador and Ragdoll Productions, for instance, are frequently cited by other companies as exemplars of the viability of, and rewards for succeeding with, the standalone strategy.[18]

Concentration and Competition

3.3.9 While the full complexity of competition policy and market analysis clearly cannot be compressed into a single indicator, the Hirschman-Herfindahl Index has frequently been used by regulatory authorities to gauge the level of competition in a market.[19] Where this is the case, an H-H Index of less than 1,000 is seen to provide one indication that a market may be predisposed to perform competitively.

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[18] PACT reports that over the last four years only seven production companies, representing less than 1% of its overall membership, have lost their independent status: Talkback and Regent Productions (both acquired by Pearson Television), Pearson Television itself (by increasing its stake in Channel 5), GMG Endemol (acquired by Telefonica), Ginger (bought by Scottish Media Group) and Action Time and Planet 24 (bought by Carlton). Source: PACT Interview.

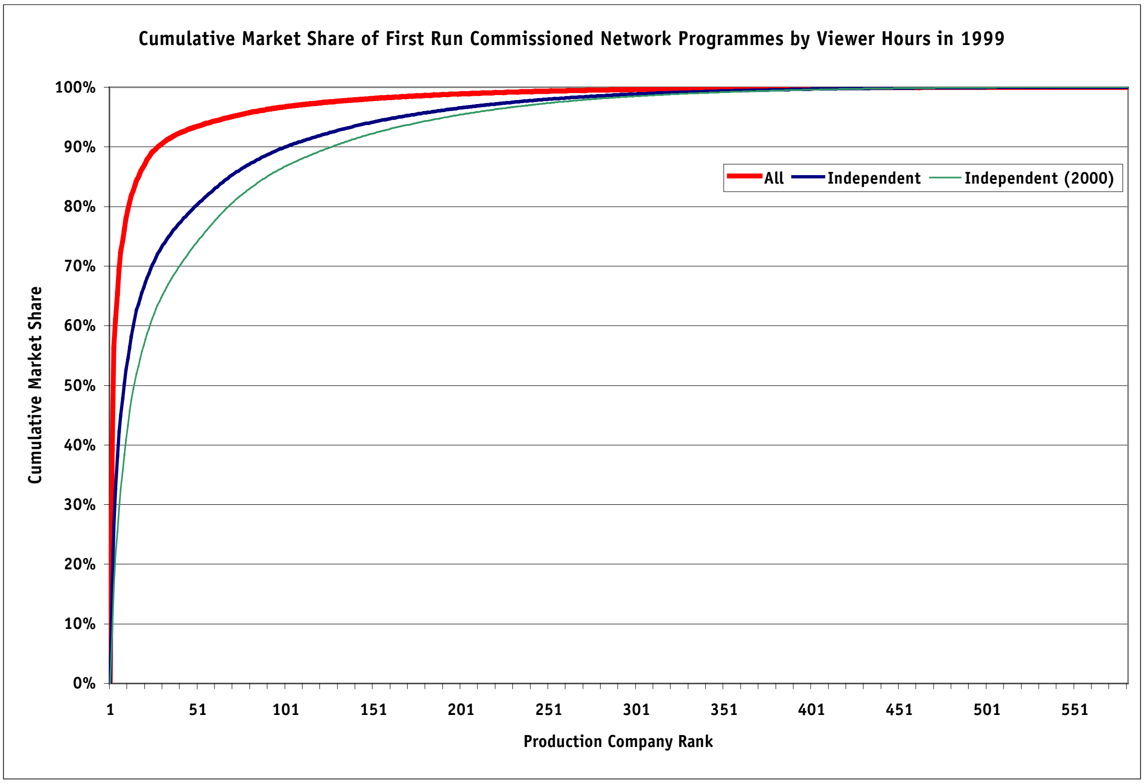
[19] The H-H Index is calculated by summing the squares of the market shares of all firms within the market. For example, if company "X" enjoyed a market share of 8%, its H-H Index value would be 8^2 or 64. Thus, the larger the market shares of the leading firms, the greater the H-H Index, and the

3.3.10 We have used the H-H Index here to highlight recent trends in the production market and to compare the concentration levels in the different production sectors.

3.3.11 The H-H Index for the market for first run, commissioned programming across all channels has fallen from 1,856 in 1997 to 1,791 in 1999, indicating that the production sector has become marginally less concentrated in recent years—with the programming demands from new channels (particularly Channel 5) outweighing the impact of mergers within the production sector.

3.3.12 As noted above, despite the decreasing concentration in the market, the H-H Index of 1,791 for 1999 suggests that the production sector as a whole is still heavily concentrated—and may not be particularly well predisposed to performing competitively. However, a different picture emerges if we analyse the independent production market separately. With the top two independent production companies in 1999 (Pearson Television and GMG-Endemol) losing their formal independent status in 2000, only Chrysalis, in ninth position, of the top 10 (Table 3 above), retains its independent status at the time of writing.[20] Prior to these mergers, the H-H Index for the independent sector was 512 in 1999: after the mergers, on the basis of the 1999 figures, the H-H Index would have fallen to 267. Both figures suggest that the independent sector remains unconcentrated and highly competitive.

Figure 13: Cumulative Market Share of Network Terrestrial Production by Market Sector—1999



Source: DGA

greater the level of concentration, within the industry. See, for example, *Video Economics*, B.M. Owen and S.S. Wildman, Harvard University Press: Cambridge, Ma., 1992, p.55–57.

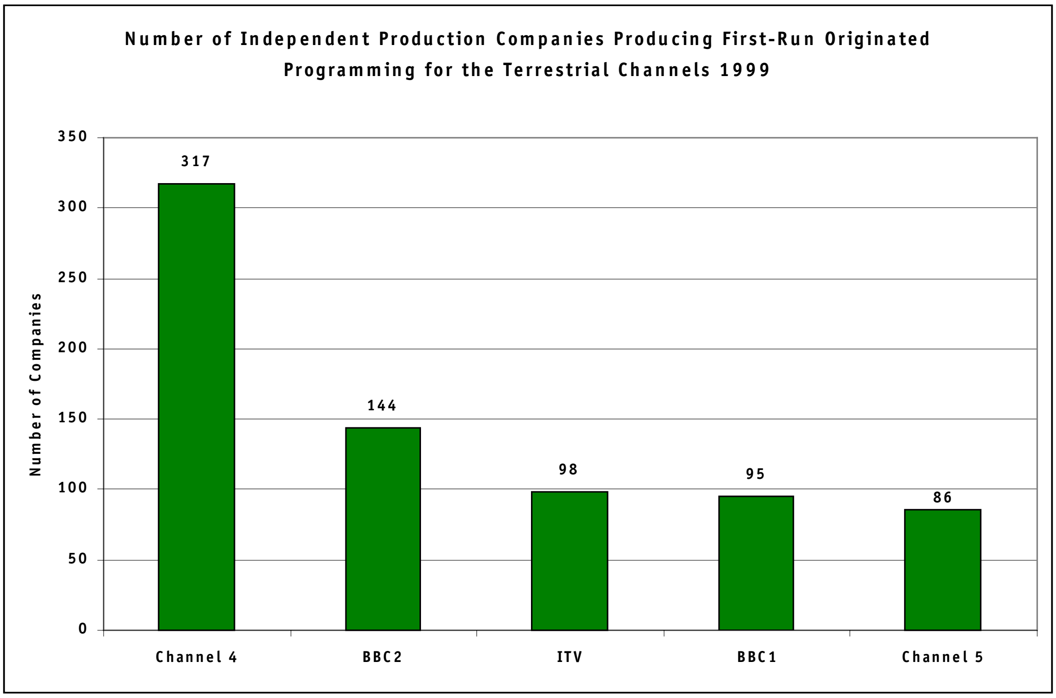
[20] Pearson Television/ RTL has increased its stake in Channel 5 above the 25% ownership threshold and Telefonica (which has acquired Endemol) has pre-existing European broadcasting interests. The former makes it likely that Channel 5 will increasingly treat RTL as its "in-house" supplier.

The Impact of the Independent Quota

3.3.13 As Figure 1 on page 20 illustrated, independent production has flourished since the beginning of the 1980s. DGA estimates that in 1999 over 560 independent companies produced just under 6,300 hours of network production for the terrestrial channels, and a further 5,000 or so hours of programmes for the non-terrestrial channels.

3.3.14 Over half (56%) of the companies produced at least one programme for Channel 4, as opposed to 26% for BBC2, 17% for ITV and BBC1 and 15% for Channel 5 (Figure 14 overleaf). The high number of companies producing for Channel 4 emphasises the continuing importance of the channel's publisher-broadcaster status, and highlights the extent to which the channel, to a far greater degree than any of the others, is responsible for maintaining the plurality of the independent sector.

Figure 14: Estimated Number of Independent Companies Producing Original Network Programmes for Each Terrestrial Channel in 1999



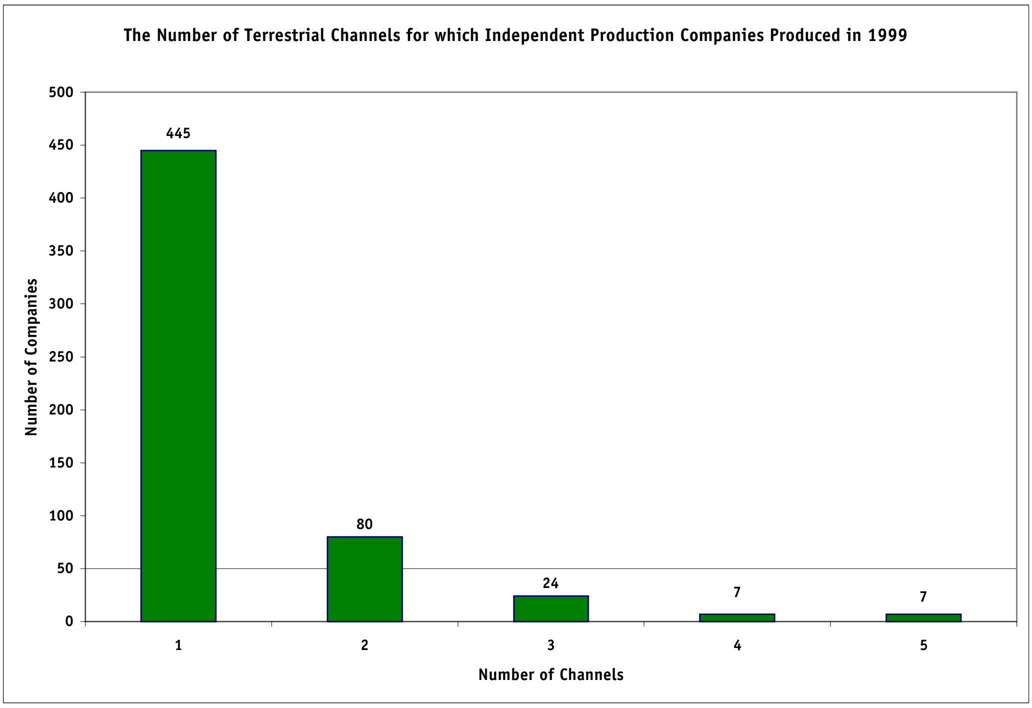
Source: DGA

3.3.15 This plurality helps to promote the cultural and regional diversity of production in the UK and lowers barriers to entry to production, but also sustains a large number of firms that are "independent" in name only—memorably characterised by Sir John Harvey Jones as enjoying "a lifestyle not a business".[21]

3.3.16 One measure of the latter can be seen in Figure 15 (overleaf), which shows that 79% of the companies produced for only one terrestrial channel in 1999, 14% produced for two channels, 4% produced for three channels and only 2% produced four or more channels. In total, only 38 companies produced for more than two channels in 1999, and only 14 for more than three.

[21] There is an astute, valedictory analysis of these issues in "Our Time Has Come, The Third Age of Independents" by John Woodward, in *Broadcast,* 30 January 1998, p.18–19.

Figure 15: The Number of Terrestrial Channels for which Independent Production Companies Produced in 1999



Source: DGA

3.3.17 Thus, although the quota has succeeded in developing a vibrant production sector, it has engendered relatively few financially independent companies.

3.3.18 There are numerous reasons for this (discussed in more detail in Chapter 5 on p.106ff.), but one of the most important has been the practice of fully-funding productions. The acceptance of this relatively risk-free option has severely restricted the ability of many independent producers to build substantial capital assets on the back of the intellectual property they have created. To some extent the independent sector has been complicit in this outcome. Fully-funded production, with a production fee on top and a minority share in the back-end is an attractive short-term option—and one which appeared all the more so at the birth of the sector when producers were simply glad to have won the right to work outside the vertically integrated divisions of the broadcasters. However, the system has also favoured the interests of the broadcasters. As the historical funding structure of the UK industry as a whole has tended to minimise the financial risks associated with production (Section 4.4, page 74 ff.), it has suited the broadcasters to link the price paid for first-run programming to the cost of production (rather than the profitability of transmission) and to retain the bulk of the rights in commissioned programmes, so that the independent sector remains creatively strong but financially dependent.

3.3.19 Although some of the larger independents have begun to move away from fully-funded production, a recent survey, conducted by DGA on behalf of PACT, suggested that over 70% of the independent programmes produced were still fully-funded in 1999.[22] Only 18% of productions were funded via pure licensed deals—

[22] The findings are based on 432 responses to 1,032 questionnaires distributed to PACT members in January 2000.

almost all of which were for the ITV Network Centre, which is compelled to follow this model.

3.3.20 In 1999, PACT submitted evidence to the OFT that some broadcasters were exploiting their market buying power to secure excessive rights in certain programmes and that as a result the true value of the rights was not being fully realised.[23] This complaint was rejected by the OFT, primarily, we understand, because of the evidence that a growing number of independent companies—particularly those with access to valuable talent, ideas or formats—are demonstrating the ability to negotiate significantly better deals for themselves. Nonetheless, it is vital for the vigour of programme supply industry as a whole and the efficient utilisation of all programme rights that the regulatory authorities remain vigilant for signs of anti-competitive practices at, and between, every level in the programme supply chain. During the transition to the digital age, this will be particularly important in the context of emergent new media rights.

Impact of New Technology

3.3.21 Digital convergence is likely to result in a substantial increase in demand for audiovisual production from which the UK producers (both in-house and independent) are well-placed to benefit.

3.3.22 As the recent high profile failures of Digital Entertainment Network and Pop.com in the US emphasise, a clear sense of the eventual form of the market, and of the revenue generating business models within it, remains tantalisingly elusive. Nonetheless, many producers are beginning to experiment with the possibilities of the emerging new media and are engaged in detailed discussions with a novel range of potential content buyers, such as Freeserve and Yahoo!. The emergence of additional buyers beyond the traditional broadcasters should help to boost the bargaining position of the production sector in the medium- to long-term.

3.3.23 However, the new technologies also bring greater complexity to the negotiation of certain types of programme rights. For example, the global availability of simulcast and non-synchronous web-broadcasts—which the broadcasters may regard as being equivalent to, and subsumed within, the primary broadcast licence—may cannibalise existing revenue streams from international sales currently enjoyed by producers and distributors. Similarly, video-on-demand rights may eventually undermine existing revenue streams from video-cassette sales. Furthermore, the rapid multiplication of new technologies itself places a greater administrative burden on the existing structures of the negotiation.

3.3.24 In this context, all parties at every level of the programme supply chain will need to exercise great care to protect their interests in negotiations over current, and future new-media, rights. And, as noted above, in view of importance of such rights to the future dynamic efficiency of the audiovisual economy, the competition authorities should remain alert to attempts by any of the parties to abuse market power to distort the outcomes of negotiations.

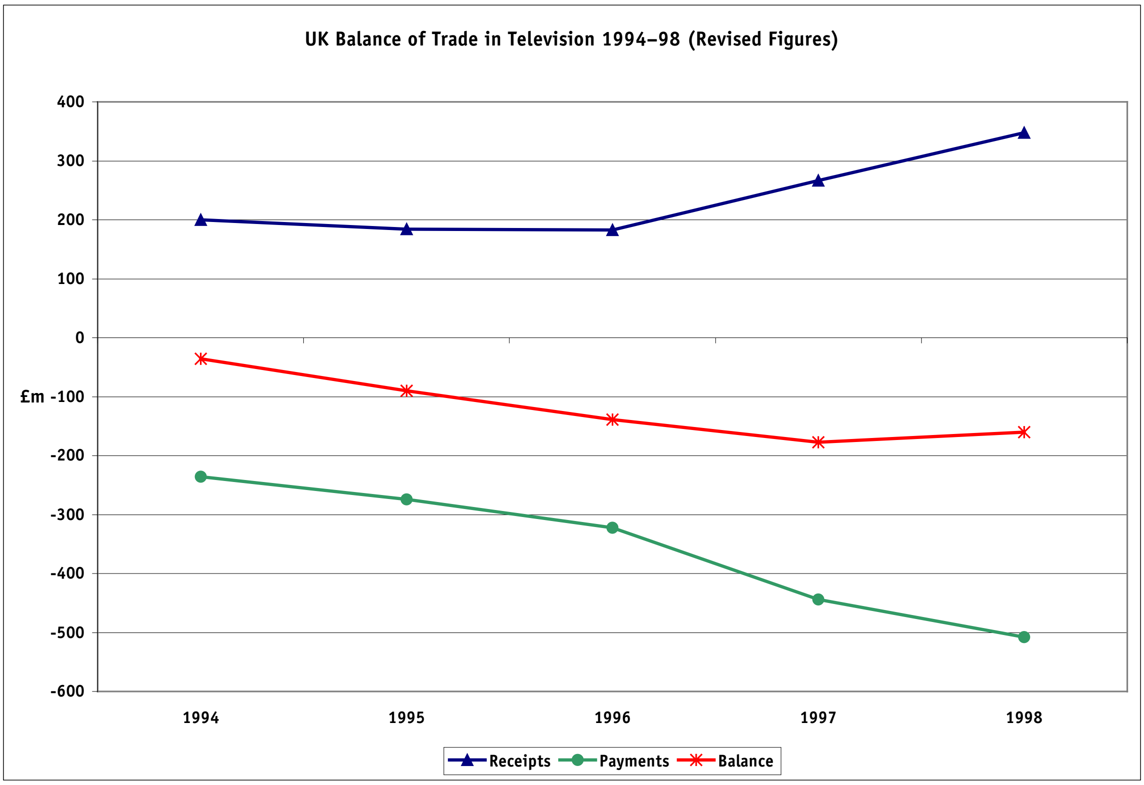
[23] Please note that DGA was one of leading advisers to PACT on this submission.

3.4 Increased Competition Abroad: More Second Chances at Home

The Balance of Trade

3.4.1 Following the publication of *Building a Global Audience* [BAGA], there has been a sustained attempt to improve reporting of UK TV exports by narrowing one data series—more or less—to the sale, purchase and exploitation of programmes or formats. It excludes "Other film and TV material," which clouds the amounts being made on entertainment properties alone. The newly-expanded British Television Distributors Association [BTDA] also now collects its own returns, and is able to provide sales by industry sector and geographical region.

Figure 16: UK Balance of Trade in TV Programmes 1994-98

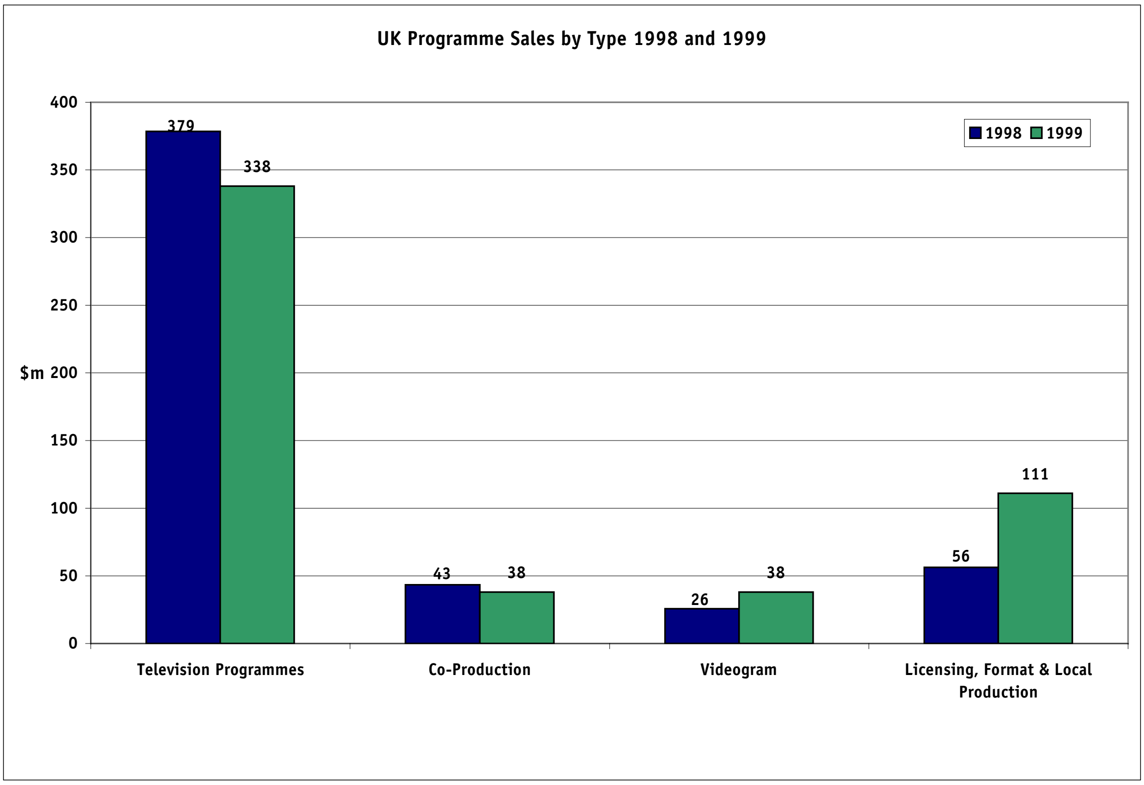


Source: ONS

3.4.2 According to the ONS figures there is still a substantial deficit in the UK balance of trade in TV programmes of £160m (Figure 16 above). Although UK exports increased rapidly from £183m to £348m between 1996 and 1998, total payments also increased from £322m to £508m. The deficit is heavily influenced by the purchase of rights to show US films on UK television.

3.4.3 The BTDA figures (Figure 17 overleaf) show UK exports increasing from $504m to $532m between 1998 and 1999. Within the overall BTDA figures, programme sales fell from $379m (75%) to $338m (64%), but this decline was more than offset by the growth in Licensing, Formats & Local Productions from $56m (11%) to $111m (21%). The statistics reflect the increasingly difficult international market for traditional programme sales as the major channels in most territories expand their commitments to original production. This trend has hit UK programme sales even in countries where few UK programmes have traditionally been shown on the major channels; as the increased original production on the major channels has made more high-quality US imports available (at more competitive prices) to the secondary channels which may have bought UK programming in the past. Hence, even where sales of UK programmes have been achieved, lower prices have been secured—with some distributors suggesting that prices may have fallen by as much as 20% over the last eighteen months.[24]

Figure 17: UK Television Programme Exports by Type 1998 and 1999



Source: BTDA

3.4.4 The same trend towards indigenous programming on the main channels has also made it harder for distributors to sell "bundles" of programmes to channels. In the face of greater competitive pressures, many leading channels are less willing to find space in their schedules for "filler" programmes and are, instead, seeking to "cherry-pick" the best programmes from the bundles offered to them.

3.4.5 The difficult international market appears to be encouraging further consolidation in the distribution sector, and several well-known and respected companies have ceased trading. We estimate that the top four companies—BBC Worldwide, Carlton, Granada/ITEL and Pearson/RTL—currently account for around 70% of total sales, and while viable opportunities remain for specialist niche players, the pressure on the medium-sized companies (with a turnover in the region of £10-15m) looks set to intensify.

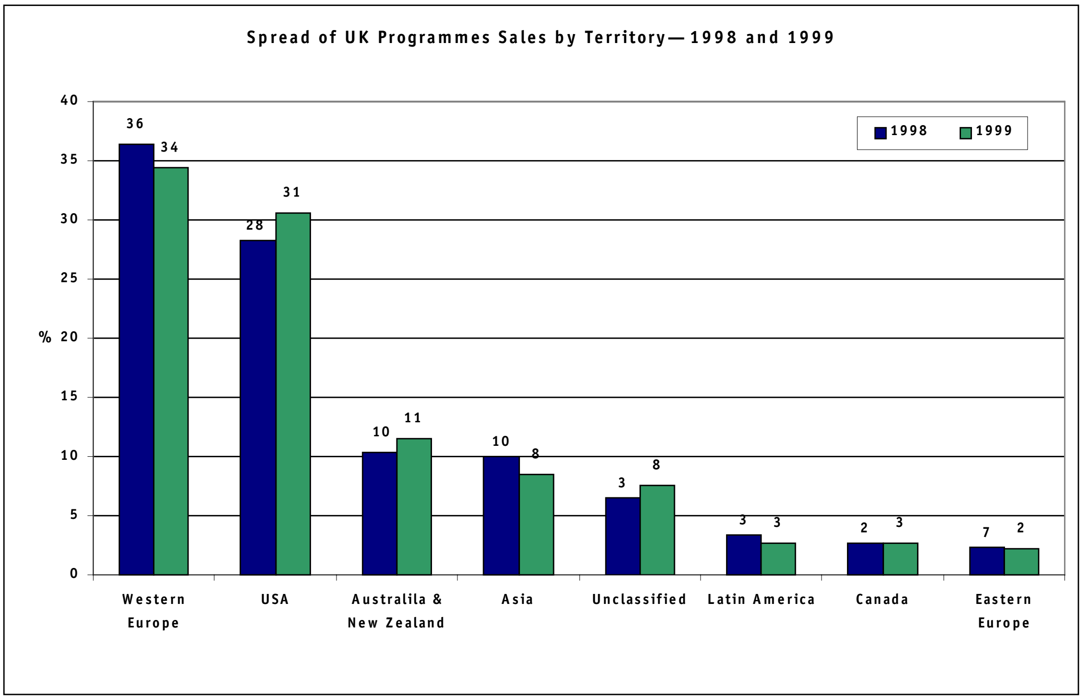
[24] As mainstream channels get harder, new markets open on satellite and cable. However, the deals on offer are of a much smaller order of magnitude: whereas a distributor might license a one-hour documentary for two runs over two years to TF1 in France for £40,000, a satellite channel might offer less than a tenth of that for multiple runs over, probably, a longer period.

3.4.6 As noted above, one of the responses to these pressures on the part of the UK industry has been to place a growing importance on format[25] sales and on the creation of their own local production division. Although the immediate revenue from a format sale is almost always lower than from the direct sale of the programme to the same channel—and typically involves a much greater commitment of time and resources to the sale—the longer term rewards from such deals can be very attractive. The recent success of the UK formats—*Survivor*, *Who Wants to be a Millionaire?*, *Whose Line is it Anyway?*—in the US and elsewhere are excellent examples of this. Indeed, it is worth emphasising that these programmes have all been shown on the main US networks in primetime, a feat that continues to elude direct sales of UK programmes. The success of these illustrates that the UK's ability to compete with the US industry on its home turf is improving, and it may well be that the UK television programme supply market offers a better platform for effective long-term competition with the US than the UK film industry.

3.4.7 As Phase I of the Creative Industries Task Force Television Inquiry identified:

> *if the UK is to improve its market position, it is most likely to be through stealing market share from the US… the UK should be aiming to compete with the US if we are to build our global position.*[26]

Figure 18: Spread of UK Programme Exports by Territory 1998 and 1999



Source: BTDA

[25] In industry practice, though not necessarily strict legal judgement, a format is commonly regarded as being "*the idea, concept, structure, setting, characters, character relationships, themes and other material factors which together comprise the original and distinctive elements in a programme*." Dorothy Viljoen, *Pact Magazine*, June 2000, p.7.

[26] *UK Television Exports Inquiry—The Report of the Creative Industries Task Force Inquiry into TV Exports*, DCMS, November 1999, p.40. Britain was identified as strongest in Factual genres, and—relative to our competitors other than USA—strong in primetime sales. An area of weakness was Drama, the largest traded genre. International channels were identified as an important new way of reaching overseas markets.

3.4.8 Though, of course, it would be dangerous to project long-term trends onto a notoriously cyclical business, the increase in sales to the US shown in Figure 18 (above), which does not yet fully reflect the success of the UK formats referred to above, suggests, at the very least, that the potential is there and that this need not be a vain hope.

Speculating to Accumulate

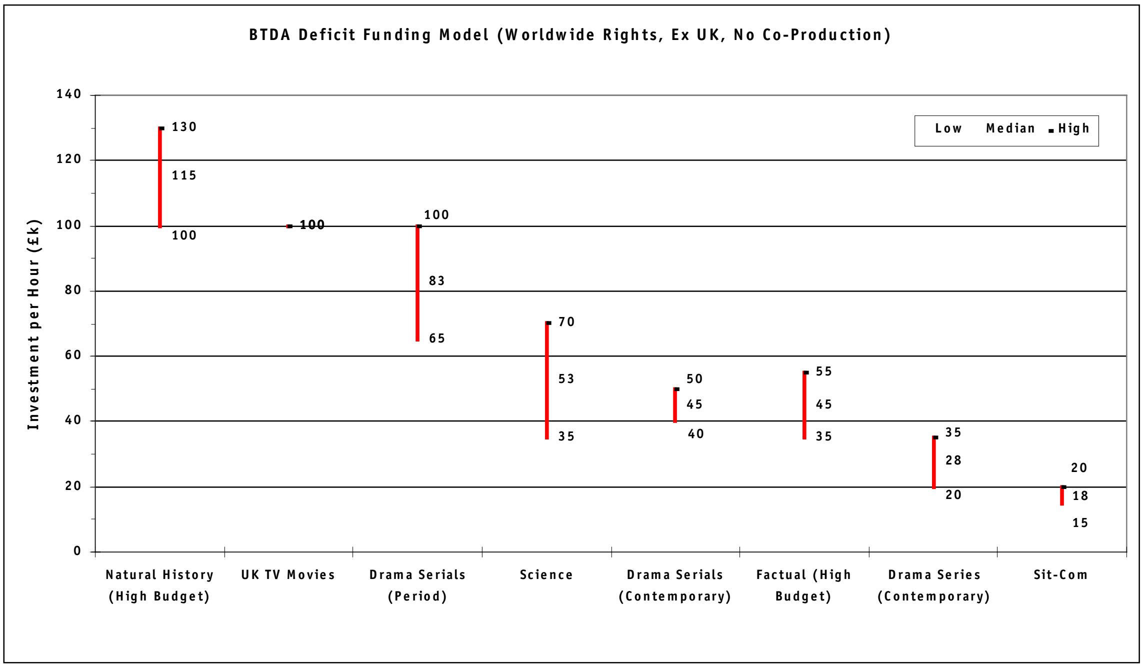
3.4.9 Senior industry sources indicated to us that they believe that currently around 25% of UK originated programming has genuine overseas sales potential. The most valuable programme exports will tend to be aimed at up-market or young audiences or have a substantial quality premium. The bulk of domestic output does not fit into this category.

3.4.10 There is some evidence that deficit financing—where the primary licence fee paid by the broadcaster does not cover the full costs of production—is being employed more often now in the production of these "exportable" types of programme. One distributor reported to us that the proportion of its own programmes with deficits attached had increased from less than 20% to around 80% over the last two years. While this extreme increase is unlikely to be reflected across the industry as a whole, the trend towards deficit financing is clear. The trend primarily reflects the intensifying competition in the domestic broadcasting market—as fragmenting audiences and strategic decisions to spread programme expenditure across expanding ranges of channels encourage broadcasters to hold down primary licence fees and force producers to rely on finance from secondary sources and windows to cover the continuing inflation in production budgets. However the trend also reflects a growing desire on the part of production companies to pursue the increasingly attractive rewards available for a genuine international hit.

3.4.11 Phase I of the Inquiry noted that co-production was common in factual genres but considered that "drama offered the greatest potential rewards", and took the view that co-production was now viewed as a "sophisticated method of attracting investment in programmes which may be... aimed at a wide international audience". The Inquiry also suggested that UK producers should show a greater enthusiasm for co-financing with European partners to produce international genres like TV Movies; an area in which British producers "can and should offer serious competition". If feasible, such a move would represent a step towards the creation of a "home market" as large as the US. As ever, the UK's position on the edge of Europe (in every sense), makes it hard to formulate and implement policies. But if UK producers can find a way to use the EU—combined with the English speaking territories—as a supra-home market from which to finance exportable products, the chances of affording the substantial quality premium needed for international projects aimed at young or up-market audiences would be significantly enhanced.

3.4.12 The deficit funding model shown in Figure 19 (overleaf) illustrates the range of investment considered reasonable or prudent under current market conditions for the exportable genres. It must be said that US-made programmes still incur far larger deficits;[27] indicating their greater probability of international earnings and also their better access to risk capital.

Figure 19: BTDA Guide to Deficit Funding by Genre



Source: BTDA

3.4.13 Recent developments suggest rapid changes in the international marketplace, some of which may be to the UK's benefit if the initiative is seized. Programmes like *Walking with Dinosaurs* and format shows like *Who Wants to be a Millionaire?* have been hugely successful, demonstrating the value of brilliant ideas and intensive programme development, and, in the case of *Walking with Dinosaurs*, international co-production partnerships. On the strengths of these successes, many more British formats are being optioned by US networks, including a number of dramas. The demand for primetime "events" on popular channels is intense. We have also witnessed a recovery in UK Children's programmes, led by titles like *Teletubbies*, *Tweenies* and *Bob the Builder*. *Ready Steady Cook* and *Ground Force* are among the most popular lifestyle formats worldwide.[28]

3.4.14 These developments have led to a new kind of company, the specialist producer, usually focussed on one genre, which creates properties, and manages both the production and exploitation of the properties. Ragdoll Productions, Celador Productions and Hit Entertainment are examples of such companies. BBC Worldwide is the distributor which has gone furthest in developing international "brands", claiming to place "brand development at the heart of everything we do", and successfully working with both independent companies, on programmes like *S Club 7* or its own brands, like *Top of the Pops*.

[27] For example, Caryn Mandabach, President of Carsey-Werner in the US, has indicated that the typical deficit on network sitcom is between $200,000 and $300,000 per episode.

[28] *Bob the Builder*, in particular, has helped boost Hit Entertainment's "ancillary revenues'"—which include video and merchandising—from £1.7m last year to £8.7m.

3.4.15 British drama remains a problem that preoccupies the industry.[29] Most Drama is made, rightly, to please home audiences and meet the financial objectives of its broadcaster, but these objectives are not necessarily consistent with generating programmes that will flourish in the international marketplace. However, the scope for improvement is also constrained by the public service programming framework. The primetime schedule is the primary breeding ground of new drama and the other genres with real international potential—the "place" where such programming is funded, launched and groomed. But large portions of UK primetime are still set aside for programmes that are created, at least in part, to satisfy the regulatory authorities. Moreover, the UK only has two mass-audience channels—the BBC and ITV—further limiting the "space" for the creation of popular entertainment programming. In the case of Drama, the problem is exacerbated by ITV's desire to reach a 40% market share, which encourages it to rely on programming with a more reliably broad demographic appeal than the kind of smart, premium "event" drama that the international market craves.

3.4.16 In other major producing countries it is usually the case that a number of channels compete for the mass-audience, resulting in some differentiation. In the US for instance, even though the three major networks compete in prime time with schedules packed with high-value entertainment properties—a process that generates a continuous stream of popular saleable programming for the domestic and international secondary markets—some competitive differentiation of audiences is still apparent. NBC tends to target younger adults, while CBS has traditionally served older audiences. Both Channel 5 and Sky One in the UK are expanding their programme budgets and will want to address a younger market, and this may well help to increase the supply of British drama attractive to the overseas viewer, providing that it can be financed. The success of *Big Brother* on Channel 4 illustrates that a so-called "minority channel" can reach a mass audience if it has the will and courage to invest in programmes that capture the popular imagination and has access to a sufficiently large proportion of the population

International Channels in the UK

3.4.17 The rapid development of multichannel TV reception in an expanding number of territories across the world has facilitated a surge in the growth of international channels such as Discovery, National Geographic, Nickelodeon, Cartoon Network, Fox Kids, The Disney Channel, CNN International, MTV, VH1 and Eurosport each mining for precious advertising and subscription revenue. Competition has been particularly intense in the children's market, and the market shares gained by the specialist Children's channels in the UK are rapidly eroding the ability of the terrestrial broadcasters to fully-fund the majority of the originated children's programming. Indeed, the children's market (and increasingly the market for popular documentaries) may offer an insight into the future of a much broader swathe of programming that is potentially vulnerable to competitive encroachment by niche, thematic channels in the digital age. The BBC's recent announcement of a children's channel spread across two of the BBC's new digital channels could be the first step in the launch of an international children's channel, and illustrates one of the main

[29] *Building a Global Audience—British Television in Overseas* Markets, A report by David Graham & Associates for the Department for Culture, Media and Sport, 1999.

ways in which the traditional terrestrial broadcasters can be expected to try to fight back over the coming years.[30]

3.4.18 The impact of the international channels in the UK to date can be broadly summarised as follows:

a. A negative impact on the UK balance of trade.

b. Raising revenues (particularly for Films, Sport and Children's programmes) that had not previously been tapped.

c. Offering British viewers extra opportunities for enjoyment that had not been previously so readily available.

d. Helping to accelerate digital switchover in Britain—there is some anecdotal evidence that demand from children to have access to the same range of channels as their classmates is now becoming a significant driver of digital take up.

e. Providing a competitive stimulus for the traditional terrestrial channels in genres in which previously there has been little pressure for innovation.

f. Providing a small, but gradually expanding, market for UK producers.

3.4.19 Some of the business models and channel themes—e.g. classic movies—pursued by the international channels are not consistent with a policy of commissioning UK originated programming. However, the apparent preference, *ceteris paribus*, of viewers for programming produced in their own countries gives other international channels a strong incentive to commission more UK-originated programming as soon as the economics of their channels permit them to risk this. The fact that a number are, albeit tentatively, starting to do so, and that this development increases the number of potential buyers for programmes in the marketplace, provides a further reason for the regulatory authorities to pay close attention to the competitive impact of launches of new channels by the existing terrestrial broadcasters.

UK International Channels

3.4.20 UK companies have been comparatively slow to exploit the opportunities presented by international channels. Several of our interviewees (See page 92 ff.) commented that the federal ITV system has had the unintended consequence of constraining the ability of the licensee companies to pursue international moves of this kind. Accordingly, UK companies have tended to follow different kinds of international strategies, with Carlton relying heavily on its acquired film catalogue and Granada and Pearson transplanting UK production expertise and skills into the international markets by building production centres overseas and producing locally. The German hit, *Die Wache*, for example is a German version of Pearson's *The Bill*.

[30] The move has provoked criticism from executives at the established children's channels—such as The Disney Channel and Nickelodeon—who have questioned the appropriateness of using the licence fee to fund new channels in a genre that is already well-served by several risk-bearing, commercial competitors.

3.4.21 However the development of international channels now represents a significant strand of the BBC's international strategy. BBC Prime and BBC America are the main vehicles for UK programmes, along with joint-venture channels like Animal Planet (with Discovery). The BBC recently announced that the joint-venture channels accounted for one third of overseas sales, and BBC Worldwide now claims to be the most substantial channel operator based outside the US.

3.4.22 To some degree the pursuit of international channels entails sacrificing short-term revenue from traditional programme sales in the expectation of greater long term reward, and there is little doubt that the BBC has experienced more of the former than the latter to date; though the joint venture with Discovery now appears to be beginning to pay dividends.

3.4.23 One of the main benefits of the BBC international channels may prove to be that they offer a means of raising the profile and promoting UK talent and programmes overseas. BBC America appears to be a promising example of this, providing a window in the US for UK series such as *The Royle Family, The League of Gentlemen* and *Wives and Daughters*. The channel currently reaches around 12 million homes and is reported to be on target to hit 20 million by the end of the year—which should provide a disproportionate boost to its advertising revenue as the channel becomes visible to the Nielsen audience rating system. Favourable media coverage of programmes shown first on BBC America has prompted some, like *The Royle Family*, to be optioned for US versions.

3.4.24 A further subtle advantage of the UK international channels may prove to be that they are more readily able to accommodate the internationally eccentric programme and series lengths that the UK broadcasters have tended to commission.

3.4.25 In the long-term, however, international channels may eventually come to be seen as a transitional step towards far more sophisticated, globally-available and locally-tailored broadband content delivery systems. If and when such systems emerge, the BBC's archive, in particular, should prove to be an immensely valuable asset.

UK Secondary Market

3.4.26 The emergence of dynamic competitive secondary markets in the UK—on cable, satellite and digital terrestrial television—has gone some way to easing the competitive pressures that UK distributors face in the international markets from the growing demand and supply of reasonable quality locally-produced programming. Indeed, several industry sources have suggested to us that overall sales into the UK secondary market will soon exceed the value of international programme sales.

3.4.27 The initial growth of the secondary market for UK-originated productions was slowed by the reluctance of the main terrestrial broadcasters to risk diluting their channel brands by allowing commissioned programming to be shown on other channels and by the then relatively inflexible structure of certain agreements with talent unions and associations that had been negotiated for an era when the UK secondary market was not a pressing consideration. As a result, many of the new secondary channels were given little option but to turn to American imports; thereby, exerting a negative impact on the balance of trade.

3.4.28 However, while the exact figures are difficult to pin down because so many of the relevant secondary channels are linked by ownership to the primary channels, there is little doubt that recent breakthroughs in talent agreements, which have facilitated a shift from residuals to a royalty based payment system, and the belated enthusiasm on the part of the terrestrial broadcasters for the financial returns from re-cycling existing programme inventories in new market windows, have stimulated substantial growth in the UK secondary market. We estimate that the value of the secondary market for UK-originated programming now exceeds £100m.

3.4.29 This market should expand rapidly as the total number of channels grows and as the primary UK channels respond to the increasing need to generate revenue across the full range of available windows. The expansion of the secondary market for UK-originated programming could well make it more difficult for new UK-commissioned programming to succeed; as the greater availability of the best programmes of the past raises the quality threshold that new programmes wishing to attract and retain viewer attention must exceed.

3.5 Talent: Finding its Market Value

It is inevitable that the evolution of multi-channel television will ensure that key production talent, both behind and in front of the camera will flex its muscles and use a developing competitive market to its full advantage.[31]

From Residuals to Royalties

3.5.1 As noted above, the number of secondary channels to which programmes can be sold is expanding rapidly in the UK and around the world but, concomitantly, the price for programme sales represents a tiny fraction of the original programme cost. Historically, the residual payments system adopted by the UK talent groups was identified by the broadcasters as a major inhibitor on secondary and overseas sales.

3.5.2 However, over the last decade, since the agreement between Equity and ITV in 1989, agreements with UK Talent unions have switched from a residual to a royalty payment basis. Residuals are calculated in advance of sales activity, and are essential when, for example, seeking fully cleared rights to exploit a programme in a particular territory. But residuals are not linked to the market value of the individual sale and may make sales to small channels in a large multi-channel market uneconomic. Royalty payments, on the other hand, are calculated by reference to the price obtained for a specific secondary use—e.g. a 5% royalty on a £10,000 sale to an Australian channel would generate £500 for the performer.

3.5.3 The royalty system is not a panacea. It can be relatively costly to administer and is not appropriate in cases where cleared rights for future sales must be delivered for a territory and the value of those sales is unknown—a growing trend as proliferating deficits on network programmes encourage producers to seek co-funding or co-production support. Nevertheless, the move from residuals-based to a royalty based system is widely held to have opened up new markets for UK programme sales.[32]

3.5.4 Each of the detailed agreements with the various talent groups have different advantages and disadvantages from the producer's perspective, but PACT's agreement with the Musicians' Union is often cited as offering one of the most flexible structures for exploitation. Among its features, the agreement provides for:

a. Either, an initial payment covering use in one transmission by the commissioning broadcaster with the provision for further payments via either a royalty (of 4% of the gross sales price of each sale) or a residual fee (calculated on the basis of a menu of territories, media and prices).

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[31] John Woodward in "Our Time Has Come, The Third Age of Independents" in *Broadcast,* 30 January 1998, p.18–19.

[32] The recent deal between Equity and BBC for off-peak programming has allowed UK-originated series like *Bergerac* and *Blake's 7* to compete with US-originated series such as *Ironside* and *Columbo* in the daytime schedules.

b. Or, an initial payment that buys out the rights for all uses of the musician's performance in the programme and any subsequent audio recording releases.

3.5.5 The possibility to buy out rights upfront is becoming more important to production companies as programme deficits force producers to seek co-production and co-financing partners who often require rights in territories to be pre-cleared for periods of a minimum of 10 years and up to 25 years. There seems to be broad recognition of the importance of this on all sides, although the talent unions and associations are properly concerned to ensure that appropriate prices are achieved on behalf of their members and that any vulnerability on the part of those who need the work is not unfairly exploited.

3.5.6 While the majority of relationships between broadcasters, producers and the talent groups remain reasonably cordial at the moment, the Directors Guild of Great Britain is currently campaigning to correct what it regards as the anomalous position of directors in the UK. Unlike writers, performers, actors, composers and musicians, UK directors have not traditionally received secondary use payments for the programmes that they have helped to create. The Directors Guild believes that its members should share in the profits from productions and that the case for this has been strengthened by the introduction of the EC Copyright Harmonisation Directive 93/98, under which Directors are now treated as co-authors of the film or television programme for copyright purposes, and the EC Directive 92/100 on Rental and Lending Rights. At the time of writing, the producers and broadcasters appear to remain wary of blanket agreements for directors, arguing that the matter should be handled via individual negotiations and, where appropriate, increased up-front payments. Furthermore, they argue that it is important to distinguish between the different levels of creative involvement by a director in for example a high-profile, one-off peak time drama and in an edition of a daily, daytime quiz show.

3.5.7 Table 4 (below) illustrates the main pattern of distribution of reward from a typical sale of a UK-originated programme into an overseas secondary market.

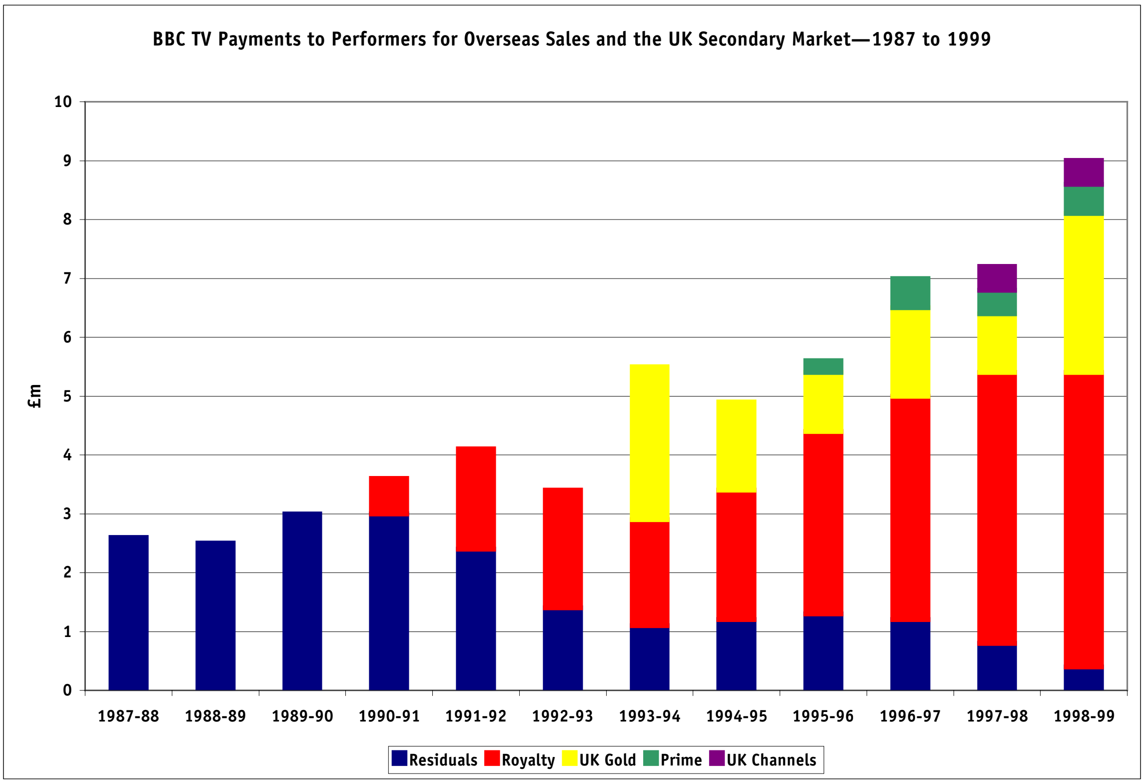
Table 4: Indicative Distribution of Reward from a "Typical" Overseas Secondary Market Sale

Gross Sales Price		**Benefit**
Actor(s)	Shared in Line with Original Payment	**17%**
Writer(s)	Shared in Line with Original Payment	**5.6%**
Musician(s)	Shared in Line with Original Payment	**4%**
Director(s)	No Benefit Beyond Original Agreed Contract Fee	**-**
Archive Footage / Photographs, Additional Music Clearances, etc.	Negotiated Separately	**Various**
Distributor	Commission on Sale	**25-30%**
Net Profit		**Benefit**
Broadcaster	Share of Back-end Profits	**50-70%**
Producer	Share of Back-end Profits	**30-50%**

Source: Industry Interviews

3.5.8 The growth in BBC TV payments to Equity performers for overseas and domestic secondary sales (set out in Figure 20, below), would seem to suggest that the royalty-based system is working well for all parties—with the acceleration in growth in recent years largely due to the joint venture channels and BBC America.

Figure 20: BBC TV Payments to Performers for Overseas Sales and the UK Secondary Market (1987 to 1999)



Source: Equity

3.5.9 An arbitration system has been established to counter potential concerns about non-market pricing in non-arms length deals between transacting parties linked by some form of common ownership or joint-interest. After an initial flurry of half a dozen or so complaints to the arbitrator, of which roughly two-thirds were upheld, the auditing and arbitration system appears to have secured the confidence of all parties. Although some continue to question whether the system is sufficiently sophisticated to cope with more convoluted contractual arrangements, such as where a large sum of money is paid up front to a broadcaster for exclusive use of certain parts of its programming catalogue in certain windows and, in return for this consideration, the broadcaster deflates the prices at which individual programmes are sold.

Substitutability and Reward

3.5.10 Intensifying competition between channels is encouraging broadcasters to pay higher prices to secure unique "must-have" talent. The reverse is also true, with the broadcasters seeking to pay lower prices for "readily-substitutable" talent.

3.5.11 In the context of talent rights, the former can be seen, for example, in the trend for high-profile recording artists to demand higher, individually-negotiated fees for the use of their commercially-recorded music in programmes. Taking music as an example again, the latter trend can be seen in the increasing frequency with which programme makers are recording music overseas where the rates for session musicians are significantly lower than those of their UK "equivalents". This accelerating polarisation is likely to become a more pressing source of concern for the talent unions over the coming decade.

3.5.12 A similar pattern is visible with audiovisual archive rights. In contrast to the situation with the talent agreements, broadcasters and producers are generally compelled to negotiate with individual archive rights owners—a diffuse array of individuals and organisations ranging from the broadcasters themselves to, for example, the Imperial War Museum. It is rarely in the interests of the owners of key archive footage to clear rights for programmes to be shown around the world, or even for multiple transmissions in a single territory. Instead, confident in the value of the rights, the rights owners generally find it more profitable to negotiate each deal separately. This places a greater administrative burden on the production industry, and often restricts the saleability of certain types of programmes; but it is essentially a natural market phenomenon and should not be a particular focus of Government concern.

Summary

3.5.13 The analysis in this chapter has identified the following key points:

- To date, the growth in available channels has been limited to an expanding minority of homes—currently around 40% for all multichannel homes and 20% for digital homes. A sizeable proportion of the population has so far shown little inclination to pay for additional programming beyond that provided by the licence fee.
- The traditional terrestrial channels' combined share of viewing falls from 82% of viewing in all homes to 57% in multichannel homes and to 50% in digital homes.
- The growth in channel availability has resulted primarily in a redistribution of viewing between channels rather than an increase in overall time spent viewing.
- Increased competition has not reduced the revenues available to the individual broadcasters, with total revenue to the commercial channels growing from £2.6bn in 1994 to £4.9bn in 1999. Net advertising revenue remains the dominant source of revenue, but subscription revenue has been increasing at a much faster rate.
- There is unease in the advertising industry about the potential impact of personal video recorders on the traditional spot funding model of commercial television. However, we suspect that the net long-term impact will be to increase rather than decrease the revenue flowing into the television industry.
- The independent sector produced just under 6,300 hours of network production for the terrestrial channels, and a further 5,000 or so hours of programmes for the non-terrestrial channels in 1999.

- The independent production sector remains extremely unconcentrated. Few companies have real freedom in the marketplace. 79% of independents produced for only one terrestrial channel in 1999 and only 14 produced programmes for 4 or more channels.
- The UK production industry as a whole remains heavily concentrated. The BBC's in-house production arm continues to enjoy a total share of original production of just under 40%. The top 12 production companies account for just over 80% of the market. Of these, only Chrysalis, in ninth position (1.8%), and Celador Productions, in eleventh position (1.5%), retain their independent status at the time of writing.
- Broadcaster-owned production teams produced two-thirds of all commissioned programmes in 1999 against one third from the independent sector. Excluding news, the two sectors produced 56% and 44% respectively.
- UK in-house and independent producers should benefit from a substantial increase in demand for audiovisual production arising from digital convergence. The negotiating positions of independent producers should be strengthened by access to an expanding pool of well-financed buyers beyond the traditional broadcasters.
- The new technologies also bring greater complexity to the negotiation of certain types of programme rights, and the competition authorities will need to remain alert to attempts by any of the parties to abuse market power to distort the outcomes of negotiations.
- Although the UK is second only behind the US in the international programme sales market, it continues to operate a balance of trade deficit—heavily influenced by the purchase of the UK television rights to US films.
- UK exports increased from $504m to $532m between 1998 and 1999. Programme sales fell from $379m (75%) to $338m (64%), but this decline was more than offset by the growth in licensing, formats and local productions from $56m (11%) to $111m (21%). The statistics reflect the difficult international market for traditional programme sales as major channels expand their commitments to original production.
- Approximately 25% of UK originated programming has genuine overseas sales potential, with the most valuable programme exports tending to be those aimed at up-market or young audiences and/or which have a substantial quality premium. Deficit financing is being employed more often now in the production of these "exportable" types of programmes.
- The growth of multichannel homes in the UK has allowed a number of international channels to establish a commercial footing in the UK. Such channels have offered new choice to British viewers, raised previously untapped revenues, provided a competitive stimulus in genres in which there has previously been little pressure to innovate, increased the pressure on the UK balance of trade, and created a new market for UK producers.

- The UK broadcasting industry as a whole has been comparatively slow to develop its own international channels. However, the development of such channels now represents a significant strand of the BBC's international strategy—with BBC Prime and BBC America and joint-venture channels like Animal Planet (with Discovery) making BBC Worldwide the most substantial international channel operator based outside the US.

- A shift from residuals to a royalty based payment system, along with a belated enthusiasm on the part of the terrestrial broadcasters for the financial returns from re-cycling existing programme inventories in new market windows, have stimulated rapid growth in the UK secondary market. We estimate that the value of the secondary market for UK-originated programming now exceeds £100m.

- Growth in payments to Equity performers for overseas and domestic secondary sales suggests that the royalty-based system is working well.

- Intensifying competition between channels is encouraging broadcasters to pay higher prices to secure unique "must-have" talent. The reverse is also true, with the broadcasters seeking to pay lower prices for "readily-substitutable" talent.

4 Economics of the Programme Supply Chain

4.1 Introduction

4.1.1 This chapter of the report seeks to illustrate how money is currently employed within the television production industry. Where possible, it compares the position in 1999 with the state of affairs in 1994/95, when our previous work on this subject was completed.[33]

4.1.2 The chapter is divided into two parts. The first uses data from published sources to produce an overall assessment of how money is used within TV. The second uses information from the DGA database to assess where money is made in TV; in particular what genres and sources of programming contribute most value to the programme supply chain.

4.1.3 The detailed analysis set out here provides a valuable backdrop from which to judge the feedback from the industry interviews and to prioritise policy recommendations.

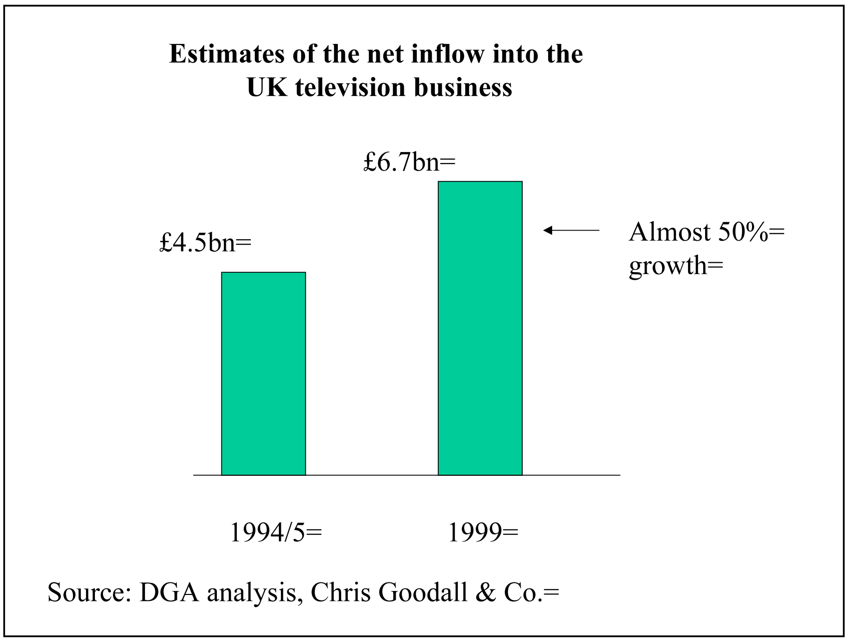
4.2 The Finances of the Television Industry in 1999

Estimates of the Net Inflow into the UK Television Business

4.2.1 *The Economics of the TV Programme Supply Chain* assessed the total size of the TV business as being about £4.5bn in the broadcasting year 1994/95 (Sept. 1 to Aug. 31). On the basis of a similar analysis for the calendar year 1999 we estimate the total size of the industry has grown by almost 50% to around £6.7bn.

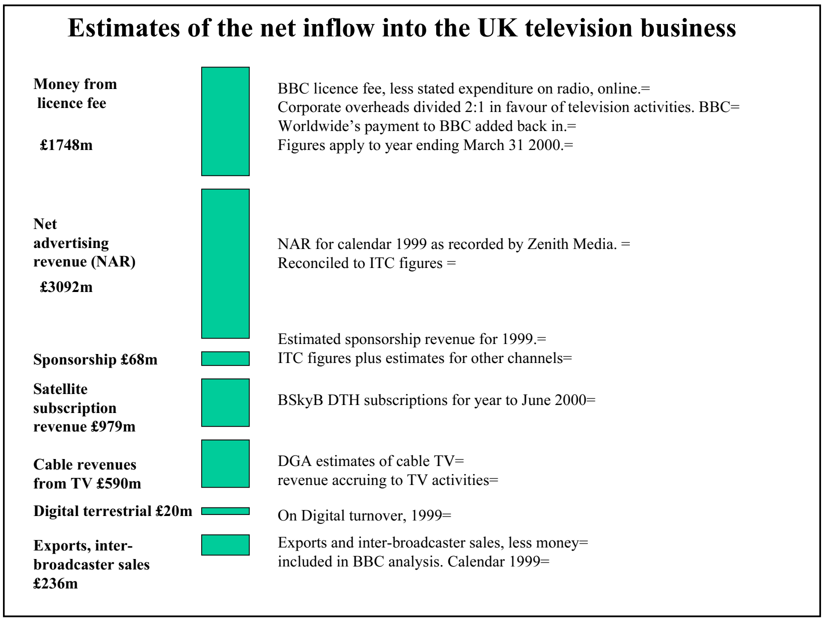
[33] *The Economics of the TV Programme Supply Chain*, A Research Study for the Department of National Heritage, by Chris Goodall & Co and David Graham and Associates, Department of National Heritage, April 1996.

Figure 21: Estimated Net Inflow into the UK Television Business in 1999



4.2.2 Figure 22 details the components of the £6.7bn estimate for 1999.[34] Subscription revenues now account for over 20% of the net inflow and are building towards the amount spent on television from the licence fee; highlighting the historical underpricing of TV programming rights in the UK and illustrating the extent to which the industry is succeeding in encouraging viewers to pay for additional television services beyond the licence fee.

Figure 22: Breakdown of the Net Inflow into the UK TV business 1999.



Source: Chris Goodall & Co and DGA

[34] As the data on which the calculation has been based have been compiled from a variety of published sources not all of which will have employed the same accounting rules, the combined figure for net inflow into the industry should be regarded as a broad estimate rather than a exact figure.

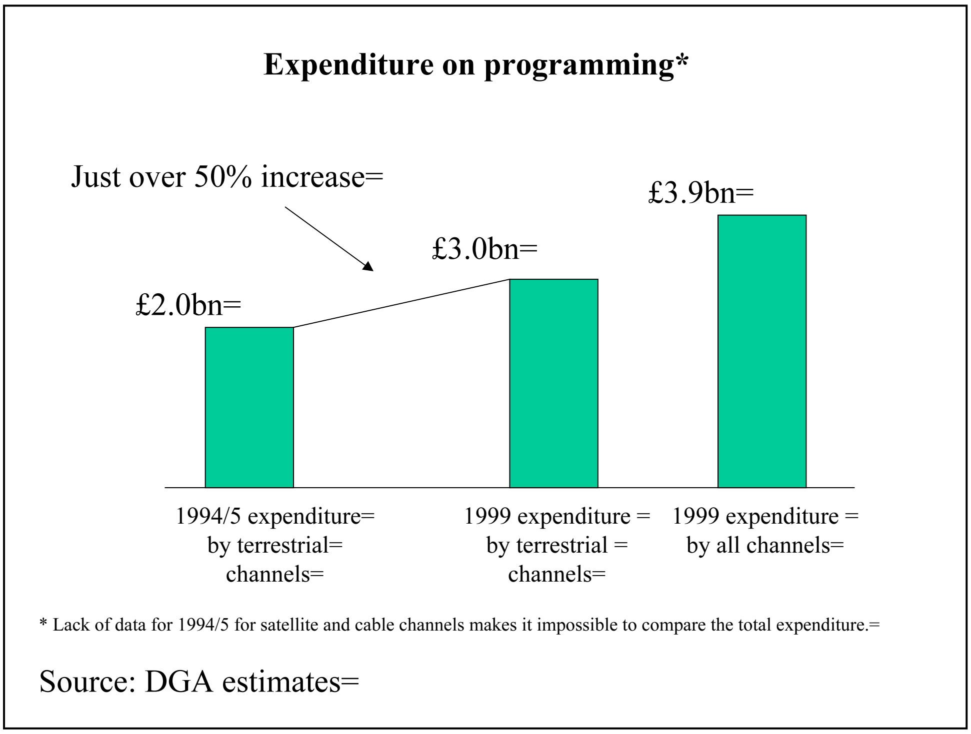
Expenditure on Programming

4.2.3 In 1994/95, we estimated that the UK terrestrial TV industry spent about £2.0 million on programming. Our analysis for 1999 shows that this figure rose to just over £3.0bn for the terrestrial channels (Figure 23 below). The non-terrestrial channels added another £800-£900m.

4.2.4 The growth rate in programming expenditure for terrestrial channels approximately matches the rate of growth of cash inflows into the industry; emphasising the continuing competitive pressure on the channels to invest in programming to maintain audience share.

4.2.5 The terrestrial channels still account for 77% of total expenditure on programming in the UK—broadly in line with their overall audience share (81.5%).

Figure 23: Expenditure on Programming 1994/95 and 1999

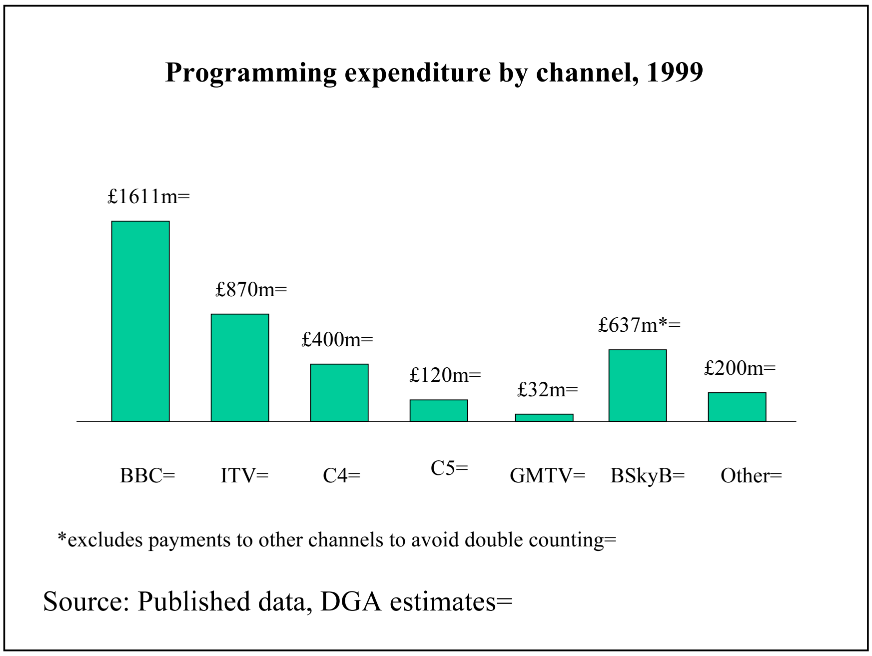


Programming Expenditure By Channel

4.2.6 Figure 24 overleaf breaks down the expenditure on programming by channel. Nearly 42% (£1.6 billion) of programming expenditure comes from the BBC. ITV contributes a further 22% (£870 million) and BSkyB's 16% (£637 million) puts it in third place ahead of Channel 4 (10%) and Channel 5 (3%).[35] Roughly 70% of BSkyB's programming spend is on sports and movies.

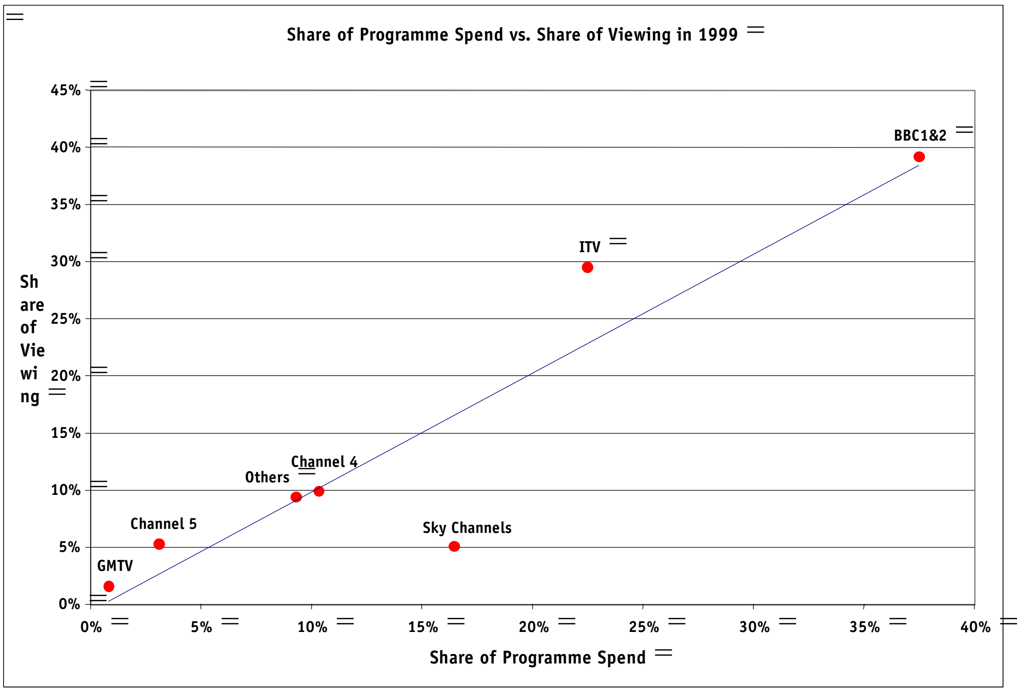
[35] The BBC expenditure figure adds together the sums spent on the two terrestrial and digital UK channels. The ITV figure is taken from submissions to the Competition Commission investigation into the ITV mergers. Channel 4's figure is from its annual report and accounts. The Channel 5 figure is an estimate based on press reports. The GMTV figure is estimated from figures contained in its annual report. The BSkyB figure is taken from its annual report to June 1999. The other figure—primarily satellite and cable channels—is estimated from a wide variety of sources.

Figure 24: Programming Expenditure by Channel 1999



4.2.7 Again, the shares of programme expenditure are broadly in line with the shares of viewing in all homes (Figure 25 below); although BSkyB, which derives over 80% of its income from subscriptions, has used its additional subscription revenue to push programme expenditure significantly above its overall audience share—a strategy that has won it around an 80% share of subscription revenue. While individual programme quality is not necessarily determined by individual programme spend, in general it would appear that boosting programme expenditure remains one of the best ways to attract a larger audience share (whether measured in viewer hours or subscriptions).

Figure 25: Share of Programme Expenditure vs. Share of Audience in 1999

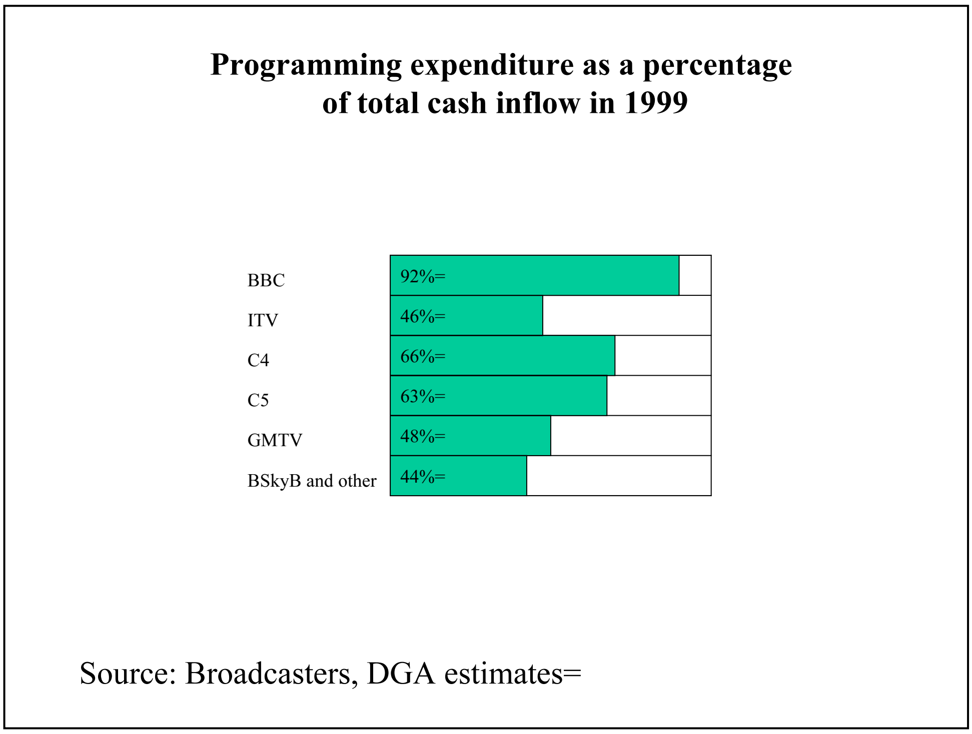


Source: DGA

Programme Expenditure as a Percentage of Total Cash Inflow

4.2.8 The percentage of available cash that is devoted to programming expenditure varies between channels (Figure 26).

Figure 26: Programme Expenditure by Broadcaster as a Percentage of Total Cash Inflow

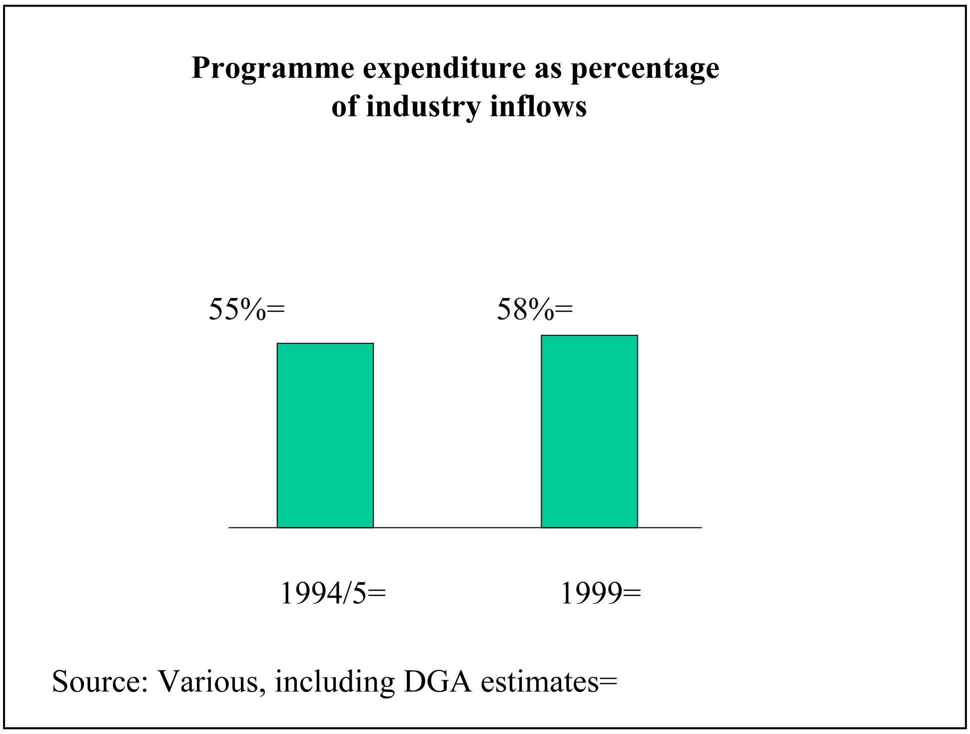


4.2.9 The variations across the broadcasters are partly an accounting artefact; for instance, the BBC applies full costing to its programmes, so that overheads such as transmission costs appear to be included in programme costs. The variations also reflect, though, the different obligations the broadcasters face—including ITC payments, satellite transmission costs, subscriber management centres and other costs which do not fall on the BBC, and which bear less heavily overall on Channel 4 and Channel 5.

Programme Expenditure as a Percentage of Industry Inflows

4.2.10 The evidence suggests a slight rise in the last 4–5 years in the percentage of industry inflows that are spent on programming. This rise is perhaps initially counter-intuitive given that an increasing fraction of industry turnover is derived from multichannel delivery and that, as these delivery systems (DTH, cable and DTT) involve extra costs to serve programming to the customer, they might be expected to have less available to spend on programming.

Figure 27: Programme Expenditure as a Percentage of Industry Inflows 1994/95 and 1999



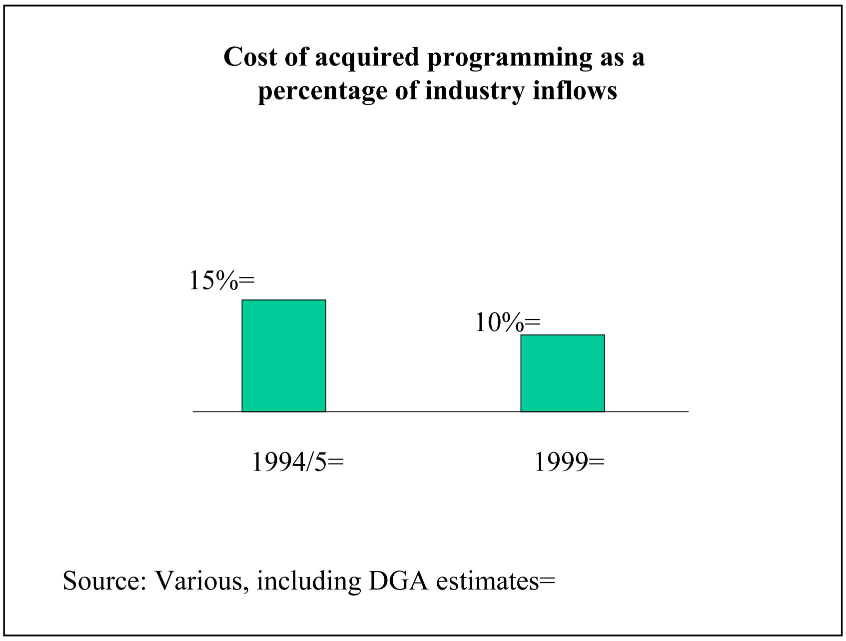
4.2.11 However, we should also note the increasing availability of funds within the commercial terrestrial sector to spend on programming as ITC licence payments are renegotiated and the C4 payment to the ITV companies was withdrawn. Moreover, as already mentioned above, the increased percentage of industry inflows spent on programming probably also indicates the increasing importance attached to programme spend (including on sports and other talent rights) as a means of building and sustaining audience share in an increasingly competitive market.

Cost of Acquired Programming as a Percentage of Industry Inflows

4.2.12 The comparison between 1994/95 and 1999 suggests that the industry as a whole appears to have become less reliant on acquired programming. The causes of this change are reasonably clear. First, the terrestrial channels are making increased use of originated programming. And second, and more significantly, BSkyB's programming spend on acquired films and series has increased at a slower rate than the business' total turnover, while its spend on sports rights has increased much more rapidly than the purchase of foreign programming.[36]

[36] In June 2000, BSkyB agreed to pay £1.1bn to Football Association and Premier League over three years for the right to continue its coverage of live football—representing a 219% per year increase on the previous 4 year deal of £670m.

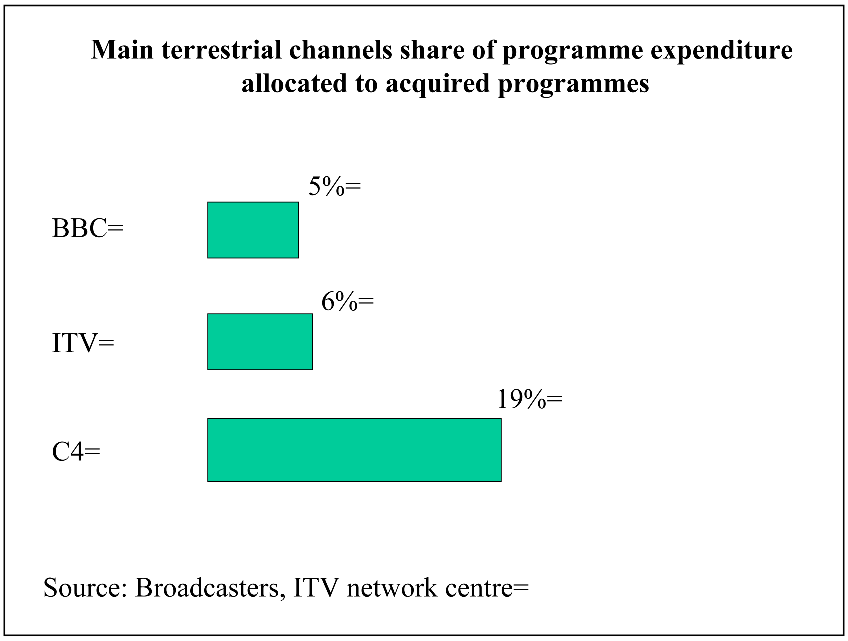
Figure 28: Cost of Acquired Programming as a Percentage of Industry Inflows



Share of Programme Expenditure Allocated to Acquired Programmes

4.2.13 Figure 29 (below) shows that the percentage of industry inflows spent on acquired rather than originated programmes are not evenly spread across all channels. While the BBC and the ITV Network appear to be spending a lower percentage of their income on acquired programming than in 1994/95 (falling from 7% to 5% and 8% to 6% respectively), the proportion of programme expenditure allocated to acquired programming on Channel 4 appears to have increased from 16% to 19%.

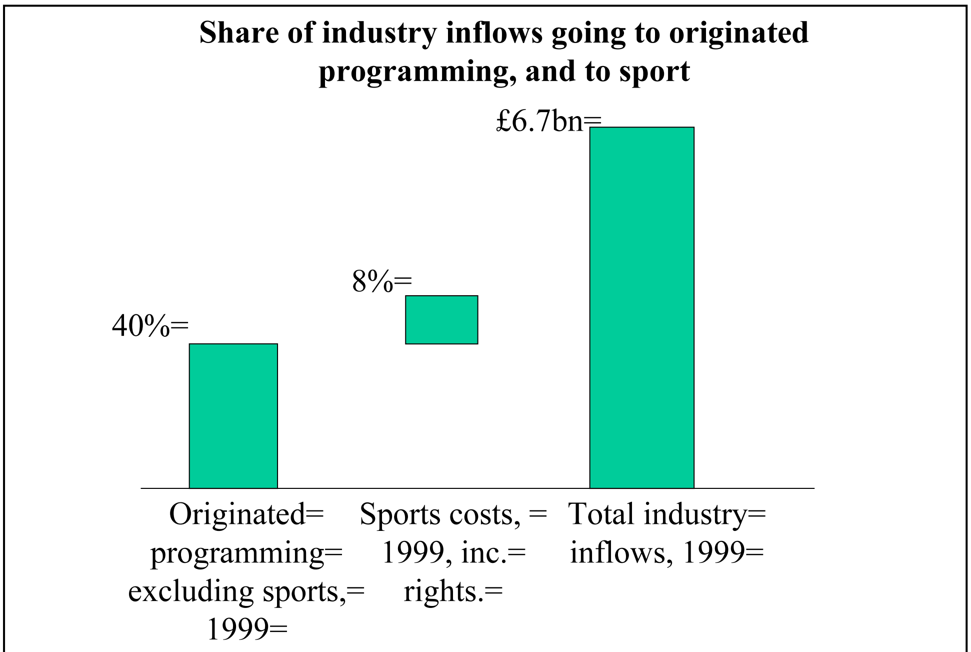
Figure 29: Programme Expenditure Allocated to Acquired Programmes



Share of Industry Inflows to Originated Programming and to Sport

4.2.14 Sports rights costs, which are no less inherently important than other types of originated programming costs, are becoming an important feature of programming budgets—accounting for over 20% of the costs of all other programming in 1999.

Figure 30: Share of Industry Inflows going to Originated Programming and Sport



Source: Primarily broadcaster annual reports, plus DGA estimates

4.2.15 This is primarily because of the well-publicised bidding wars for exclusive and non-exclusive football rights, but also, to a lesser extent, other popular sports such as motor racing, cricket, boxing and rugby (union and league).

4.2.16 The decline in acquired programming costs noted above may partly be a response to the increased costs of securing sports rights.

Independent Production's Share of Total Originated Expenditure on Programming

4.2.17 We estimate that the total expenditure on independent programming by all UK broadcasters (terrestrial and non-terrestrial) was around £750m in 1999[37]—representing 23.5% of the total spend on originated programming and an increase of 37% on the figure of £550m for 1994/95. This rate of increase is slower than the growth in total programming expenditure over the same period.

[37] This figure is also drawn from a number of different sources, including the broadcasters themselves. We are broadly confident that the figure is correct to within 5%.

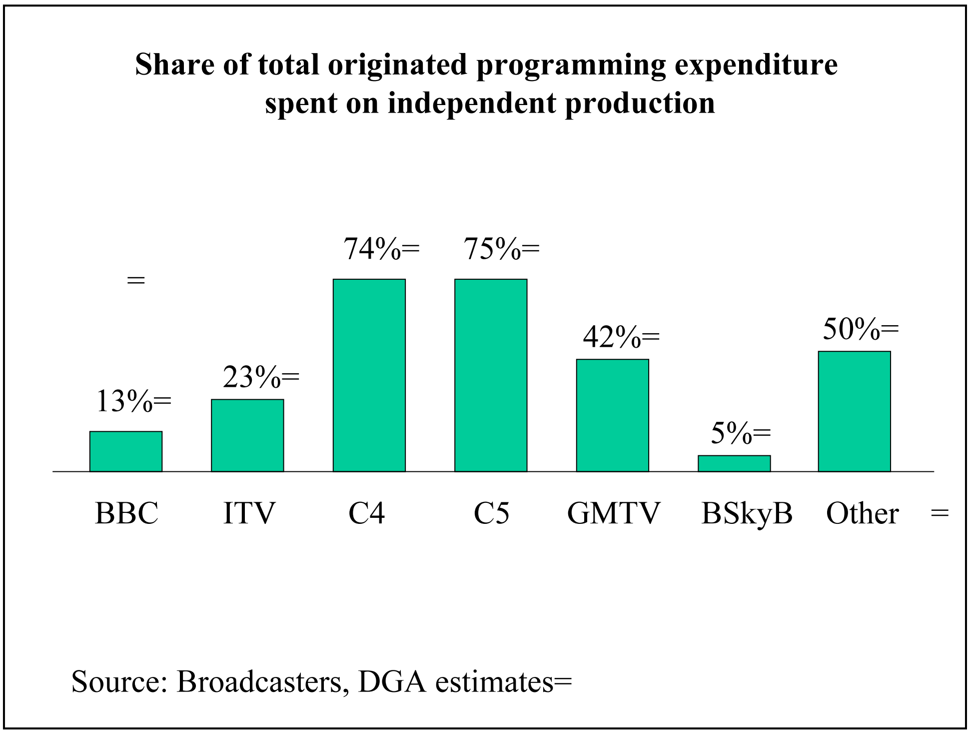
Share of Total Originated Programming Expenditure Spent on Independent Production

4.2.19 As shown in Figure 33 (overleaf) Channel 4 and Channel 5 devote around three quarters of their originated programming expenditure to independent producers—although a considerable proportion of Channel 5's expenditure was on programmes produced by Pearson Television, one of the principal shareholders in the channel and which, by increasing its shareholding in the channel this year, has recently sacrificed its status as an independent producer.

4.2.20 The BBC's implied share (13%) is probably held down by its practice of fully costing programmes, and including items of overhead that might be separated in the ITV accounts.

4.2.21 The low figure for BSkyB (5%) reflects the relatively small proportion of non-sport originated programming spend in the context of high spending on originated programming linked to sports rights.

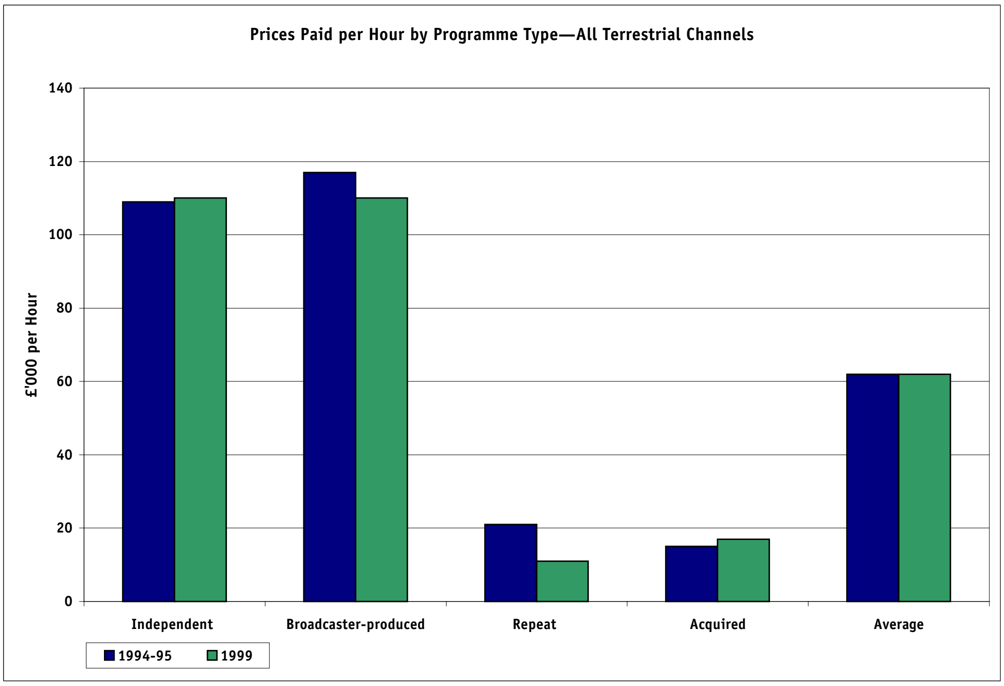
Figure 33: Share of Total Originated Programming Expenditure Spent on Independent Production by the Broadcasters in 1999



Prices Paid for Programmes

4.2.22 On the basis of our analysis summarised in Figure 34 overleaf, we estimate that the average price per hour paid across all programmes by the terrestrial channels remained constant at around £62,000 per hour between 1994/95 and 1999.

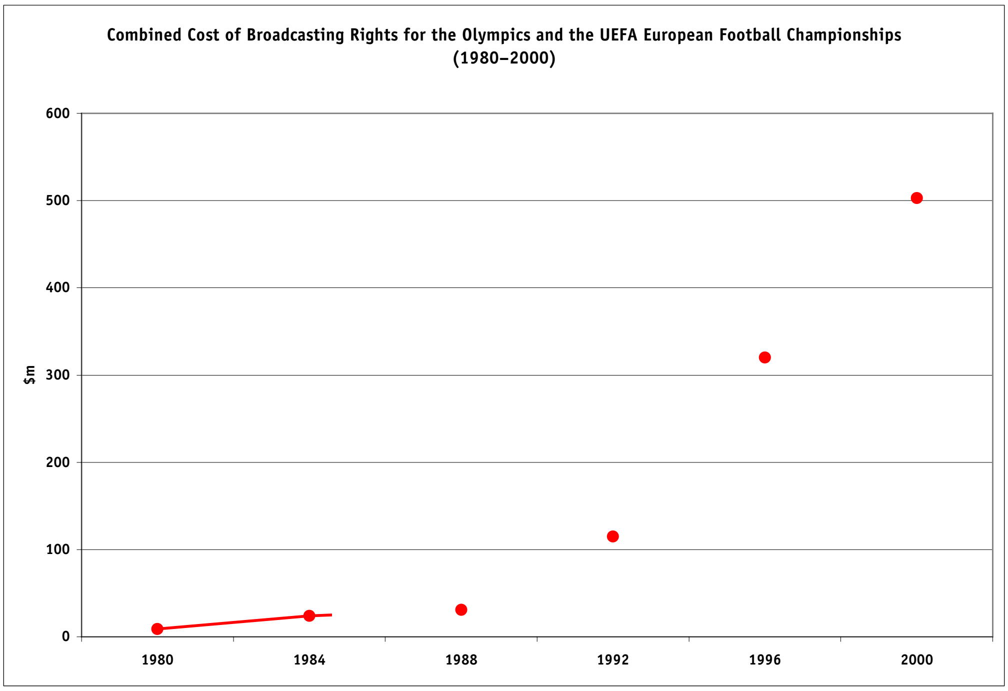
Figure 34: Average Prices Paid per Hour by Programme Type 1994/95 and 1999



Source: Chris Goodall & Co/ DGA

4.2.23 However, the apparent overall stability conflates more complex underlying movements: with Channel 5's relatively small programming budget, the growth in the number of relatively cheap transmissions during the day and overnight as the industry has fully embraced 24 hour broadcasting and the increased use in peaktime of cheaper reality and lifestyle series counterbalancing the upward pressure on the prices of programmes dependent upon sports rights and on-screen performing and presenting talent and on premium US drama and comedy series.

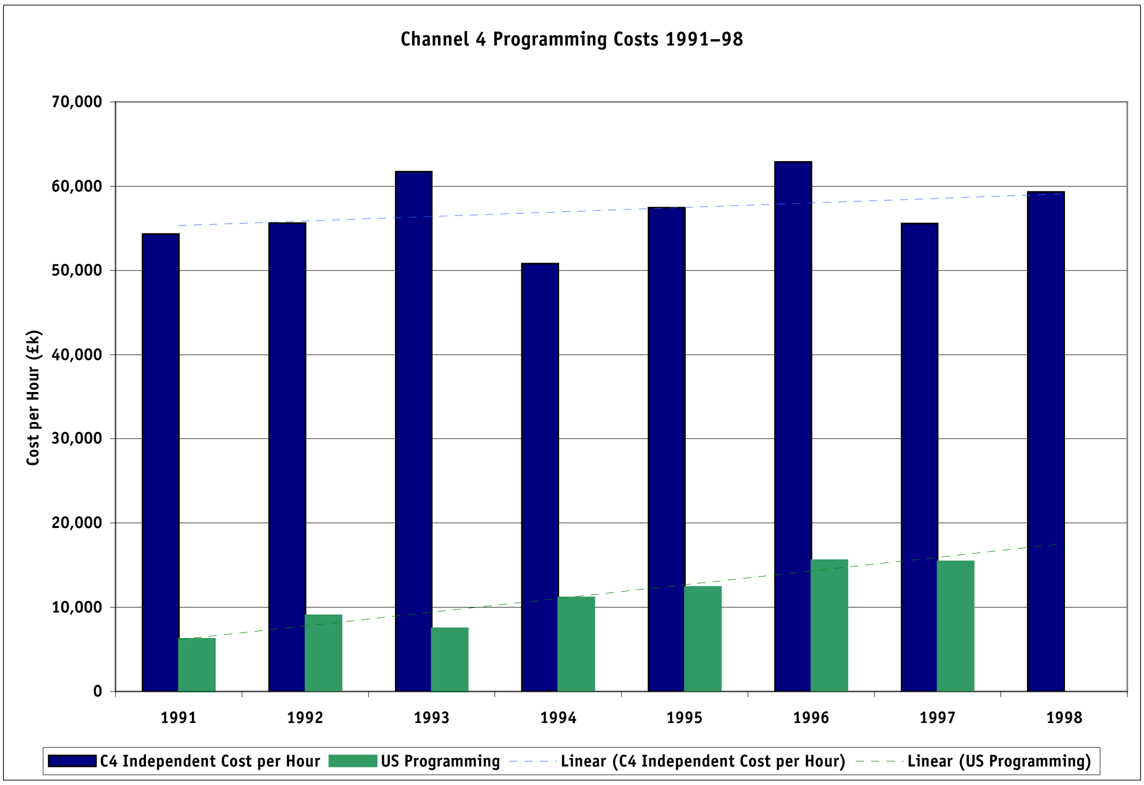
Figure 35: Increasing Sports' Rights Costs



Source: European Audiovisual Observatory

4.2.24 Within the average, broadcaster-produced material fell from £117,000 to £110,000. Independently produced material increased in cost very slightly. Although independent producers are responsible for a large number of low-cost hours, they also make some of the material that attracts the highest prices. Repeat prices fell, as fewer hours of programming involving heavy residual or repeat fees were used. Acquired prices rose, reflecting, as noted above, the increased competition for sports rights and some US drama and comedy series.

Figure 36: Average Cost per Hour of Independent Productions and US Series for Channel 4 1991–98



Source: Channel 4 Report & Accounts

Summary

4.2.25 The analysis in this chapter has revealed the following trends:

- The programme supply industry is expanding rapidly, with expenditure on programming by the terrestrial channels having grown by around £1 billion since 1994/95. Moreover the non-terrestrial channels account for a further £900 million.
- Programme expenditure as a percentage of industry inflows appears to have increased from 55% to 58%
- The BBC continues to be responsible for a substantial proportion of' programme expenditure—over 40% in 1999.'
- The programming spend on the independent production sector has grown substantially from £550 million to £750 million between 1994/95 and 1999,

but at a slower rate than the overall growth in programme expenditure (37% versus 50%).

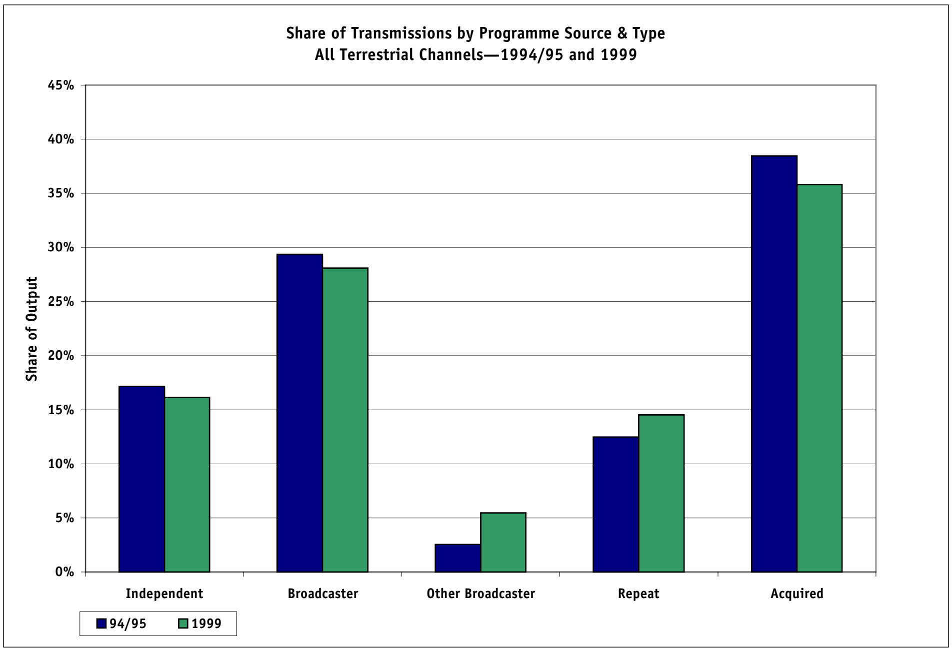
- The proportion of programme expenditure on acquired programming has declined from around 15% in 1994/95 to 10% in 1999.
- The broadcasting function is waning—there may be early signs of a shift towards “factory” type intensive long-run programming becoming concentrated in-house as the broadcasters seek to maximise the utilisation of their fixed asset bases (for example, the recent commissioning of two new daytime soaps in-house by ITV) and the talent/format based ideas that command a higher premium moving to become more the preserve of the independent sector.

4.3.3 First run originated production, which has increased from 13,000 to 19,300 hours, accounts for 49.7% of transmissions (versus 49.1% in 1994/95). Within this figure, independent production has grown 38% to just under 6,300 hours while the broadcasters' own in-house production has grown 41% to just under 11,000 hours. The use of other broadcaster production units has increased by over 200% to 2,100 hours, partly as a result of the acquisition of independent producers (such as Planet 24 by Carlton) and of strategic decisions on the part of the ITV licensees to allow their in-house production teams to produce for Channel 5 and the BBC (with notable successes, such as *The Royle Family*).

4.3.4 Total transmissions of Acquired programming have increased by 37% to just under 14,000 hours, while repeats have increased by 60% to just under 5,700 hours.

4.3.5 As shown in Figure 38 (below), as a percentage of total transmissions independent material has decreased slightly from 17% to 16% since 1994/95 while the total share of production by broadcasters (for their own and other channels) has increased by 32% to 33%. Acquired programming has fallen from 38% to 36% and repeats have increased from 12 to 15%.

Figure 38: Share of Transmissions in 1994/95 and 1999—All Terrestrial Channels

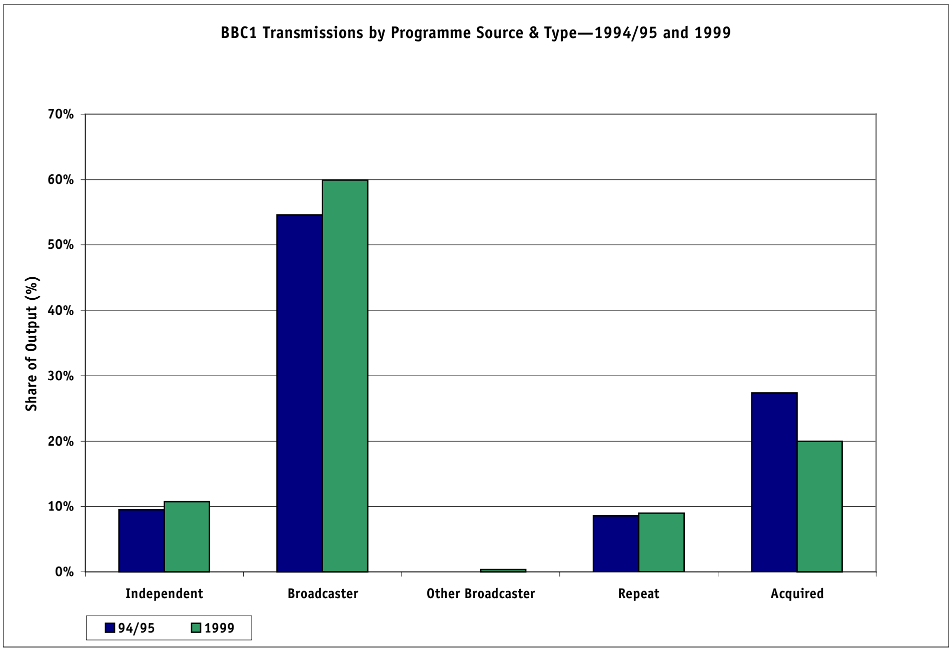


Source: DGA and Chris Goodall

4.3.6 Overall then, it would appear that the broad pattern of transmissions by source across the terrestrial channels has been relatively undisturbed by the move to 24 hour broadcasting, the launch of Channel 5 and the increased share of audience secured by the non-terrestrial channels; perhaps reflecting the fact that both net advertising revenue accruing to the commercial channels and BBC licence fee receipts have grown over the period.

4.3.7 The transmission patterns on the individual channels clarify the underlying trends. BBC1's output pattern (Figure 39) is dominated by newly originated material produced in-house, which now accounts for 60% of transmissions. Independent productions have also gained share slightly from 9% to 11% since 1994/95, but the amount of acquired programming shown has decreased substantially from 27% to 20%.

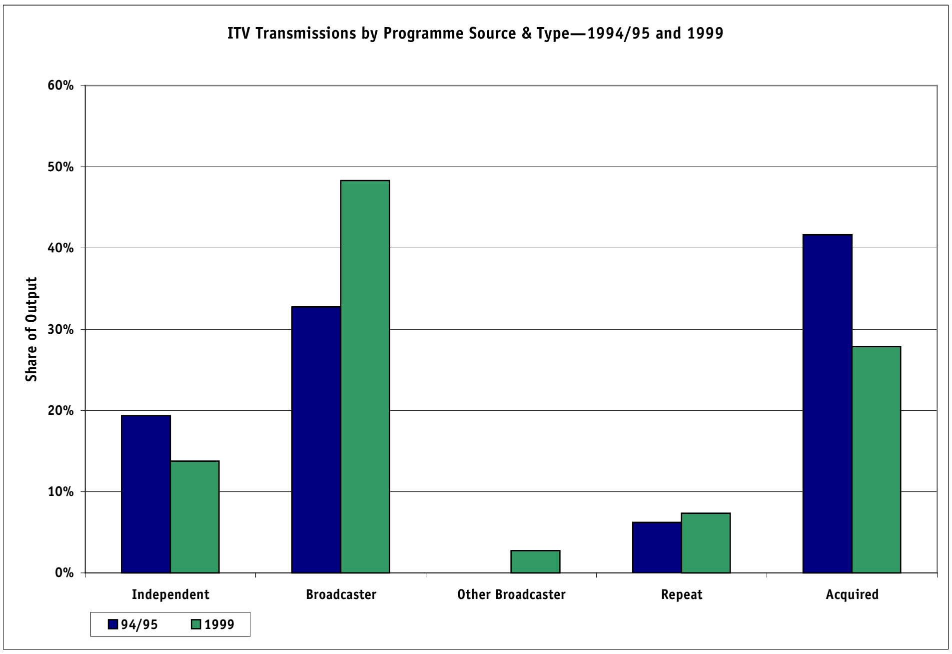
Figure 39: Share of Transmissions in 1994/95 and 1999—BBC1



Source: DGA and Chris Goodall

4.3.8 The in-house production units of the ITV licensees have also significantly increased their share of ITV transmissions since 1994/95, boosting their share from 33% to 48%, partly at the expense of independent producers whose share of transmissions has fallen from 19% to 14%. Again, as with BBC1, there has been a clear shift away from acquired programming, which has fallen from 42% to 28%.

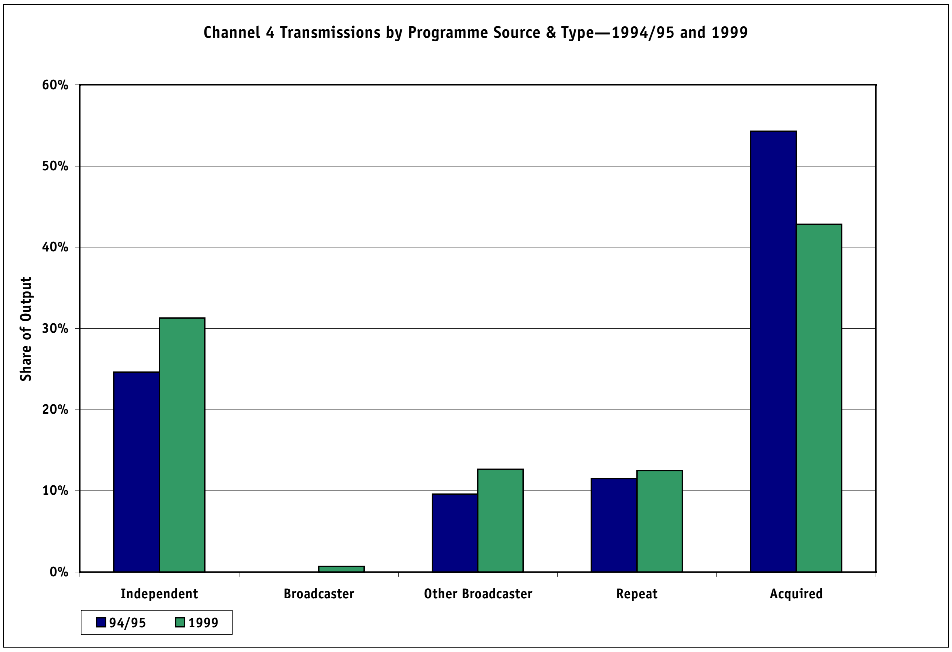
Figure 40: Share of Transmissions in 1994/95 and 1999—ITV



Source: DGA and Chris Goodall

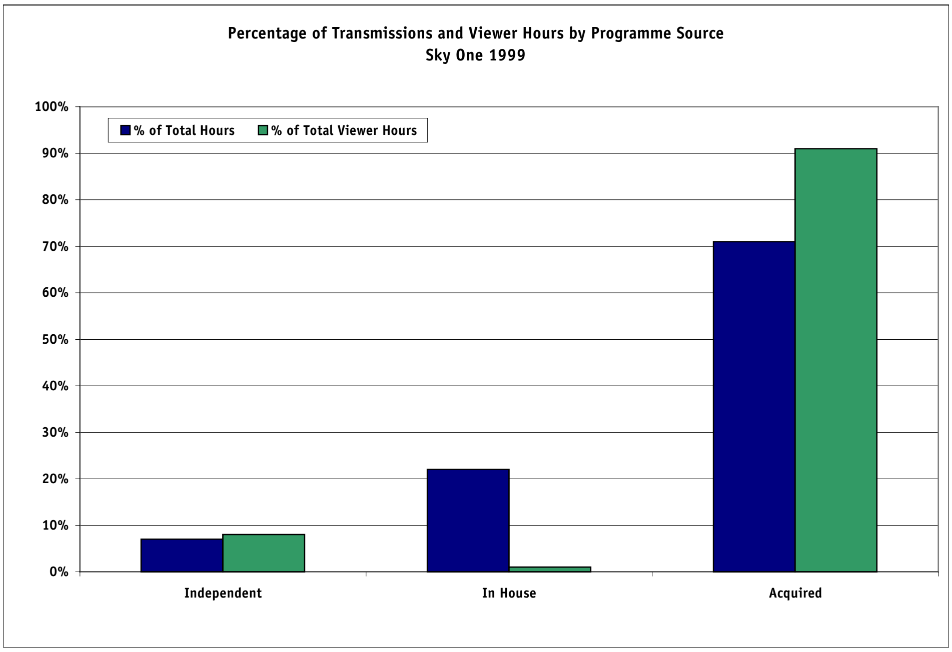
terrestrial channels (such as Harry Enfield and David Baddiel) succeeds in drawing larger audiences to the channel.

Figure 42: Share of Transmissions in 1994/95 and 1999—Channel 4



Source: DGA and Chris Goodall

Figure 43: Share of Hours and Viewer Hours by Programme Source in 1999—Sky One



Source: DGA and Chris Goodall

4.3.14 Independent producers and the terrestrial broadcasters will also be watching closely the success of a new batch of sit-coms airing on Sky One in 2000/01. Sky has shown a greater willingness to commission longer series runs (including the 22-part series starring Al Murray, *Time Gentlemen Please*) than the terrestrial channels, and will be keen to secure a terrestrial window to help offset the added risk and to help attract new audiences to the channel for a hoped-for second series. If Sky One can succeed with one or more of the new crop of shows it could well spark a significant new dynamic in the originated production market, and strengthen the competition for top quality comedy and drama talent.

4.3.15 Within the timescale available for the Inquiry, we have not been able to carry out the detailed analysis of the programme type and source across all of the non-terrestrial channels. However, there are a few global observations that can be made about patterns in transmission hours.

4.3.16 First, and most obviously, as illustrated in Figure 44 below, the total hours of transmissions to multichannel homes far outweighs those to terrestrial-only homes—even with the limited selection of channels included in the analysis the figure is four times greater (172,000 hours) than that of the terrestrial channels combined.

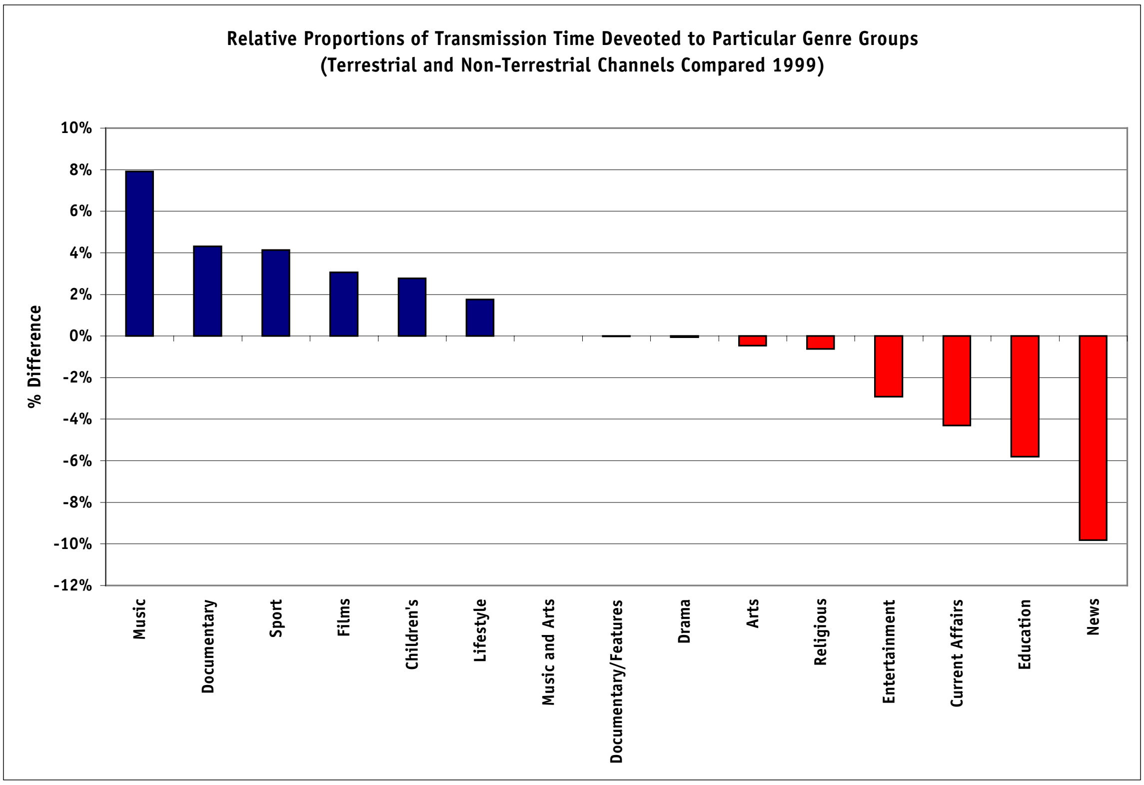
Figure 44: Hours of Transmissions in 1999—Analogue Multichannels Only

Genre	Films	Sport	Documentary/ Features	Children's	Entertainment	Drama	Music	Lifestyle	News	Current Affairs	Filler	Music and Arts	Arts	Religious	Education	Grand Total
Animal Planet			3,726	147		40					6					3,919
Bloomberg TV								92	498	24						614
Bravo	1,471	121	653	3	381	547		44	11		40					3,270
Cartoon Network	38			5,857	41						1					5,937
Challenge TV					3,873			3			11					3,887
Comp.tv			24					571		16						611
Discovery			3,068		69			178		3						3,317
Eurosport		5,875														5,875
Film 4	3,499	51	100		9	196					53	12	52			3,972
Fox Kids	58			3,751		93					6					3,908
Granada Breeze			307		760	21		2,852		73	25					4,037
Granada Men and Motors		201	29		125		13	609			1					977
Granada Plus	36		26	2	1,308	4,073	21	158			20					5,642
Home/Liesure		8	471		60			2,720			1				20	3,280
MTV	5		58		201		6,660	1,088				56	1			8,068
National Geographic			2,067								1					2,068
Nickelodeon				3,546	390						109					4,045
Nickelodeon Junior				405												405
Paramount	190		10	38	2,653		12				14					2,918
Rapture TV		15	10	28	339		12	65				6	14			490
Science Fiction Channel	1,324		670	20	35	4,294			108		215		36			6,702
Sky Movie Gold	4,682		102		2	3							18			4,807
Sky Movies	6,449		191		13	10			12				4			6,679
Sky News			5					567	6,485	948						8,005
Sky One	47	153	548	711	2,475	2,151	1,645	25			84			50		7,888
Sky Soap						523										523
Sky Sports 1		7,239	29						91							7,360
Sky Sport 2		7,397	3						14							7,415
Sky Sports 3		4,156	127						6							4,289
Sky Travel			157					969			28					1,154
The Disney Channel	1,047		25	3,420	881	263					23		6			5,664
The History Channel			2,533								1					2,534
The Movie Channel	6,875		111		125	21							1			7,132
TNT	2,069	220	67	1	8	125	21				5		3			2,518
Trouble			121	1,339	1,637	750	113	52			1	3				4,016
UK Gold	326				1,582	4,661	10									6,579
UK Horizons	2		5,042	17	118	14		345	95	289	6	1	4		4	5,937
UK Living	744		862	593	1,908	883	1	652	60	130	24	3				5,860
VH1	17		19		84		7,358	209				403				8,089
Grand Total	28,877	25,436	21,161	19,875	19,079	18,668	15,865	11,196	7,380	1,483	674	484	139	50	24	170,390

Source: DGA

4.3.17 Second, there is a clear difference in the overall mix of genres transmitted on the terrestrial and non-terrestrial channels. Figure 45 depicts the divergences in relative shares of transmissions devoted to each genre by subtracting the percentage figure for a particular genre for the terrestrial channels combined from the genre's equivalent share on the non-terrestrial channels. A greater proportion of multichannel output is devoted to Music, Popular Documentaries, Sport, Films, Children's and Lifestyle programming, and less is devoted to Arts, Religious, Entertainment, Current Affairs, Education and News.

Figure 45: Relative Proportions of Transmission Time Devoted to Different Genre Groups—1999



Source: DGA

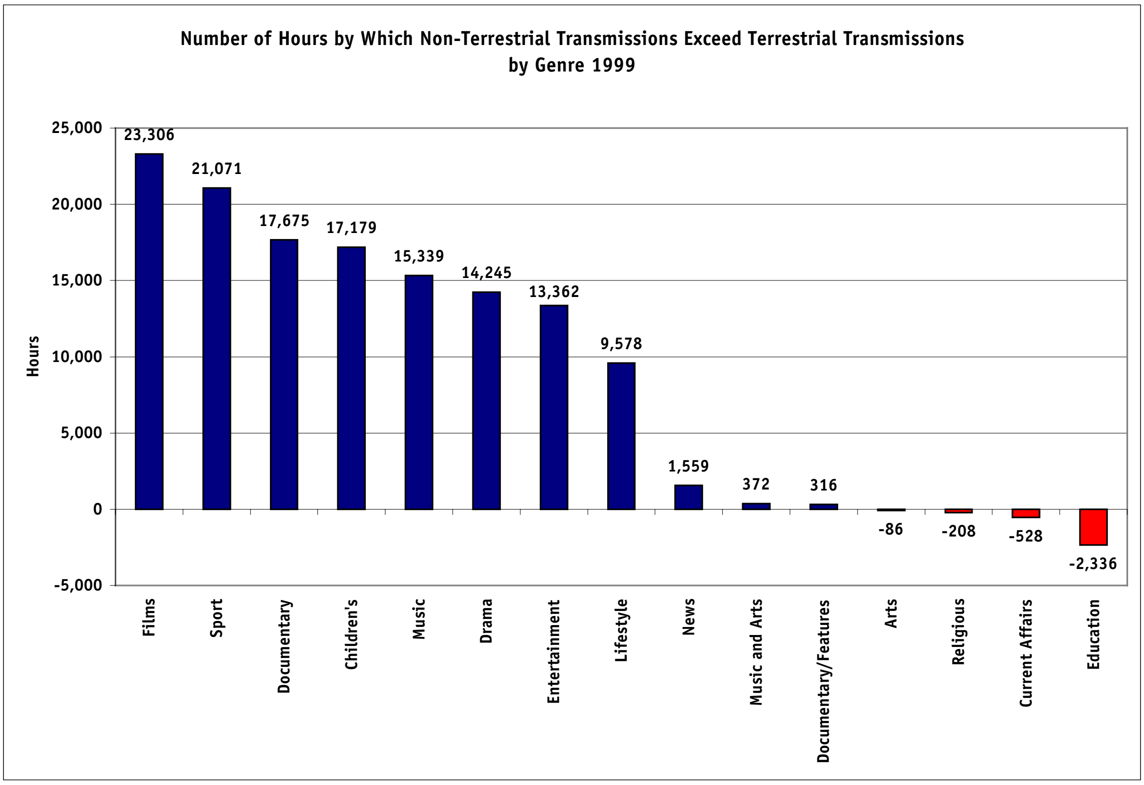
Figure 46: Hours of Transmissions on Analogue Non-Terrestrial Channels by Genre in 1999

Genre	Non-Terrestrial Hours	% of Total
Films	28,878	**16.8%**
Sport	25,389	**14.8%**
Children's	21,021	**12.2%**
Entertainment	19,041	**11.1%**
Documentary	20,851	**12.1%**
Drama	18,681	**10.9%**
Music	15,873	**9.2%**
Lifestyle	11,608	**6.7%**
News	7,260	**4.2%**
Current Affairs	1,599	**0.9%**
Education	24	**0.0%**
Music and Arts	484	**0.3%**
Documentary/Features	427	**0.2%**
Arts	139	**0.1%**
Religious	62	**0.0%**
Total	**172,031**	**100.0%**

Source: DGA

4.3.18 Finally, as illustrated in Figure 45, it can be seen that the extra volume of transmission hours available in multichannel homes does not, in itself, guarantee a greater volume of transmission hours in all genres.

Figure 47: Non-Terrestrial vs. Terrestrial Transmission Hours by Genre in 1999



Source: DGA

4.3.19 However, in interpreting the figures presented here it is important to emphasise that the analysis only includes the channels available in analogue multichannel homes. Given the limited number of channels available—albeit far greater than in terrestrial only homes—and the comparative lack of positive programming requirements on those channels, it is perhaps not surprising therefore that the genre mix should skew towards the more obviously commercial end of the programming spectrum. As more and more channels become available in digital satellite and cable homes, there will be greater opportunities and incentives for new, niche/thematic channels to experiment with the less obviously commercial—but not necessarily non-commercial—genres of programming such as Arts, Religious and Education genres that have not yet been able to push their way through the channel congestion in analogue multichannel homes.

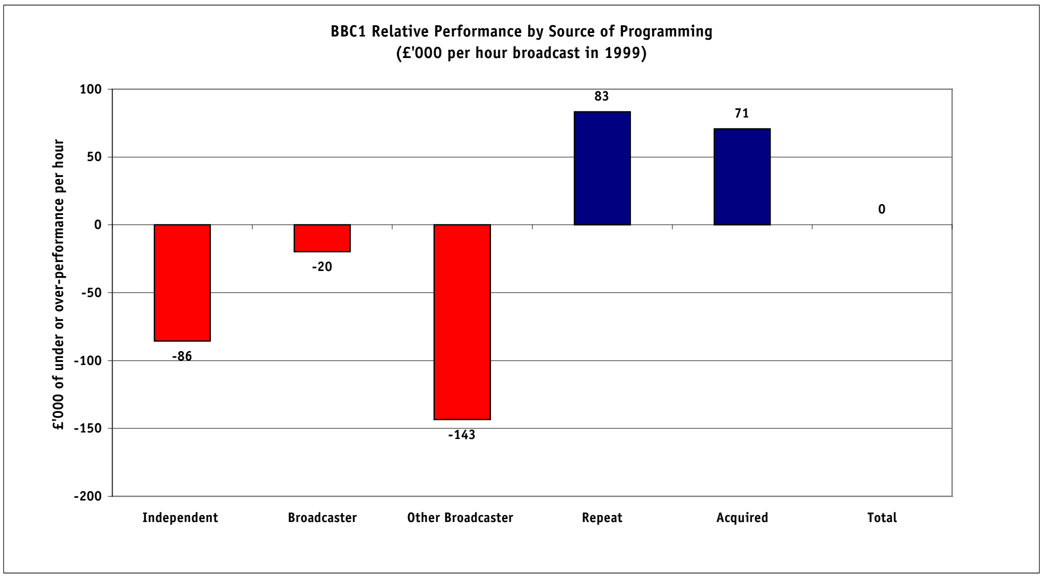
Summary

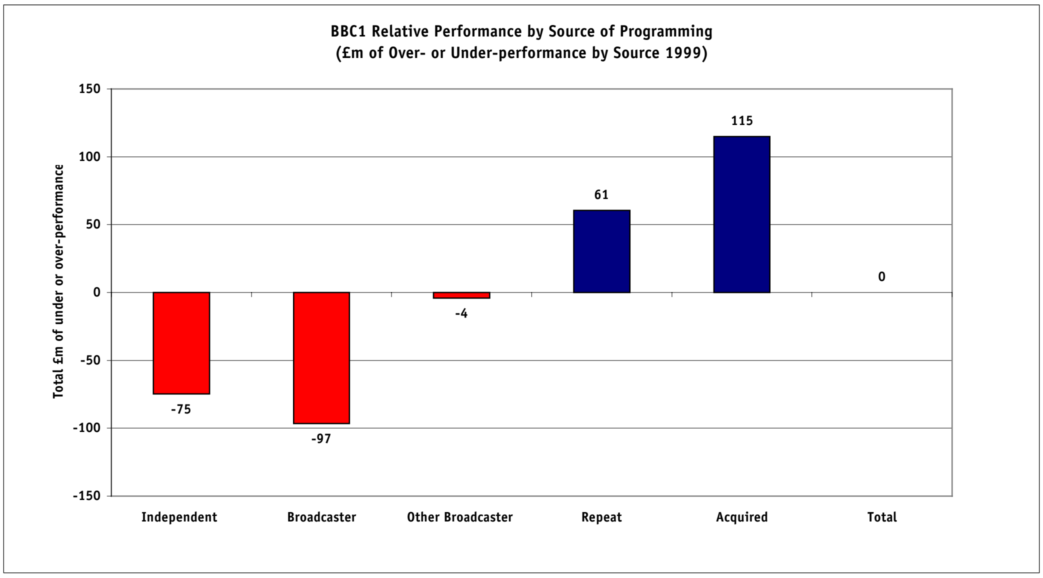
4.3.20 The analysis in this section has revealed the following trends:

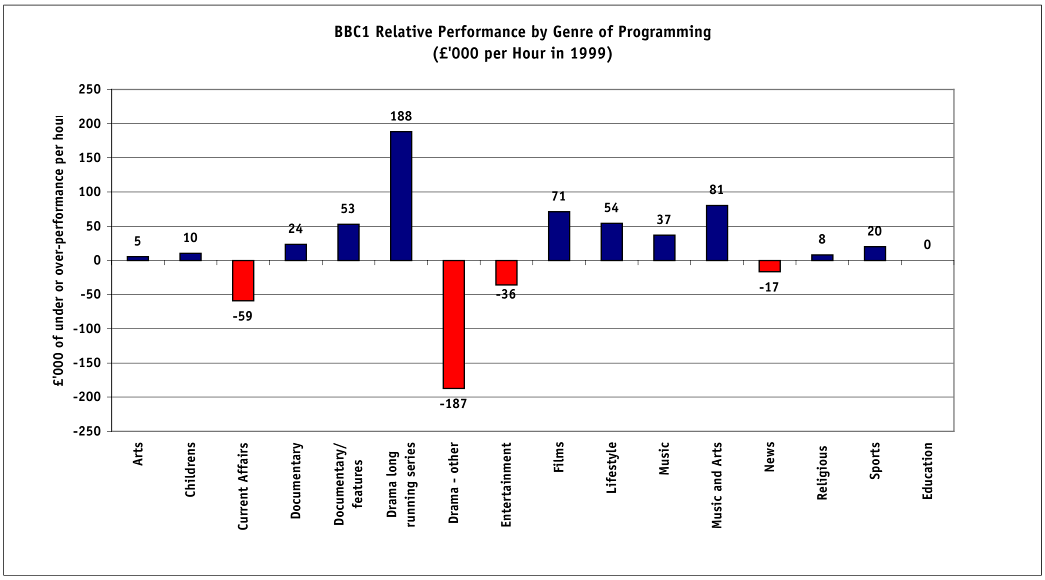
- While hours of output have increased from all sources, the terrestrial broadcasters have increased their share of output and their use of repeats at the expense of acquired programmes.
- With the exception of Channel 4, independent producers are ceding share of output to the broadcasters' production units. However, while the sector's share of total transmissions is declining, the overall growth of the market has, thus far, more than offset this—so that the total volume of hours being produced by the independent sector has continued to expand.

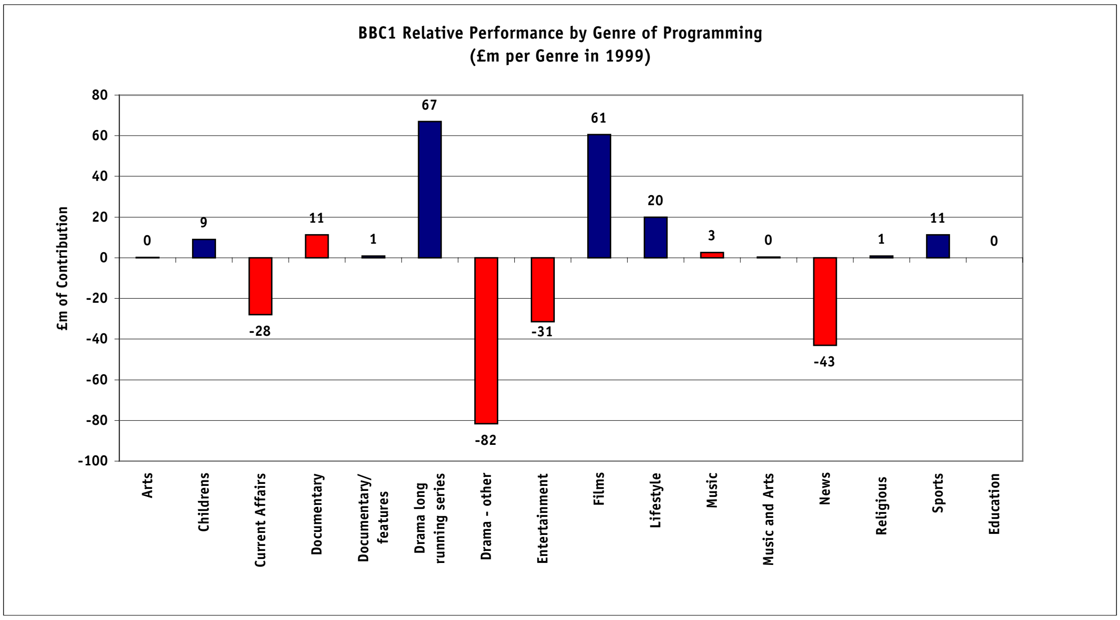
- The genre mix across the cable and satellite channels as a whole is significantly different to that of the terrestrial channels, partly reflecting from the disparity in positive programming requirements between the channels. The genre mix is skewed towards the more obviously commercial end of the spectrum—to such a degree that there are, for example, fewer hours of religious programming across the analogue cable and satellite channels than across the five terrestrial channels.
- In an ideal world, you would want all genres to earn a commercial return. The freeing up of more channel space following, say digital switchover, would open up more opportunities for genres to be creatively reinvented and to become profitable—indeed this may be one of the underlying reasons why the BBC is launching, for example, BBC Knowledge—rather than simply being made and scheduled in a rather perfunctory way, in the possibly misguided belief that it is inevitably “market failure” programming.

Figure 48: BBC1 Relative Performance by Source of Programming 1999









Source: DGA and Chris Goodall

BBC1 Summary

4.4.6 Acquired programming makes the largest net contribution (£115m) for BBC1.

4.4.7 Repeated programming does significantly better than five years ago, generating a positive contribution of (£61m).

4.4.8 The BBC's own productions "lose" almost -£100m on first transmission and independent productions "lose" -£75m—i.e. both generate a lower share of audience on first transmission than their share of total programme spend. It is important to note that some of the contribution made by repeats actually represents a contribution from the second (and further) transmission(s) of previously originated programming.

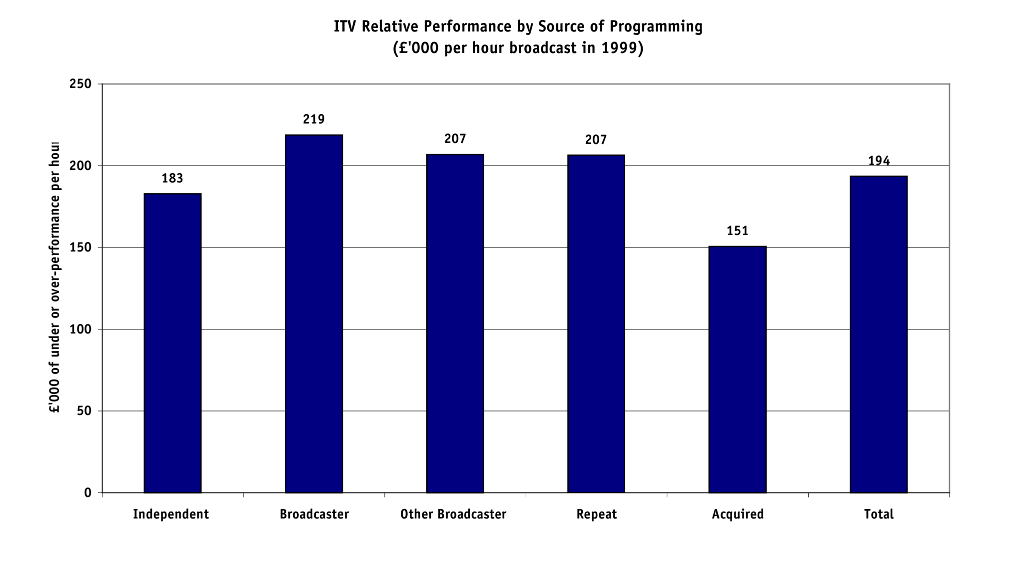
4.4.9 In total, originated programming makes a negative contribution of -£176m.

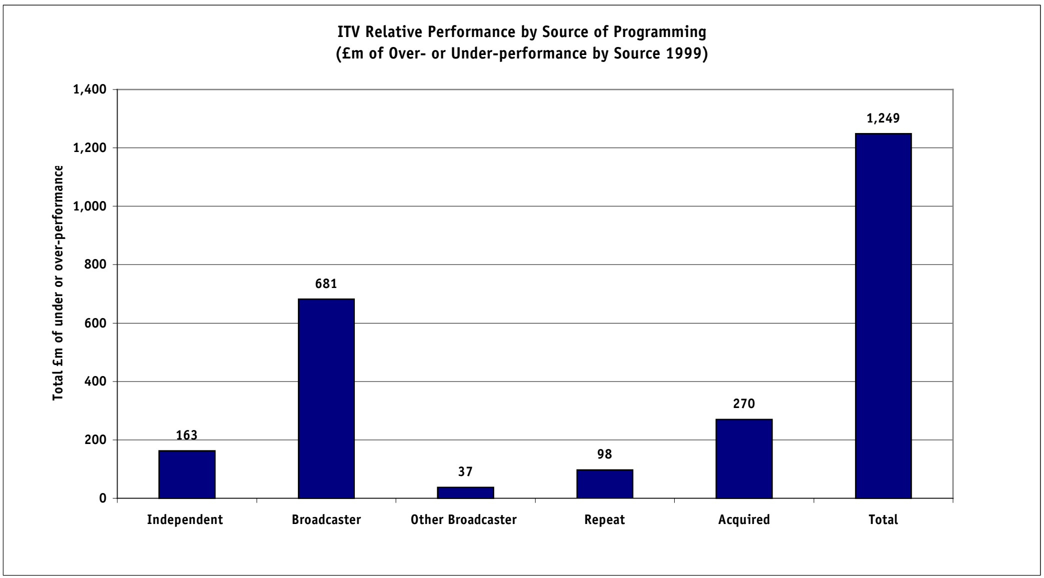
4.4.10 The most successful genres for BBC1 are the Soaps (Drama–long running series), Films and Lifestyle programming, which contribute £67m, £61m and £20m respectively.

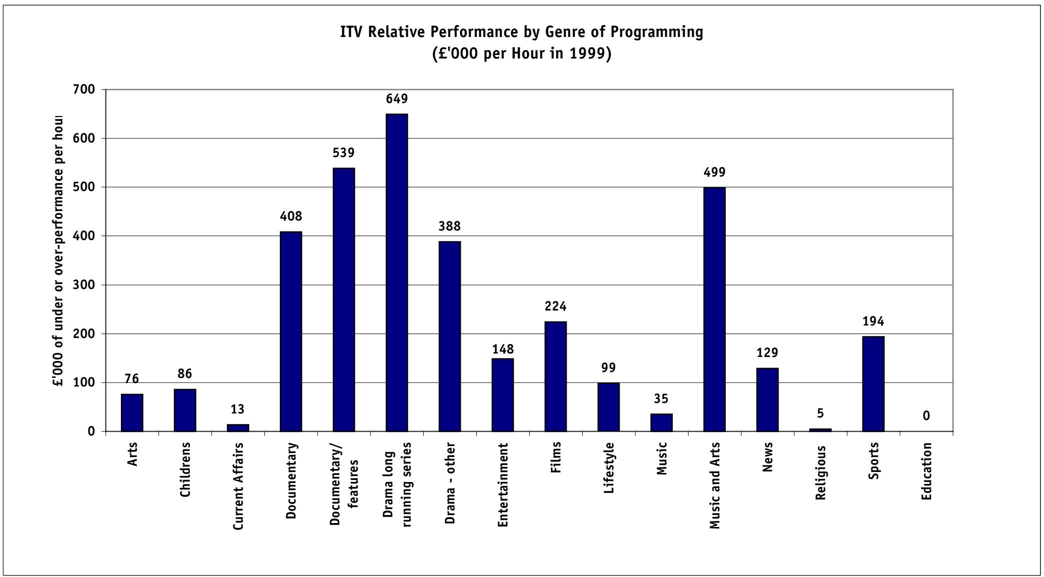
4.4.11 The largest negative contributions on BBC1 are from Other Drama (-£82m), News (-£43m) and Entertainment (-£31m).

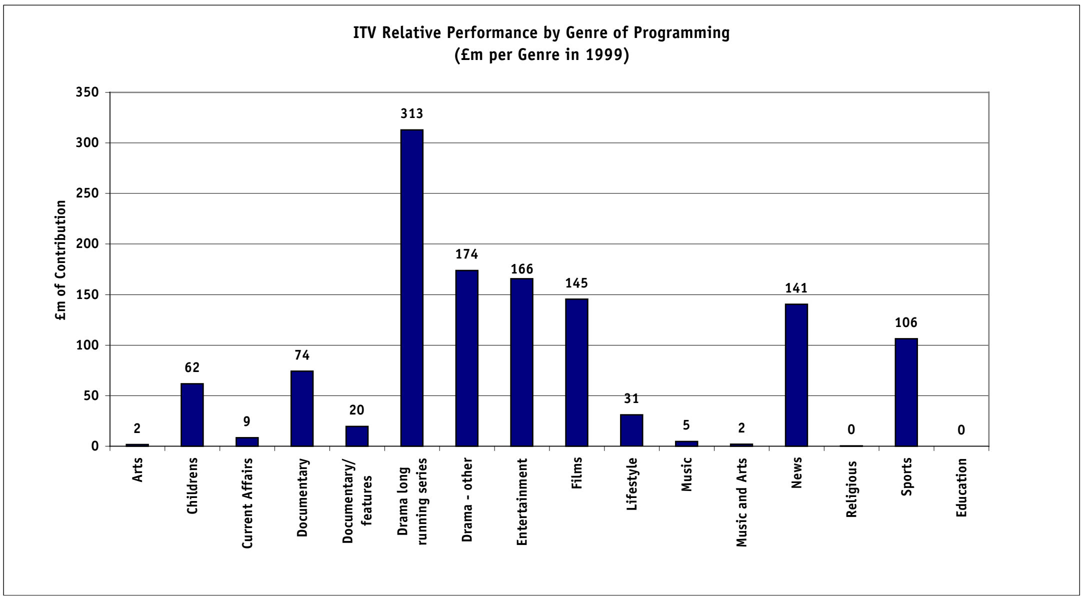
4.4.12 The most improved genre since 1994/95 is Children's programming: the biggest deterioration has been in News programming (though this may well be an artificial consequence of the different cost structures associated with the transmission of BBC News 24 programming overnight).

Figure 50: ITV Relative Performance by Source of Programming in 1999









Source: DGA and Chris Goodall

ITV Summary

4.4.17 Strikingly, in contrast to each of the other channels, every source of programming makes a positive contribution for ITV—reflecting the fact that ITV's total revenue from advertising and sponsorship is several times greater than its programming budget. This suggests that the underlying economics of ITV as the prime mass audience commercial channel remain strong despite its declining audience share. The extent to which ITV will be able to sustain this premium is uncertain, but the channel still retains considerable room for manoeuvre with its programming budget to respond to competitive encroachment by other channels and/or a decline in advertiser confidence.

4.4.18 The positive contribution per hour from originated programming is, on average, greater than that from repeated and acquired programming. This represents a significant change from 1994/95. Then acquired programming accounted for almost half the global contribution: now, it contributes just over 20%. New in-house produced programming accounted for over 50% of the total contribution in 1999, compared to 25% in 1994/95.

4.4.19 In 1994/95, Children's and Current Affairs programming made negative contributions but, by 1999, all the main genre groups recorded a positive margin. Soaps also generate a strong contribution for ITV, though Documentary/Features do surprisingly well on a per hour basis. Arts programming of all types achieves respectable results, but Current Affairs and Religion lag behind. Lifestyle programming, which does well on BBC1, achieves relatively poor results on ITV.

4.4.20 The highest total contributions on ITV are made by Soaps, Other Drama and Entertainment. This is in considerable contrast to BBC1, on which only Soaps make a positive contribution. The performance of Art and Music programming is less good, but the number of hours shown is small. Children's programming again provides the greatest improvement in contribution since 1994/95: the biggest deterioration has been in the Films genre.

£475m on revenue of just over £4bn. Broadcasters make a further margin of £115m on the distribution of programmes and related activities, in contrast to a figure of about £29m earned by non-broadcasters.

The 1996 report was widely seen as criticising the small share of the total margin in the broadcasting industry that accrued to the producers of programming.

Industry Profits

4.5.4 While in 1999, the biggest publicly-held media groups still controlled much of the profit within the industry,[42] it is no longer possible to assert that a disproportionate amount of the economic rent within television is controlled by those with control over broadcasting as opposed to production or distribution.

Figure 54: Sales and Operating Profits of the Major ITV Licensees

Company	Division	Sales	Operating profit
Granada	Media Group	£998m	£275m
Carlton	Media	£859m	£176m
United News & Media	Broadcasting/Entertainment	£562m	£60m

Source: Chris Goodall Analysis of published Accounts

4.5.5 An examination of industry profits for the last year shows that although United, Granada and Carlton made an operating profit of about 21% of turnover in their TV divisions, up from about 19% in 1996, other broadcasters reported significant losses (the Carlton figure is for 1997, not 1996). Channel 5 made an operating loss of £15m in 1999. BSkyB and NTL's investments in digital distribution were at least partly responsible for these companies making losses on broadcasting activities in 1999.

4.5.6 So although holding an ITV licence may still be regarded as a valuable asset, broadcasting *per se* no longer dominates the television value chain to the extent that it did. The main reasons are as follows:

a. Broadcasters face increased competition. Not only has satellite, cable and digital access grown substantially, but Channel 5 now provides increased terrestrial competition. While there was real "spectrum scarcity", the broadcasters—who controlled the key bottleneck, access to the airwaves—could capture a disproportionate return. This is no longer the case to the same degree as in 1995.

b. Producers increasingly have access to foreign markets for sales and finance. The stranglehold exercised by UK terrestrial broadcasters over producers is no longer as powerful.[43] Producers, particularly independent

[42] Please note that the divisions of the three companies contain activities that are not strictly television related, such as consumer books within Carlton. Furthermore, some of the operating return shown here would have derived from programme production, not broadcasting.

[43] The Director General of Fair Trading has considered various complaints by producers under the terms of the Competition Act 1998, but, to date, has found infringements of the Act or areas of particular concern in the relationships between broadcasters and producers.

producers, are raising increasing portions of their turnover from non-UK terrestrial channel sources.

c. The most successful independent producers now themselves often have control over “scarce resources”. In their case, this is not spectrum or broadcasting licences, but exclusive access to valuable production brands, such as *Big Brother* or *Who Wants to Be a Millionaire?*, or on- or off-screen talent, from which substantial profits can be earned.

4.5.7 Many independent producers still make a poor financial return. These companies are generally producing programming on a commissioned basis from a major channel. The channel, however, is taking most of the financial risk on the programme, and the producer generally has very little capital invested in its business. So it is not wholly unfair that such companies should make a constrained and limited return. Other producers, including those able to finance programmes overseas, or with a significant share in the overseas sales of their products or who have the rights to exploit the activities of artists and writers, can build up businesses of substantial value or from which the owners can take high incomes.

4.5.8 One of the most noticeable changes in the industry since our similar work five years ago has been the high returns available to some production companies from developing international links or from selling their companies to big media groups, eager to acquire rights to particular shows or groups of producers or artists. This adds further credence to the suggestion that financial returns in the industry are now much more fairly spread.

4.5.9 We have been particularly struck by one finding from our work. We have shown that the typical price paid per hour for programming produced by independent producers appears to have risen slightly in the last five years. The equivalent figure for broadcaster’s own production has fallen slightly. We caution against placing too much reliance on these figures, but do believe that this demonstrates that independent producers are not being driven to produce more and more low-budget material for off-peak use. Overall, our work in this project suggests that the “balance of power” has shifted slightly towards programme producers, who are consequently able to capture what might be thought of as a fairer return for their risks and effort. In the years since Channel 4 was first mooted, this has been an objective of Government policy and there are signs that results have been achieved.

The Ecology of Public Service Broadcasting

4.5.10 Another key finding appears to be that increases in the number of platforms/channels enriches rather than diminishes the creative output of the industry; contradicting one of the assertions made to Sir Quentin Thomas that “*since the country can only afford a finite amount of original programme production the audience needs to be concentrated so that the necessary investment in content is made*.”[44] The pattern of change in the balance between acquired and originated production also suggests that more competition stimulates more demand for more originated production; as the need for competitive differentiation increases and as

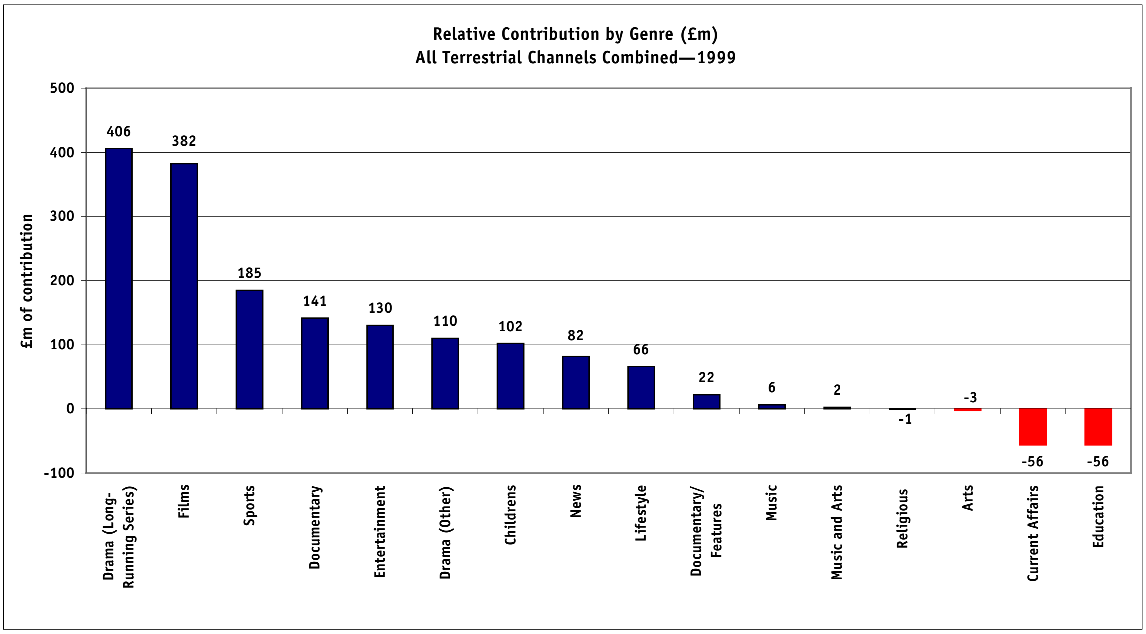
[44] *Communications Reform Legislating for the Future*, Sir Quentin Thomas, July 2000, p.5.

the previously easy trick of buying cheap acquired programming and making lots of money from it, becomes harder to accomplish.

4.5.11 If we look in detail at the way in which the internal economy of public service television works we can see how the way in which it has traditionally worked would become increasingly untenable if there were to be more competition in the mainstream area. Although, since 1994/95 ITV, in particular, has moved to make its originated programming more profitable, Channel Four still relies heavily on imported films and programmes for its profits, and both the BBC and Channel 5 make “losses” on certain genres, most notably Entertainment, that one might expect to be profitable. Broadly, the least profitable genres are those which it has to transmit as part of its public service responsibility—i.e. those that tend to be included in broadcasters’ schedules because they are required to do so.

4.5.12 In this way, the contributions' analysis set out above provides a microscopic insight into the way our terrestrial public service channels “work”. By public service channels, we mean channels with specific public service content commitments as a condition of their licences. The analysis reveals the form and extent of the traditional cross-subsidisation between different types of programmes on the terrestrial channels, which has been one of the defining characteristics—and, arguably, one of the greatest successes—of the UK programme supply market over the last forty years. In essence, the “profits” reliably made on some sources of programming have been used to pay for the “losses” consistently made elsewhere—most notably in the genres of programming most closely associated with the positive programming commitments placed on the channels (Figure 55 below).

Figure 55: Contributions by Genre from All Transmissions on the Terrestrial Channels in 1999



Source: DGA and Chris Goodall

4.5.13 In total, the transmissions generate a net positive contribution to overheads of approximately £1.5bn. About half of this is accounted for by films and soaps. Other important genres are Sports and Documentaries. Education and Current Affairs are the only genres to incur significant negative contributions. The spectrum of profitability is even more pronounced for originated programming alone (Figure 56):

4.5.15 It will be readily seen that a market that is more competitive, or in which profits are threatened, would find it hard to sustain this ecology. As we have already seen in the genre mix analysis of the analogue cable and satellite channels on page 71, profit-maximising commercial broadcasters, free of positive programming requirements, tend to schedule a different “mix” of programmes. Thus, while in many ways the analysis above has revealed an industry that is growing rapidly and one in which the delicate ecological balance between commercial and public service goals has remained relatively undisturbed throughout the changes to date, the technological and competitive changes that are just beginning to unfold may well make the ecology unstable—and, possibly, no longer appropriate—in its current form in the medium to long term.

4.5.16 The Director of BBC Television recently stated that many of the props of public service broadcasting over the years have fallen away, signalling the beginning of the end of the idea of a mixed public service channel offering a diverse range of programming[45]

> *By not maximising potential advertising revenue and cross-subsidising budgets within its schedule, Channel 4 is able to commission innovative, high risk, minority interest programmes. But it cannot operate in permanent defiance of the market for the simple reason that it is itself in the market.*[46]

4.5.17 Greater competition in the mainstream space from more broadcasters will tend to reduce the profits of mediocre programmes and compete them away—programmes that in the past would have been watched primarily because of the paucity of available choice. Under such circumstances, programming will be more polarised between “hits” and “failures” than in the past—when there was little opportunity for the programmes produced by broadcasters benefiting either from a licence to print or spend money to fail financially (as opposed to critical embarrassments)[47]—and the opportunities to subsidise the public service programming will wane.

4.5.18 Hence, one of the most important challenges over the coming decade for the industry and, where appropriate policy makers and regulatory authorities—will be to find ways in which to enable the fruits of the existing system to flourish in the more competitive digital age without stifling the growth of the new. As Sir Quentin Thomas has noted:

> *In due course, the Government will need to propose a clear framework for achieving public service broadcasting objectives whether through continuing to support and subsidise institutions like the BBC, ITV and Channel 4 or whether, as some anticipate as the communications market develops, by more directly supporting specific programmes or services….*[48]

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[45] *Zapped: Why Public Service TV has to Change*, speech given by Mark Thompson , Director of BBC Television, Banff, Monday 12 June 2000.

[46] *Communications Reform White Paper, Channel 4’s Response*, p.5, 23 June 2000.

[47] With the notable exception of the difficulties TV-AM experienced shortly after its ill-fated launch.

[48] *Communications Reform Legislating for the Future*, Quentin Thomas, July 2000, p.17.

4.5.19 We will return to this theme in final chapter, after exploring the views of the different participants in the programme supply chain about this, and other pressing issues, as the industry moves into the digital age.

we've achieved the best result we could have done over time: although I think we've served the audience well. So I think that the strengths are the weaknesses: and the weaknesses are the strengths—all at the same time.

5.2.1 Many of the interviewees we spoke to echoed this sentiment, identifying that the comparative historical strengths of UK industry have grown out of the regulatory balance struck between commercial and public service objectives:

Britain is so well placed when it comes to the creative industries because we have had a structure in broadcasting which has led to more investment in content and programmes than the market or the industry would have done left to itself—a combination of the subsidy via the BBC and a similar subsidy via the free-to-air commercial networks, which they have recouped by having cheap access to spectrum.

The great strength of the British television market is that it currently can, by and large, fully-fund the programming it needs. There are very few markets in the world, I think, that sustain the level of production that British television does.

The great miracle of British television is that a channel that gets 10% of the market can put the value into a programme, which a channel that gets 30% of the market would also invest.

5.2.2 While most people acknowledged that the special achievement of regulatory policy has been to ensure that a high proportion of the UK schedule has been produced domestically and put the "home audience first" many recognised that this was not the best platform for global success—pointing to the fact that the lack of real competitive pressure at home has discouraged the UK broadcasters from aggressive pursuit of the international market place:

The British TV industry is stunningly insular.

Regulation has fractured and fragmented British television in such a way that it almost forces itself to concentrate on its own self. With the bizarre situation that ITV has three separate international sales operations. It's just loony, utterly loony.

ITV didn't pursue international channels because of its federal structure, which has been a disaster for them. It is sod's law, isn't it, you get one combined ITV, just about owned by one organisation, just about the time when it's too late. That's what regulation often does.

You have a whole chunk of the creative community locked into a non-market mentality which then affects everything else around it, but its such bad news for the licence fee payer too—so inefficient and wasteful.

On the whole the UK broadcasters/producers are risk averse and I think that that is a key factor in our lack of success, certainly from an export point of view.

5.2.3 And perhaps, at times, encouraged a little complacency:

> *There's a snobbishness about the way in which the UK generally regards broadcasting. There's this extraordinary claim that British television is the best television in the world. How many people are actually in a position to say that with any degree of authority? How many people speak other languages and have lived in other cultures sufficiently widely to be able to make that claim? I mean, it can't be made. It's just a sort of dogma, which gets repeated from generation to generation in the UK.*

5.2.4 More significantly, we detected a growing sense that the benefits of the regulatory dispensation had been over-claimed—that it was not the unalloyed benefit once thought:

> *We've made a conscious, deliberate choice in the UK to have a deliberately over-funded, inefficient broadcast business, for the interests of the UK consumer—interpreted by politicians and broadcasters.*

> *The crowding out effect of the public service broadcasting framework transforms the whole economy. Which is why we have acres of pretty second rate origination in peak time: because we can afford it. You know, we've got the money, so we spend it.*

> *The value chain is so distorted, because virtually all the value is expressed in the broadcast. Why is Coronation Street sold at such a low price to the ITV network? So as not to push any value down the chain because then other people will want a slice of that. The actors, the writers will say, hang on a minute, if this were the US, Coronation Street would be selling for a million an episode—Friends style, or Seinfeld style—and we would get a slice of that cake. So, at the moment, there is a long term conspiracy within the television industry to contain as much as possible of the value at the broadcast end.*

> *The bizarre thing is that we accept that logic these days in terms of acquisitions. If you remember back to the Dallas days in the 1980's when there was a "gentleman's agreement" that no British broadcaster would bid against a competitor, after the first series had been allocated in the market place and you had it forever. Now, we have a much more open market in acquisitions, so something like Friends or ER, has been bought by Channel 4, I think for $1 million an hour, which is for an acquisition more than they would pay for any origination because they wanted to buy pay-TV as well as free-TV rights and they had to bid against Sky as well as Channel 5. And of course Channel 4 is immensely rich because it doesn't pay for its frequency and therefore has £600 million of public money to play with. It takes £100 million of that and gives it to Hollywood. So, Warner Brothers and the cast and producers of Friends and ER are immensely rich by our public funding of television. Could Alan Plater do a deal like that? Could Tom Stoppard? It's just a joke, but it's the*

thing everybody seems to agree on is that it's valuable to create content.

5.3.3 Moreover, the interviews revealed a widespread desire for the digital switchover to happen as quickly and smoothly as possible—with several people suggesting using a portion of the revenue released from the sale of the analogue spectrum to finance a content and training fund for the industry. However, as one interviewee noted, any intervention on the part of the Government to accelerate the switchover should strive to be as technologically neutral as possible:

> *Providing that the transition isn't actually carried through in a totally crass way, which favours one technology over another, then I think it's got to be good for all the players involved. It would be incredibly dangerous to do it in a way which favoured one technology over another because each of the technologies have pluses and minuses, and it really should be for the companies like NTL, or Sky or OnDigital to make those sorts of decisions on risks and not the Government or any other public body. But, provided the transition is done in a way which genuinely enables and encourages the population to move to receiving digital services—and doesn't then discriminate between the three different sorts of digital services that the consumers want to take—it has got to be good for the industry as a whole.*[50]

5.3.4 We found a growing concern that advertiser-funded channels face an uncertain future in the digital age. There were various reasons for this. First, competition from other media has meant that share of the audience held by traditional terrestrial channels has declined. These losses to satellite and cable have meant that they are finding it harder to deliver the "reach" that advertisers want from big popular programmes watched simultaneously by millions. As the funding of certain kinds of "quality" programmes like expensive drama has traditionally depended on this ability to aggregate large audiences around single transmissions, and as this becomes progressively harder as the number of viewing options becomes vast, some felt that the ability to continue to provide certain kinds of "quality" programmes would require continued intervention or protection in the new era. Others felt that the growth of alternative "windows" and opportunities to release new programmes would provide the revenues needed.

> *We get television very cheap in Britain. You can foresee a position in which people are expecting to get all their television programmes of a similar quality for free and the advertising revenue isn't there any more. Then I suppose you're moving very fast towards pay-per-view. That's why, I think, regulation will really come to accept the need to*

[50] It is worth noting in this context that the business strategies of most of the companies are already broadening to encompass more than one platform, and that the announcement of a clear timetable for the digital switchover would probably accelerate this trend. A more fundamental risk might be that accelerating the switchover could, by dint of following the path of least resistance, unduly favour digital terrestrial television—thereby, potentially: (i) creating a new obstacle to the subsequent proliferation of two-way broadband technology throughout the country and (ii) restricting the overall number of new channels made available to the majority of the population by the switchover.

embed advertising more into the programme structure. Otherwise the price of television programming to the viewer will accelerate hugely.

5.3.5 Furthermore, there was a wide awareness that changes in technology mean that the advertising spots may become obsolete. This is because new kinds of "black box" mean that an evening's viewing will become more like a menu of options to be taken at your convenience than a sequential schedule. When nothing is watched "live", traditional advertising spots can be skipped more easily. There was therefore a wide acceptance that new kinds of advertiser involvement should be explored and encouraged—and some felt that doing so would actually bring more money into the industry for investment in programmes. Indeed, there was a general view that some of the old restrictions were already obsolete and inappropriate. We must be ready for very different approaches.

> *Advertising will have to become more integrated into content. With the technology that can edit out commercials there also comes technology that offers greater interactivity in terms of commercial proposition and product placement. For example, a Ford advert might be replaced by the range of Ford cars in ITV drama and give viewers the ability to click on the car.*

5.3.6 One of the other new advertising models, masthead programming, has made relatively little impact to date in the UK because:

> *The owners of the airtime—the broadcasters—believe that they had something that the owners of the mastheads—the publishers—would want. The owners of the mastheads believe that they had trusted and valued equities that would attach well to broadcast properties. Each, therefore, believed that they had something to sell to the other. Each believed that what they had to sell to the other was of greater value than what the other had to sell to them. Hence, the impasse.*

5.3.7 As a result, many publishers are now turning their attention to converting mastheads into channels rather than programmes—as with the Q channel and Kiss TV.

5.3.8 Some observed that as advertising exploits new technology to become increasingly targeted and sophisticated, the net effect will be to bring more money into the production sector via new types of programming:

> *In five years time, Nike will be a major broadcaster, creating extraordinarily high quality content, which they will be saving in file form and e-mailing to many people in Europe.*

5.3.9 Several people expressed unease about the disruption that unfolding market developments would bring to the ecology of the programme supply market, and particularly about the ability of the commercial terrestrial channels to continue to fund high quality programming in the context of a fragmenting market:

> *The market is inevitably going to push* [ITV] *away from one of its historic positions, which was the public service broadcasting end of what it did. That was always the deal, wasn't it? The deal was, you did the public service stuff and in exchange you gained your licence,*

which would help you make some money. Well, as making money gets harder, you'll get pushed that way.

What happens if the commercial market ceases to invest at the top end in ambitious high-quality programmes? What will that do, to our exports, to our creative industry's infrastructure, to attracting talent into our creative industry? I see the danger of a downward spiral, that will destroy what we've built up over fifty years, just at the time that we need the talent, the investment, the generation of content, to go on the new technology.

I think the big challenge for the industry and for audiences, is continued investment in original UK production. As channels multiply and audiences fragment, there's obviously a demand for filling acres and acres of air-time, with cheaper and cheaper programmes. In such a market, inevitably, you acquire from abroad, or you make rather repetitive low-cost programming that's derivative. And the high investment in landmark programmes becomes quite a business risk—much more than it was in the duopoly days.

I think the balancing act becomes increasingly difficult. In the last few years, we've seen the price of feature films increase enormously. You might remember the Channel 5/ITV battle over the Warner's package. We've seen the price of American series increase, we've seen the price of sports rights increase, we've seen the price of talent increase. So making the money stretch to not only encompass all those price rises, but also continue to fund interesting documentaries, ambitious arts projects and so on… It's a hard juggling act.

I think you have a danger that you will get a thinning out of programming in a multi-channel market. Unless the viewer is going to be asked to pay a lot more for product.

5.3.10 A parallel was drawn with the German market, articulating an underlying concern held by many people that more programming does not necessarily mean better quality:

German stations that started up in the early nineties, bought lots of American stuff, got up to speed, exploited what the public service broadcasters weren't doing and now produce nearly all their own peak-time programming. But they were not, what we in the British television industry, would call quality television production. They were the bottom end of the market and although [the Acquisitions] *have been replaced by indigenous programming, they've been replaced by indigenous programming at the bottom end of the market. They would not make Warriors. They wouldn't even make Inspector Morse or Frost or those sort of things; it's just too expensive.*

5.3.11 Different responses were proposed to counteract this trend:

If you hobble ITV with too much regulation, it will do all these things that people don't watch, but in the end it will not have the money to do the things that it really wants to continue doing. It does want to *continue making Current Affairs and factual programmes. It does want high quality News and it does want high quality drama. It does want to do Inspector Morse and those sort of things, but if the money isn't there, you can't do it. So, in actual fact, by freeing it from much of the detailed regulation it's got today, you make it financially stronger and therefore better able to invest in top quality UK-produced programmes.*

The privilege of being small—i.e. the relative liberalism of the regulation upon you whether you're Sky One or whether you're UK Gold—was borne out of encouraging new channels to grow. At some point, when those become more universally available, they should start to take on the responsibility to invest in the production sector. I mean, if you're looking at how you create a healthy production sector in the UK, you see that it has largely been driven by a limited number of very well-funded channels, whose scale is being attacked by the growth of more choice. Then you have to say, how can you share that out more? If public service broadcasters lose the power to invest by dint of the economic circumstances changing, there has to be some transference of that responsibility elsewhere. Otherwise the production sector will suffer.

By 2006, multichannel will be in 75 per cent of homes. Then you've got different economics, and it's possible then to start considering greater investment in programmes.

It's also for the ITV MD's to have the ambition that recognises that really excellent programmes will bring in the punters and will create a virtuous circle of business success. I don't see enough confidence in the commercial sector, in regulation, or in Government, that this is the case and yet it seems to me, that it's proved itself time and time again. Ambition in the creative industries has proved to be commercially successful.

You will not get diversity of programming in a multi-channel world, unless you have a diversity of funding structures.

5.3.12 Others didn't agree that the proliferation of channels would necessarily lead to a decline in programme standards, and some suggested that dynamics of a more competitive market place would actually encourage the production of high quality programming:

In a world where there are hundreds of channels, what you really need is a brand that breaks through those channels. One of the things that feeds your brand is landmark excellence—and it seems to me that ITV's brand relies very heavily on a long tradition of landmark excellence. It's in their business interest, as well as the public interest, for them to continue to invest in some of those programmes.

The established channels can only hang on to their positions by being really, really good, not by making more and more and more.

I think that we will view very differently in a digital multi-channel world. There will be more instant gratification. "Turn on. What do I want to watch? I want to watch something that I want to watch and I want to watch it now. Oh look, there it is. Click". People won't be channel loyal. So the strength and quality of content is where it's all at—because unless you're producing and supplying stuff that people want to watch, they just won't watch it.

Commercial TV companies could make more money from shows getting smaller audience if they're the right type of people. A show getting 20% less viewers if it had more AB's or young people, would actually earn more money for ITV.[51]

Quality at the end of the day is what drives popularity, but that means investment.

5.3.13 Indeed, some people saw the prospect of a decline in the ability of the terrestrial channels to fully-fund production as being as much an opportunity as a problem.

It's much more difficult to get something clearly 100% funded by one party. That, to a degree, presents some problems, but also presents opportunities, if you're clever about how you fund projects and can leave yourself in some sort of position on it. When somebody is funding something 100%, they dictate the terms. When they're not funding it 100% they have to make concessions.

I think we have had a tendency to be extremely parochial as an industry and I think the very fact that things are now going to have to be funded from different sources is going to automatically change that. If, for instance, you're looking to do a big drama on ITV, you know effectively what licence you're going to get, you know that's not going to be enough to fund it, to do the production properly. So you need to know that you're going to be able to sell it overseas. In which case, you're automatically going to have to make something, which is probably more of international appeal. That's good for the industry—and for general British business.

5.3.14 A different type of response to the changing economics of programme making, suggested by several of the interviewees, is to rethink the nature of programme making:

If you can create content, then you have a valuable commodity. The question is how you maximise the value of that commodity. That is where simply doing things in the traditional way—while it may be what you're familiar with doing and while you may think that you're going to be able to make money out of doing it—is now becoming a risky decision to take. You actually need to be looking around at all the different ways in which that content value can be maximised.

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[51] In the short term, even if ITV's share declines, the effect may well be to increase its income as advertisers have to pay more to reach what is still the last mass audience available. *Narrow Outlook*, Peter Bazalgette in *The Media Guardian*, p.9, 25 September 2000.

Creativity in future is going to be as much about the creation of services out of content, as in creating the content in the first place. If you use the analogy with the manufacturing industry, the UK's image has always been that, we were great at producing the inventions, but we haven't been so good at exploiting them. Well, the equivalent, I think, within the creative industry sector, is that having the best creative brains to create content will not get the UK to the front of the pack internationally, unless we're also the best at creating services that consumers ultimately consume from that content. That's going to be where a lot of the imagination comes in future.

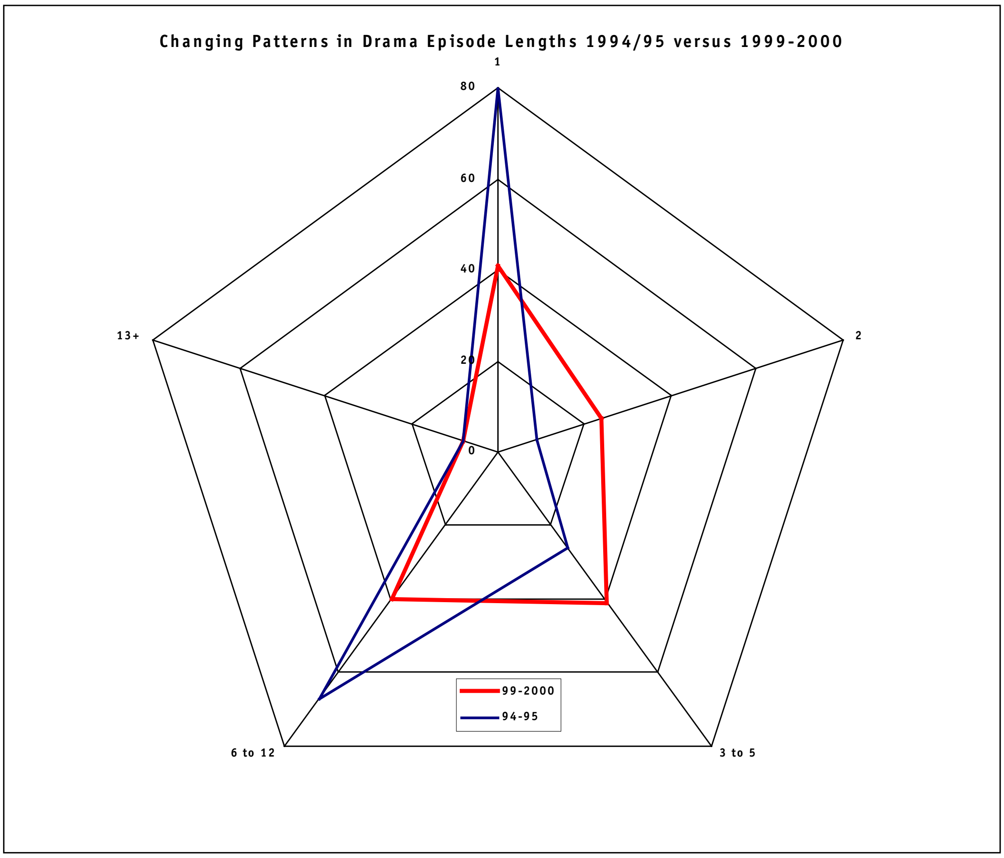
5.3.15 Another trend identified by the interviewees was the growing importance of programme marketing driven by the need to attract viewers' attention amid a myriad of potential programme choices:

You're going to have spend much more money on marketing a programme compared to making it. That ratio has changed dramatically in the past year. It's going to be a totally hit-driven business, where you spend a fortune on marketing.

5.3.16 One person commented that the dynamics of marketing in a multichannel world, and the need to build brand loyalty, make a move to commissioning longer series runs more likely:

Schedules need to be more easily navigable than in the past and the cost of marketing multiple short-run shows are becoming harder to sustain. So, you look to simplify your schedule by extending runs. Hence, the output in drama is polarising into pieces that can run for 16 or 26 weeks and event pieces that run for one or two nights—and there will be less of the traditional "six of this and six of that".

Figure 58: Changing Patterns in Drama Episode Length—1994/95 vs. 1999/00[52]



Source: DGA

5.3.17 Some observed that, in addition to the chance to make more of the catalogue available at any one time and to target different sections of the audience, part of the rationale behind the launch of new channels was the need to create a bigger, more attention-grabbing presence on the increasingly important electronic programme guides. Accordingly, most traditional broadcasters now see themselves not as a single channel, supplying programmes to an audience through a schedule of simultaneous transmissions, but are trying to reconfigure themselves as owners of programme rights or "brands" which they will need to exploit across a wide variety of "platforms" or media.

> *The broadcasters are going to use the revenue of this last decade to buy themselves into all the other things that add value in the chain. It's exactly what's happened in the USA… broadcasters will want to be re-integrated or will want to own the production. They won't be able to make as much money out of broadcasting, but they might well be able to make the money out of the production, because of the other things they can do with it.*

5.3.18 The broadcasters may not be able to, or indeed wish to, create all the powerful programme brands themselves, and are starting to look to form relationships with producers similar to the development deals that are prevalent in

[52] The chart, which does not include soaps, would appear to support the suggestion of a move away from single dramas and six part episodes. Recent commissioning trends indicate that the number of 13+ episode series will increase over the next couple of years.

consolidate to prepare for the scale of change that was coming. But this was not a return to the past. The old “cosy duopoly”, as it was described in the Peacock report, had become complacent and inefficient, and we should not go back to that.

> *First and foremost, the development of stronger more integrated media groups within the UK has got to be helpful. The Government would be mad to veer towards fragmentation as opposed to sensible consolidation and the efficiencies that that can drive. It’s not abdicating dominance, but its abdicating reasonable critical economic mass. Otherwise, what will happen is that organisations will not be able to make risk investment that Americans make in the development of new content. This is not something that’s driven by a cottage industry. The cottage industry added onto our economy can bring benefits, but you need a structure that enables corporations to fund major risk developments.*

5.4.4 Some concern was expressed about the future of the industry if domestic companies aren’t able to achieve global scale:

> *I think, there’s a danger we’ll end up with the British content and archive being owned by the Americans.*

5.4.5 Views were mixed, though, on the global potential of British media companies. There was a desire for British global players, along with a certain cynicism about the rhetoric sometimes used. We were left with the feeling that for many who work in the UK television industry today “going global” is an awkward necessity rather than an exciting opportunity.

> *British broadcasting is pretty introverted.*

> *Whenever you hear Granada or Carlton saying that moves to consolidation in ITV are “to help us to compete more effectively in the international market place,” you know it’s complete baloney. They’ve been saying it for decades. They’re not interested in the international market place. It’s all to do with controlling the UK market—to control the advertising marketplace or the programme marketplace, that’s what consolidation is about. They don’t have the slightest interest in the international market place.*

5.4.6 Some argued that any moves into the international channel market need to take account of national differences:

> *As each territory and each market is so peculiar to itself, I think that the best global strategies are those that actually let the local services develop in an organic way peculiar to that market and don’t try to impose a homogenous global brand. The channels and the brands need to develop their own facets for the territories they’re in, otherwise you’re not maximising what is valuable about the brand to the people in those territories.*

5.4.7 Others argued that current international channels were just a stepping stone towards the global availability of the full programme archive via broadband delivery.

move from a meritocracy to a system where we favour a sector that is not delivering the goods. As long as you are picking the best shows that's fine, but at the point you start to pick shows to fill the quota, the quota's become a problem.

I don't think you can abolish vertical integration completely because it is legitimate for a broadcaster to say I want to have some dedicated suppliers: people who put me first. It works in the US in an open market. All the major broadcasters are either owned by or own major producers. Most of them take more programmes from their own producers than anyone else and equally those producers supply more to those networks than to anyone else, but they supply elsewhere. Twentieth Century Television couldn't be the hugely successful production company it is, if it weren't also supplying ABC, NBC and CBS as well as Fox. With series like N.Y.P.D. Blue, Murder One etc. Fox would be daft to yank them off the competitor channels because they'll never sell another programme to those competitors and they make at least as much money from production.

When the independent quota started, it was the kick-start of an industry. Well, that industry's kick started.

How can you work a quota when you get a successful schedule going and you suddenly find out that by the very nature of the success on your channel, the thing has got sold for a very large sum of money. Are you then supposed to abandon that next year.

I've never been a fan of the 25% quota, in principle because it makes the independents sound as if they are getting the crumbs from the table. I've said this before, it always seems to me that that's a 75% license for broadcasters to buy from themselves. So, I would rather regulation creates a framework in which these things are governed by normal commercial pressures, but that's very difficult in broadcasting because you can't leave it completely to the market place.

What I don't like about the quota is that it makes the independents seem like a sort of junior partner in a grown-up broadcasting industry. It always sounds so defensive. I don't like the phrase independent production. I always think it means, independent of what. As the market evolves, it'll become more and more meaningless in my opinion.

As long as you have that residual vertical integration in ITV and the BBC it's not surprising that there's pressure for quotas… it would be better to release BBC Production into the open market, in exchange for abolishing their 75% entitlement, and get the channel controllers to treat suppliers on equal terms, then you'd be getting somewhere.

5.6.5 There was concern that the removal of the quota would lead to a rapid change in the pattern of programme supply:

I think that we all genuinely believed at one point, that the cream of ideas would rise to the top and therefore this would be a brilliant *thing for the audience. But I don't think the best does necessarily emerge either at ITV or at BBC because of politics and 'buggins turn' and all of that stuff. At ITV for instance, Carlton are screaming mad because they're paying 'x' per cent of the programming budget and not getting the same back in commissions. And at the BBC, you've got Greg Dyke saying that he's got a factory to feed and that he wants to build a production house to beat other production houses—and you can't blame him for that—but it means that he's going to favour something that comes from his entertainment stable rather than something from outside.*

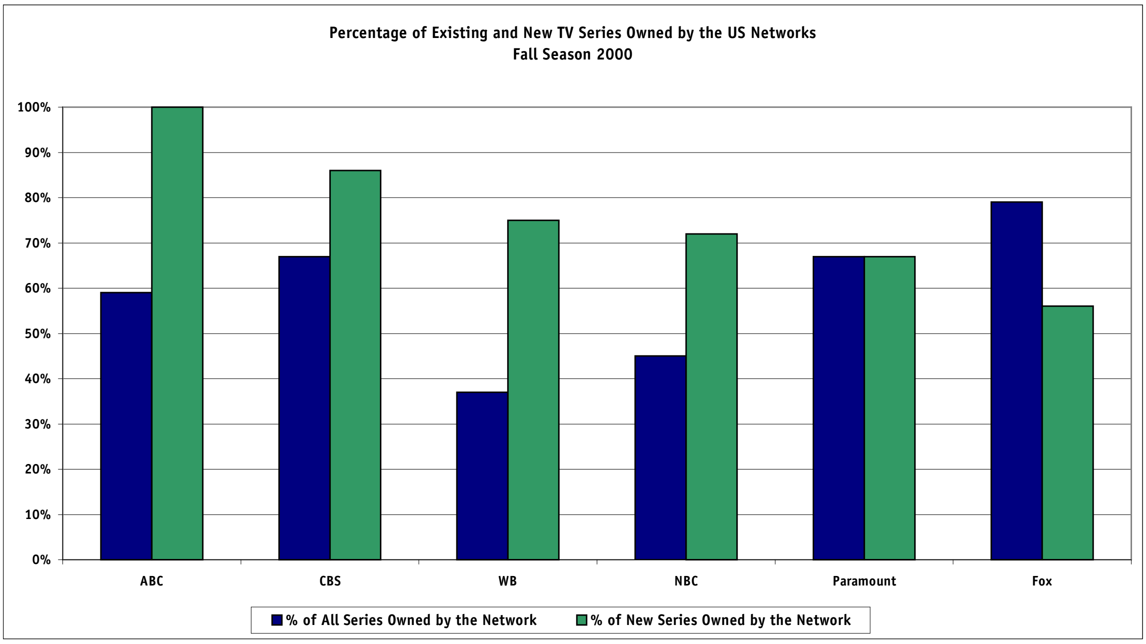
Look at what happens in the rest of the world, particularly America and you have to say these are economic trends that will happen here. They just will. One of them is, broadcasters will want to be re-integrated or will want to own the production because actually you won't be able to make as much money out of broadcasting, but you might well be able to make the money out of the production. Because of what other things you can do with it.

I think it's rather disturbing, what's happening in America, since the rules were changed and the sort of bully boy instincts came back into play in the schedule. Pretty quickly, to the point where, a studio, at the end of the day, has to accept joint ownership of the show from a broadcaster or they simply don't get picked.

In something like four years, the pilots being made in Los Angeles, being made for the most screenings, they went from 0% in-house to 52% in-house. Why, because they all thought one of them might be ER. And they also saw what ER did to them, so they all said, "we're not going to have this anymore, we want our own ER". Well, no one's been successful have they? The interesting thing is, when did anybody in the United States last produce a powerful new one hour, half hour. The stuff that's still working is stuff from 5 years or 6 years ago.

Ironically, they've been saved a bit by European independent producers—by the Millionaires and the Survivors and so on. Without them they would be facing severe problems of securing sustainable hits to replace the declining hits. In part, I think that it's driven by broadcasters making compromise choices—driven by a different perspective on the business.

Figure 59: Existing and New TV Series Owned by the US Networks—Fall Season 2000[53]



Source: Variety

5.6.6 Many interviewees referred to the polarisation in the independent sector between a large number of very small companies that depend on fully-funded commissions and production fees, often on a small number of programmes per year, and a smaller group of bigger companies driven by commercial as well as artistic goals and developing the resources or access to talent that enables them to negotiate on a more even footing with the broadcasters. One person, for example, observed that most of the people working in the independent sector were not there primarily to be business people.

> *I think by and large, they [*independent producers*] are creative people and they want to get their products done—they want to get their programmes made—but they're not business-type people particularly. They tend to be creative people. They are more focused on programme making, than the business elements around it.*

5.6.7 Some of the interviewees suggested that forcing the independents to become more businesslike would be a good thing for the independent companies themselves and programme supply market as a whole:

> *I think the effect of the producer being able to bring some money to the table, whether it's through this or any other mechanism, is an opportunity to argue for retention of rights. If they are being fully cash-flowed, which has been the position in the past by the broadcasters, then they don't have that much leverage. They can't*

[53] In 1970, the U.S. Federal Communications Commission [FCC] acted against vertical integration with the "fin-syn" (financial and syndication) rules, which prevented TV networks from controlling their own production suppliers—and enabled the Hollywood studios to enter the TV business as sitcom and drama producers. The FCC allowed the "fin-syn" rules to sunset in the early nineties, prompting the studios to rush to acquire the U.S. networks. Now Disney owns ABC, Paramount controls CBS, Century Fox controls the Fox Network, and Warner Brothers owns the WB Network.

negotiate with the broadcasters how the rights get split. If it's fully-funded, the broadcasters can say, "you just get a fee and that's it." A sort of work for hire individual. "We'll give you a production fee, that's it. Go away." If the producers are able to look to other mechanisms to bring money to the table, then I think it gives them an opportunity to argue more strongly for the retention of some rights. Of course that's what the independent producers are all about because otherwise they're just living from hand to mouth from one production to the next. If they can start to build up a rights catalogue—so that they have a continuing flow of income from past productions, as well as the stuff that they're embarking on—it builds them up as a stronger company.

5.6.8 The range of arguments for and against the independent sector mentioned in the interviews have been summarised in Table 5 (overleaf). Although, as noted above, there was considerable disagreement about the way forward with the quota, everyone agreed on the ideal aim for the system:

You want to create a system that makes the maximum number of good programmes get on air, rather than a protected market that selects programmes just because they fulfil a quota or because they're made from an in-house department. A supple and fluid market that encourages the best programmes to be made is in viewers' interests, advertisers' interests and in television's interests broadly.

Table 5: Arguments in Favour and Against the Independent Sector Raised by Interviewees

For	Against
Gives new channel operators, who lack resources to make own programmes, a way to access originally produced programmes without recourse to their direct competitors.	The quota would be unnecessary in a perfectly competitive world.
Introduces greater competition into the programme supply market, and provides creative and price competition for the broadcaster's in-house production arms.	The sector imposes inefficient transactions and regulatory costs (in house lawyers negotiating costs, monitoring costs) and places a heavy administrative burden on broadcasters.
The most successful production companies act as magnets for new talent—attracted by the reputation of the existing talent and the creative focus of small teams—and marshal the skills necessary to help new talent fulfil its potential.	Recent changes in ownership make the commissioning process more complex and the process of planning a schedule harder for broadcasters.
Produces some of the most innovative, popular and challenging programmes.	Casualisation has broken down traditional training and knowledge management structures—many smaller independents lack the administrative resources to make up for this.
Brought greater efficiencies in programme production, innovative production techniques and a greater diversity of programme formats.	The value of some production companies has been inflated beyond their real worth.
Acts as a countervailing force against media concentration.	The current terms of trade make it harder for broadcasters to own and control all rights—even for programmes they've fully funded.
Nurtures a diverse range of cultural voices and creates an easier route of entry for minority and regional voices.	The quota creates a reward for something that is not a real property. Many "lifestyle" independents rarely take on real production risk.
Provides an external stimulus to encourage broadcasters to maximise the value of existing programme rights.	It's been a long time since the independent sector provided a truly alternative cultural voice.
Encourages proper cost accounting / more transparent trading practices on the part of the vertically-integrated broadcasters.	When production companies are taken over a large chunk of licence fee payers' investment ends up in the producer's pockets.
Allows schedulers to pick programmes on merit rather than simply to meet the needs of in-house production teams.	Uncertain volumes of production output and lack of production guarantees make it harder for in-house production teams to spread risk across an entire programming schedule.
The rewards open to independent producers act as a spur to dynamic efficiency in the production economy.	Links between talent/sports rights agents and production companies represent a potential source of conflict of interest.
Facilitates the publisher-broadcaster model.	

rest of the world is changing beyond recognition. It's all about stable doors and horses and Nero and Rome, isn't it? And it shows the power of the politicians because it's quite clear that the politicians pile pressure on them and their inability to resist it.

You get a lot of ticks if you put on market failure programming—obligation programmes—because it's the simplest way of measuring public service. But it isn't necessarily in viewers' interests or in the interests of providing a richly diverse broadcasting system. At the end of the day, the politics of Britain will ensure that there'll be two hours of religion forever on ITV and frankly this is one of the problems—a pragmatic compromise that will happen because you don't take on the bishops.

What we don't want is all the detailed regulation about how many hours of current affairs and how many hours of children's programmes we need to make. And getting into arguments with the ITC about whether one programme belongs to one category or some other category, for the purpose of satisfying a quota. We should get rid of all that detailed regulation, all that box-ticking, all that quota counting and concentrate on the main thing.

The ITC's sponsorship code, for example, is almost certainly too complicated and too protected, and it's not as if there's a major benefit for the viewer— it's just counting how many angels are dancing on the head of this particular pin.

5.8.3 There was strong support for maintaining different models of public service broadcasting, and willingness to allow the broadcasters to play a large role in determining what role they should play within the ecology:

Diversity of content has been very much dependent upon diversity of funding, so that the BBC has developed a different culture and a different set of expectations of the audience to that of Channel 4. Essentially the BBC has to be universal, therefore establishment and therefore based on consent, whereas Channel 4 should not be conformist, but instead look at pushing forward creativity and setting agendas. Similarly, because Channel 4 is not funded through a shareholder model, it means that it doesn't have to maximise revenues per slot, which increasingly is the role in ITV—hence the News at Ten is moved not because it doesn't make money, but because it doesn't maximise the money that could be made in that slot. Because Channel 4 pays its dividend directly to the viewer and not to the shareholder, it is in a position to take a wider range of risks with a wider range of supplier, with a wider genre of programme forms.

5.8.4 One producer highlighted the choices presented by the different broadcasting models in the mixed economy.

I think the squeeze has been put on the BBC to such an extent, particularly BBC1, that if you had anything highly desirable in *programming terms, be it comedy, drama, anything, by going to the BBC you are automatically commercially disadvantaging yourself. They don't give you enough money to make the programmes and they want increasingly more rights. The end result of that is that, if you have very valuable properties, you go out into the market.*

I think it's difficult to balance between commercial and public service broadcasting and there are certain things, if you're working for a public service broadcaster, you expect to concede, than working with a commercial one. There are advantages, creative and otherwise, in working for a public service broadcaster though. They can, if they get behind something take a longer term view and help it grow and they can also offer artists a broader portfolio of programming—not pigeonholing them in a single genre.

5.8.5 The BBC wishes to continue to supply a universally-available, broad range of quality programmes while all around it is changing, and to take advantage of the new technology by spreading the programming across six digital channels. The licence fee continues to guarantee its ability to do this "free" to the viewer, while elsewhere old sources of revenue may begin drying up or changing with consequent shifts in pricing. The BBC portrays this as part of a continuous process that runs throughout the history of British television—redefining the meaning of public service television in practice. It will not be able to realise this vision fully though until all homes have gone digital, a process that is unlikely to be completed without a plan to convert homes that cannot afford or do not wish to acquire extra channels.

5.8.6 Against this there were many expressions of concern that such a plan should not permit the BBC to do what other media companies might aspire to do without having to bear any of the risks that shareholders would have to bear. Several interviewees argued that the commercial activities of the BBC should be monitored more carefully to ensure that they did not unfairly disadvantage real risk takers and that the new regulatory framework should encompass the BBC and the public service functions in a unitary whole.

Unfortunately we don't address the issue of the BBC's dominant role in the market place nearly enough, and the way the BBC operates informs virtually everything else.

5.8.7 Partly for this reason the majority of people seemed to be in favour of a single regulatory authority, with most adding the rider that economic and content issues required the retention of separate expertise. There were however some dissenting views, most notably the concern expressed by one interviewee that:

It's much easier for politicians to nobble one content regulator than two or three.

5.8.8 And another, from a different perspective, concerned about the risk of regulatory capture:

The important thing is for the Government to create a framework that resolves the current conflicts and frictions between the existing regulatory regimes and which then sets out to encourage the UK to

> *move into a digital future… The risk is that the agenda will get hijacked by a whole bunch of increasingly parochial broadcasting issues—which don't really get to the heart of the matter.*

5.8.9 There was a widespread acceptance that certain kinds of rules and industry-specific requirements may soon have run their course and that regulation should be aligned more closely with general competition law. Some of the interviewees regarded any limits on competition, whether quotas or revenue share limits, as being ultimately inconsistent with such a policy. Above all, there was a clear desire for freedom by companies of all kinds to explore this new world in their own ways without unnecessary interference.

> *The whole environment needs to be open to people who are looking at the future rather than at the past. It needs to be encouraging them. It doesn't need to be subsidising them. It doesn't need to be guiding them. It just needs to be open to them.*

5.8.10 Overall, we found a widespread feeling that digital convergence is creating greater space in which different forms of business plans and models can co-exist with greater equanimity, and that within this space a growing recognition and tolerance of mutual strengths and interdependencies is beginning to emerge.

5.8.11 It would be wrong to overstate this, clearly individual interests within and across different levels of the programme supply chain do, and will continue to, collide—most visibly in the allocation and retention of rights and rewards. Furthermore, most interviewees acknowledged that some aspects of digital convergence make the need for clear and vigilant regulation, of both economic and content issues, more pressing than before. But there is clearly considerable enthusiasm and support within the industry for a much more self-determined and self-determining approach to achieving the Government's regulatory objectives than has been possible before.

5.8.12 Now that "broadcasting" is no longer the homogeneous activity that it was, individual companies need to explore alternative futures. That means investing, taking risks, competing. The future is unclear, and, put succinctly, the emergent theme of the interviews seemed to be that the future needs to be discovered by a process of dynamic exploration, that it is time to let companies take the lead and do it their way—and that their energies and willingness to bear risk will be all the greater from being able to follow their chosen paths.

for the era of spectrum scarcity and the strong preference of UK audiences for original, indigenous programming has advantages and disadvantages. It has enabled the UK terrestrial broadcasters to continue to fully-fund the majority of domestic production—an increasingly rare phenomenon around the world—and sustained a high quality mix of commercial and public service programming that leaves the UK well-placed to exploit the growing worldwide hunger for top quality audiovisual content. The BBC's archive, in particular, will be an immensely valuable asset to the nation once full video-on-demand technology becomes widespread around the world.

6.1.4 On the other hand, the privileged power offered to the main broadcasters in the domestic market and the Byzantine regulatory structure erected in return, have slowed the emergence of a truly vigorous market for programme-related rights and discouraged the UK broadcasters from pursuing more aggressive plans for global expansion. As a result, despite their undoubted strengths and potential, the UK terrestrial broadcasters have not risen to the first rank of global media companies as the global audio-visual industry has flourished around them.

6.1.5 The regulatory principles that have governed the industry over the last fifty years look increasingly like a modern day *Maginot Line*—an edifice designed for use in the last war not the next. We believe that the programme supply market will be served best if the dominant response by the industry and regulators to the challenges of the digital age, is characterised by enthusiasm for the expanding range of opportunities rather than resistance to the decentralisation of control. In this respect, we would echo the prescient conclusion of the *Peacock Report* that the UK television industry is moving towards a sophisticated market system based on consumer sovereignty, in which viewers interests—of which they ultimately are the best judges—can best be satisfied if they have the option of purchasing broadcasting services from as many alternative sources of supply as possible. And hence that:

> *The fundamental aim of broadcasting policy should be… to enlarge both the freedom of choice of the consumer and the opportunities available to programme makers to offer alternative wares to the public.*[57]

6.1.6 That said, it is evident that we are still at an intermediate stage between spectrum scarcity and the promised land of broadband access to all homes and, for all the enthusiasm of the techno-enthusiasts, this transformation will not happen overnight. The fundamental challenge for the White Paper will therefore be to establish the context in which the expansion of the sources of supply can unfold to the maximum benefit of the nation as a whole and to ensure that decisions taken about the regulatory framework now reflect this direction and, in so far as possible, establish a clear statement of intent—so that the industry can begin to plan with greater confidence and that the more painful consequences of change can be smoothed.

6.1.7 The changes will have consequences for relationships throughout the programme supply chain; with greater pressure on distributors, broadcasters and

[57] *Report of the Committee on Financing the BBC*, Cmnd 9824, July 1986. para. 547, p.125.

indicative timescale of 2006 to 2010. Accordingly, we recommend that the Government should seek to accelerate the completion of the digital switchover.

6.2.4 Clearly there are many other substantive considerations for the Government to take into account when addressing this complex issue, but from the perspective of the programme supply industry we believe the completion of switchover should be accomplished as soon as practicable, and that it could be achieved ahead of the Government's indicative timescale. While we recognise that it is for the Government to decide how to take this recommendation forward, it will be important to ensure that any plans to accelerate switchover are as technologically and organisationally neutral as possible. Accordingly, we believe that there should be an early announcement of the intended schedule to give each of the competing platforms—including cable and ADSL—a reasonable opportunity to put forward their best cases for consumer choice.

6.2.5 In summary, we believe that accelerating the switchover would bring the following benefits:

a. It would accelerate the production of digital-related programmes and services by UK creative talent and rapidly expand the UK's skill base and expertise in these areas, giving UK companies the chance to steal a march on international rivals.

b. It would stimulate greater competition in the programme supply market by making it possible for a larger number of channels to reach a larger proportion the audience, thereby increasing the number of prospective buyers and commissioners of audiovisual content.[63]

c. It could help to remove one the principal obstacles to the formation of a single ITV company—a move that most of our interviewees felt would benefit the UK programme supply industry at home and abroad (p.92 ff.)—by giving other commercial channels greater scope to seize larger audience shares and thereby hasten the decline in ITV's dominant position in the net advertising revenue [NAR] market.[64] In a fully digital world, for example, both Channel 5 and Sky One might be available to whole population.

d. Completing switchover ahead of 2006 would make it easier to define the BBC's future role and functions when the current Charter expires in 2006 by removing two of the principal uncertainties that would otherwise cloud the issue, namely the exact timing of digital switchover and its immediate impact on the BBC's market position.

e. Revenue from the sale of spectrum would be released for other uses.

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[63] Moreover, increased competition in the domestic market tends to promote competitive strength in the global market: "*In global competition, successful firms compete vigorously at home and pressure each other to improve and innovate… We found, in contrast, few 'national champions' or firms with virtually unrivalled domestic positions that were internationally competitive. Instead, most were uncompetitive though often heavily subsidised and protected*." Michael E. Porter, *The Competitive Advantage of Nations*, p.117.

[64] ITV accounted for 60% of all TV NAR in 1999 and the Competition Commission has indicated that, ceteris paribus, it does not expect this figure to fall below 50% within five years.

The Regulatory Framework

6.2.6 The expected benefits from the intensified competition in the programme supply industry following the accelerated digital switchover are, to some extent, contingent on the ability of the regulatory framework to secure their release. Most of the people we interviewed doubted whether general competition policy alone would be sufficient to secure these benefits and felt that some form of sector specific regulation will be required.

6.2.7 As OFTEL observed in its consultation response to the Green Paper, the broadcasting industry is still “characterised to high degree by oligopolistic market structures” and competition law alone may be “inappropriate to deal with the long term and widespread advantages enjoyed by historically incumbent firms.”[65] However this observation does not imply any predisposition against dominant firms *per se*; simply that one of the key objectives for the regulatory framework will continue to be vigilance against the abuse of the dominant position.[66] As some of our interviewees observed, there is evidence that the ITV/BBC duopoly has, in the past, had the effect of setting the prices for programmes lower than their true market value—as the recent inflation in the value of sports rights and certain types of premium acquired programming attests. Greater competition within and between every level in the programme supply chain will make it easier for more programme rights to find their true market value.

6.2.8 Nor should there be any predisposition against vertical integration per se. Provided that vertical integration isn’t abused either via design or institutional inertia, it represents one of several models that can flourish for the national good under the right competitive conditions.[67]

6.2.9 The institutional structure of the new regulatory framework is one of the most pressing and delicate questions for the White Paper. The issue has been debated at great length elsewhere and while a full analysis lies beyond the scope of this report, the findings from this Inquiry help to clarify the principles that the framework should embody from the perspective of the programme supply industry—whatever institutional form it finally takes. In brief, in our view, the characteristics of a regulatory framework that would enable a competitive programme supply industry to fulfil its potential would be as follows:

a. The economic analysis and interviews carried out as part of the inquiry have highlighted developing pressure for a lighter, more flexible regulatory framework that, within reason, enables greater discretion on the part of the broadcasters—particularly Channel Four and ITV—of the ways in which they should define and deliver their public service responsibilities within an overarching framework of policy that

[65] *OFTEL’s Response to the UK Green Paper—Regulating Communications: Approaching Convergence in the Information Age*, January 1999, p.3.

[66] The OFT has indicated that any firm with a market share less than 40% is unlikely to be held to be dominant, whereas the European Court of Justice found that firms with a market share above 50% should be presumed to be dominant.

[67] See also Sir Quentin Thomas (echoing Mark Oliver) in *Communications Reform Legislating for the Future*, July 2000, p.15.

encompasses the BBC. Put succinctly, as previous technological constraints begin to dissolve, there is greater scope to encourage a greater diversity of programming strategies and to achieve public policy goals across, rather than within, those strategies. Provided that there are adequate safeguards in place to guard against regulatory capture and "rent-seeking" on the part of the various parties—especially the historical incumbents—we believe that the programme supply industry will best serve the needs of the growing audiovisual economy if the players are free to focus their energies into the strategies they have shaped for themselves.

b. The regulatory authorities need to develop a clearer definition of the concept of public service broadcasting. In part, this will require the ability to quantify the costs and benefits of certain types of public service programmes and objectives, and a willingness to experiment with novel ways of achieving some of these where a more efficient and effective means of doing so can be identified. Such an approach could, for example, help to facilitate the emergence of mutually favourable outcomes in any negotiations over the future roles of ITV, Channel 4 and Channel 5. As we have indicated earlier, we would prefer the totality of public service provision to be based first on what existing players want to offer, then amended or extended, in a flexible way, from the most appropriate sources, if and when something desirable has been identified as missing from the mix.

c. As far as possible, the regulatory framework needs to be transparent, unambiguous, free from political interference, as consistent and fair as possible between competing organisations and platforms, technologically neutral, and grounded in detailed market expertise. The latter point is particularly important given the well-documented difficulties in defining the relevant market in the context of the programme supply chain—as, depending on the question asked, regulatory policy might, for example, need to focus on the market for peaktime drama, the market for originated drama, the market for all originated programmes, or the market for all programmes from all sources. Similarly, the sports rights market would present a different set of questions. Accordingly, the regulatory framework will need to possess the necessary expertise to make these judgements. Such expertise is most likely to be readily available if there is a clear functional split between the different regulatory functions involved—though it will be important to ensure that economic and content regulation are harmonised. This does not, in itself, preclude the idea of a single overarching regulatory authority. We do believe, however, that the BBC's high shares in the production and distribution markets, and the widespread concerns expressed to this Inquiry about the comparative lack of restraint on its commercial activities, make it imperative for the emergent regulatory framework to be able to oversee the activities of the BBC as an integral part of its economic regulatory role.

The Independent Production Quota

6.2.10 As discussed in Chapters 3–5, the 25% Quota[68] has helped to create a dynamic independent production sector and to fuel competition in the programme supply industry beyond the vertically-integrated production divisions of the broadcasters. When it was first mooted, there was some suggestion that the Quota should be seen as a temporary launch-pad intended to propel the sector into orbit around the broadcasters, but not to artificially sustain that orbit once achieved. Accordingly, any examination of the Quota needs to be vigilant of the risk identified by George Yarrow that it has not become part of the "fossil record" of an earlier stage of economic development.[69]

6.2.11 However, while we believe that the case for retaining the 25% Quota will diminish as the industry moves fully into the digital age and the production sector begins to reap the benefits from the emergence of new content buyers, almost everyone we interviewed asserted that the competitive forces within the industry are not yet sufficiently strong, and the market positions of the incumbents not yet sufficiently open to challenge, to warrant its removal at this point in time. In accepting this view, we are mindful of the obvious desire of the BBC and the ITV companies to produce a greater proportion of their programming in-house, of the events in the US following the sunsetting of the fin-syn rules, and of the increasingly strong likelihood that Channel 5 will treat RTL as its in-house production division.

6.2.12 Public policy towards the independent sector has tended to be driven by three distinct objectives. The first, perhaps most salient in the years immediately after the launch of Channel Four, concerns the pursuit of freedom of expression and cultural diversity, opening up the system to new energies and voices. This objective remains valid and, though several interviewees thought, almost two decades on, that the voices within the sector seemed noticeably more institutionalised and homogenous than at the outset, few doubted the sector's continuing role in offering, for example, greater regional diversity.

6.2.13 The second was to inject competition into the production sector and to make the broadcasters' production divisions more efficient. As we have already indicated we believe that this objective has been fulfilled to a large degree and that the move to channel abundance will drive this process forward more readily from this point onwards.

6.2.14 The third, interrelated goal, has been to promote the growth of small and medium sized enterprises. The fact that over five hundred companies produced programmes for the terrestrial networks last year illustrates that, in this sense at least, the objective is being met. However, the failure of the original quota legislation to reflect the importance of competition within the distribution sector, the relative lack of external sources of finance and the continuing predominance of the fully-funded model of programme production, mean that, in general, small and medium sized production companies are not as financially strong and independent

[68] DGA has a material interest in the retention of the quota, as the company is currently contracted to monitor the BBC's compliance with the quota on behalf of the Office of Fair Trading.

[69] Yarrow, ibid. p.15.

as they could be. We believe that securing this goal should be an increasingly important objective of public policy towards the sector, not least, to prepare it and guide it towards that point at which the quota might be removed.

6.2.15 Taking all of these factors, and the general tenor and direction of the interviews, into account, we do not see a convincing case for extending the Quota to 40% as some have suggested, or for including news programming within the calculation of qualifying hours. As indicated in Table 2 on page 31, across the terrestrial networks as a whole independent production accounted for 44% of all first-run commissioned programming in 1999 if news is excluded from the calculation, and 33% if it is included. This seems to suggest that, particularly so long as Channel 4 retains its publisher-broadcaster role, the sector has a fair degree of in-built buoyancy derived from the continuing quality of programme development and production. Although independent produced news programming does not count towards the current quota calculations, this has not prevented the sector from producing in the genre, albeit to a fairly limited degree thus far—and we feel that, given the growth in the number of programme buyers, the sector will have opportunities to break through in this area without the aid of a quota.

6.2.16 However, we believe that it would be prudent now to make a number of minor modifications to the current arrangements governing independent production to correct anomalies that have arisen since the original regulations were introduced, and/or to prepare the industry for the point at which the quota ceases to be necessary.

Encouraging Free Choice of Distributor for Non-Fully Funded Productions

6.2.17 As discussed above, arguably one of the weaknesses of the original legislation was its failure to recognise the significance of freedom of choice of distribution partner as a determinant of genuine independence. This oversight is all the more odd given that the legislation recognises that the independent status of a production can be compromised by the compulsory use of broadcaster staff and facilities. We believe that this flaw should be corrected at the earliest possible opportunity, such that the compulsory use of the broadcaster's in-house distribution facilities as a condition of the production contract should result in the disqualification of the programme for the purposes of the quota calculations. This rule should apply, however, only to productions that have <u>not</u> been fully-funded by the broadcaster.[70] Where a broadcaster has fully-funded the production, it should be entitled to compel the use of its own distribution facilities if it so desires; though we suspect that the broadcaster, the producer and the industry as a whole would benefit greatly if those distribution rights were routinely open to competitive tender.[71] It should be emphasised that the rationale for this rule is not to

[70] In current practice, a programme is fully-funded, when its full budget, including a profit element, is met by the broadcaster.

[71] Though monitoring the inappropriate compulsion of the use of in-house distribution facilities would present various practical difficulties, experience with the prohibition of compulsory use of other staff and facilities suggests that not only they would not be insurmountable and, more importantly, the inclusion of the provision in the legislation would be likely to reduce the incidence of compulsion.

discourage or preclude the involvement of in-house distributors, but simply instead to encourage a climate in which their involvement flows naturally from making the best competitive offer. Similarly, the rule would not prevent a broadcaster from compelling the use of its in-house distribution division should it wish (and be in a position) to do so; rather it would simply acknowledge that this action compromises the qualifying independent status of the production.

6.2.18 To block a potential loophole in the above, any programme in which an in-house distributor makes an "investment" should be regarded as a licensed rather than a fully-funded programme—i.e. a broadcaster should not be able to claim that a production is "fully-funded" because the budget has been met by a combination of its own funds and an arms-length contribution from its in-house distributor. Again, the intention behind this is not to prevent the investment by the in-house distributor, but simply, under the terms of the proposed change, to ensure that the investment by the in-house distributor is open to competition, if the broadcaster wishes the production to count as a qualifying independent production for the purposes of the quota calculations.

Encouraging Investment and Increasing the Scale of Production

6.2.19 The programme supply industry as a whole, in spite of all the changes taking place, is still highly concentrated, with in-house production divisions retaining high market shares. The independent sector on the other hand is extremely fragmented. We would like to see the two sectors move closer together, thereby creating a better balanced and more competitive programme supply industry better placed to maximise the value of programme rights it develops and creates. This process could be further enhanced by giving greater encouragement to the in-house production teams to make programmes for, and compete for contracts from, other broadcasters. In our view, the BBC should <u>not</u> be excluded from this in the long-term; although with its current share of the production market standing at close to 40% (Table 3, page 32) any such moves would need to be carefully monitored by the competition authorities.

6.2.20 In addition, some "scaling up" within the independent production sector would appear to be desirable; so long as it remains consistent with the public policy objectives for the sector as a whole, and, in particular, does not threaten the continuing promotion of small and medium sized enterprises within it. The primary need for successful creative companies is that they have creative independence, along with sufficient financial resources to bear risks, support development, and maintain and train their staff. We believe that many independent producers fail to meet this criterion, and that strict "purity" of independence is of relatively little use—or real meaning—if it is not supported by adequate funds for development and talent growth, along with the opportunity—and dynamic incentive—to participate appropriately in the profits of successful programmes.

6.2.21 While profit participation, in itself, encourages some scaling up, as successful companies can afford to expand their staff at the expense of less successful competitors, the principal source of this growth will come initially from external investment. There is growing recognition, evidenced by recent take-overs, that talented teams that develop successful properties are worth investing in, and it may well be counter-productive, from the perspective of the programme supply industry as a whole, to overly constrict the flow of investment from broadcasters in this regard. This is clearly a delicate issue, for any broadcaster involvement inevitably questions the meaning of “independence”. However, the principle of permissible broadcaster involvement has already been recognised and extended from the original 15% to the current 25% ownership limit. Accordingly, we think consideration should be given to extending the maximum permissible investment by a broadcaster in a “qualifying” independent company (or by an independent producer in a broadcaster) to 49%—with the rider that any cross-holding between a broadcaster and a producer would prevent any programmes made by the producer for that broadcaster from counting as an independent production for the quota calculations.[72] As a further incentive to investment, domestic or overseas broadcasters with a total share of UK viewing that remains beneath 1%, should be allowed to own fully (or be fully-owned by) independent production companies without compromising the independent status of the production company[73]—with the rider, again, that any cross-holding between a broadcaster and a producer would prevent any programmes made by the producer for that broadcaster from counting as an independent production.

6.2.22 The current statutory instrument offers no grace period to broadcasters when the status of an independent producer changes after a programme has been commissioned. We found broad support across the industry for a change to the definition of an “independent production” in the Broadcasting (Independent Productions) Order 1991 (as amended in 1995) that would allow programmes commissioned from independent producers to be regarded as independent productions for a reasonable period—probably, in view of typical commissioning cycles and programme contracts, for two years—after the date of commissioning. To remove the possibility of the exploitation of the period of grace by a broadcaster—by, for example, acquiring an independent production company immediately after it has commissioned a substantial volume of programming from the producer—the period of grace should not apply to any productions produced by a production company for the acquiring/commissioning broadcaster.

6.2.23 While there is a general view in the industry that the independent quota should not be abolished yet, there is a natural abhorrence of “quota programmes”—i.e. programmes commissioned solely to meet the formal terms of the quota, rather than on relative merit. We have uncovered no evidence to suggest that any examples of this practice have occurred to date. However, we anticipate that multiple channel launches by individual broadcasters in the digital age might unintentionally increase the risk of its occurrence. For example, we can foresee

[72] We recognise that the rider may act as a disincentive in some cases to the further investment that we are seeking to encourage by raising the maximum broadcaster shareholding to 49%, but believe that the rider addresses concern on the part of the regulatory authorities that, in its absence, broadcasters would be able substantially to weaken the impact of the quota. On balance, we would rather find an acceptable, if somewhat more convoluted and restricted, way of freeing up the possibility of further external investment than fall back on the *status quo* by default.

[73] We would also hope that this rule would allow, for example, production companies to invest in small (less than 1% audience share) broadcasters, particularly local television stations established via Restricted Service Licenses (RSLs), without compromising their independent status. Investment by independent production companies in RSLs would, among other things, help to strengthen UK regional production.

circumstances in which the particular skills, structure and economies of scale of a broadcaster's in-house production division might make it logical to focus on producing for one (or more) of the broadcaster's channels and to encourage external companies with specialist skills in different genres to produce primarily for the broadcaster's other channels. Where such specialisation is consistent with a continuing commitment to seeing the best programmes on screen and is driven by economic efficiency rather than an attempt to subvert the terms of the quota, it would be perverse for the quota to restrict this outcome. Clearly, it remains important to ensure that the launch of new channels by the main broadcasters does not dilute their commitment to, and the stimulus from, external independent supply, and that, for the industry as a whole, the stimulus continues to be applied across a range and diversity of productions.[74] However, we believe that in a digital environment the case for enforcing the quota, and the range and diversity requirement, individually across each of a broadcaster's channels is much less clear. Accordingly, we think that a broadcaster should be free to choose, if it so desires, for the independent production quota to be applied globally across its fully-owned channels and for the rules on the range and diversity of productions to be relaxed to allow for specialisation on the part of its in-house production division—provided that, in doing so, it can demonstrate that it is not reducing its spend on independent production below 25% of its original programming budget. The latter point would be necessary to ensure that the relaxation of the rules could not be exploited to reduce the overall spend on independent production.

6.2.24 The broad review of the rules relating to the independent production quota outlined above also offers an opportunity to consider streamlining and harmonising the organisational arrangements for monitoring and enforcing the implementation of the 25% quota and the European original and independent production quotas. At present, these responsibilities are divided variously between the ITC, the OFT and the DCMS. The scope for rationalisation of these arrangements will be determined to some extent by the more wide-ranging review of regulatory responsibilities currently being conducted by the Government, which could, for example, open up the possibility of transferring global responsibility for the enforcement of the quotas to a new overarching regulatory authority. However, in the absence of any such change, we believe that an individual broadcaster's compliance with the 25% quota and the European quotas should be monitored and enforced by the same regulatory authority, and that the responsibility for monitoring and enforcing all of the non-licence fee funded channels' compliance with the 25% and European quotas should lie with a single regulatory authority.

6.2.25 We recognise that the ability of the UK Government to modify the legislative framework relating to independent production is to some extent contingent on agreement with the European Commission and the other Member States advising in the Contact Committee, and that this has already been the subject of some discussion. It would appear that the exact legal position remains ambiguous, and may be further complicated by the pending review of the *Television Without Frontiers Directive*. In view of this, we recommend that the Government considers the

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[74] The Broadcasting Act 1990 requires broadcasters to transmit a range and diversity of independent productions, which is to include "*a range of productions in terms of cost of acquisition as well as in terms of the types of programmes involved*."

amendments suggested above and, where it is minded to act, further clarifies its latitude to do so with the European Commission as soon as practicable.

6.2.26 Finally, we believe that the Government should be prepared to review the quota again promptly following any significant changes in the marketplace, including: substantial shifts in audience shares or corporate shares of production, or the conversion of all homes to digital access.

Organisational Structures—Promoting Investment in Creativity

6.2.27 As discussed in paragraph 2.3.4, the twin imperatives for a successful creative industry are for small creative units and deep investment pockets—because innovation and excellence seem to flow most readily from small competitive and focused teams, but the scale of risk requires deep financial pockets and the ability to spread risk over multiple projects. The size and spread of the activities of main broadcasters mean that they have a vital role to play in supporting programme development and improving the quality and earnings of UK programmes, but in-house production divisions are not necessarily always the most conducive working environments for all types of creative individuals. Equally, our analysis also suggests that the independent sector is too fragmented, for the most part, to bear risk on the scale sometimes required. This speaks for flexibility in allowing a miscellany of arrangements between broadcasters and producers, perhaps along the US studio model, to emerge.

6.2.28 With this in mind, from the perspective of the programme supply industry as a whole, we see no overriding objections to, for example, Channel 4 moving to establish closer longer-term relationships with chosen producers if it wishes to do so, or of BBC Worldwide taking equity stakes in existing independent production companies and/or in new companies formed as offshoots from BBC in-house production teams—in the latter case, perhaps, following a model similar to that of a university science park.[75]

Tax Breaks

6.2.29 While perhaps not the original intention, the current Fiscal Investment arrangements for Film Production have started to inject a significant element of new finance in the UK television production sector—partly, perhaps stimulated by the attention drawn to the scheme by Phase I of the Inquiry. The scheme—which has predominantly taken the form of sale & leaseback[76] arrangements between

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[75] In general, we have refrained from making definite recommendations about the future structures of the broadcasters principally, because to do so would be inconsistent with our belief that the main industry players should be given greater freedom to shape their own futures—and specifically in the case of BBC Worldwide because its role within the BBC has recently been the subject of a detailed review, which has to all intents and purposes foreclosed immediate discussion about its future ownership and role in the marketplace. Gavin Davies, *The Future Funding of the BBC* Report of the Independent Review Panel Department of Culture, Media and Sport, 1999 available from http://www.culture.gov.uk/BBCREPORT.htm, Pannell Kerr Forster, *Review of the BBC's Financial Projections,* and the statement by the Secretary of State for Culture, Media and Sport, Hansard, Column 1239 ff. 21 Feb 2000.

[76] The scheme is not solely applicable to sale and lease-back, although particularly in the independent production sector it has tended to be accessed in this form because the smaller independent producers lack their own tax capacity. In essence, the sale and leaseback scheme works

independent producers and either banks or groups of high wealth individuals seeking to offset corporate or personal tax—currently generates a sum roughly equivalent to 7–8% of the programme budget for production companies, which can be used either for up-front investment in programme production to help offset a deficit on the primary licence fee or as development funding for future productions. Industry sources estimate that, to date, the tax break has been utilised on a range of TV productions with a combined total budget in the region of £40-50m and brought in around £3-4m of new investment to the sector.

6.2.30 While TV producers, in general, have been rather slow to seize upon the opportunity the scheme presents, we believe that more than twenty of the larger independent production companies are now benefiting from the scheme. The positive effects of this include giving the companies greater scope for retaining certain programme rights (if they wish to do so) and encouraging some investors who have benefited from the scheme to consider more speculative direct investments in production.

6.2.31 In providing an alternate source of external finance for production companies, the scheme is, albeit in a relatively modest way thus far, helping to counteract one of the long-term structural weaknesses of the UK television programme supply industry.[77] Accordingly, we recommend that HM Treasury should be asked to consider extending the scheme beyond its current cut off point in July 2002.

Regulations on Advertising, Sponsorship, Masthead Programmes, and e-commerce

6.2.32 From the perspective of the programme supply industry as a whole, and in the context of our expectation of greater competition in the broadcasting market following an accelerated digital switchover and the growth of new digital services, we believe that the ITC's recent relaxation in the rules governing programme sponsorship should be regarded as the first step in a much more comprehensive process of relaxation in the rules governing sponsorship and advertising over the

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as follows. The owner of a film with a production budget of under £15m—say, in this case an independent producer—sells the film to the investor group, typically either a bank or a partnership of individual investors, and then takes a lease-back of the film, under which all the rights flow back to it. The lease period is normally 15 years and the producer undertakes to pay a rent to the new owner of the film annually throughout the period of the lease. After the acquisition, the investor group is able deduct the cost of that film from their taxable profits, thereby saving, in the case of the banks, 30% corporate tax and, in the case of individuals, 40% personal tax. Over the next 15 years the investors pay tax on the rental payments as they come in over the next 15 years; in effect gaining a tax deferral from year 1 to years 2–15. As investors are often wary of taking on the 15 year credit risk of a small producer, the producer will often need to seek a bank guarantee, which the bank gives on the basis of the deposits of a sum of money (derived from the sale & leaseback deal) sufficient with interest to meet the rental obligations as they fall due. Hence, the benefit to the producer is the difference between the sales price of the film to the investor group and the costs of the deposit, interest and bank fees.

[77] *The Creative Industries Report on the Creative Industries Finance Conference* provides further evidence that the risk structures are not yet fully in place, noting that the banking and financial sectors need to be encouraged to move away from manufacturing-based lending criteria toward lending against intellectual assets. *Creativity with Capital*, DCMS, 29 November 1999.

next five years. With the possible exception of certain additional safeguards for children, this process should bring the regulatory framework and rules governing television as closely into line as possible with those that govern other media, such as print.

6.2.33 This view is underpinned by four arguments:

1. On a practical level, it will become increasingly hard to justify and impose different restrictions on converging platforms, and, rightly or wrongly, the standards of the lowest common (and least controllable) denominator—i.e. the internet—will apply. It already seems increasingly anomalous, for example, that Disney can promote its theme parks and new theatrical film releases in streamed audiovisual material on its web site but is prohibited in programmes produced for its UK television channel, and that News International, for example, can't produce masthead news-related programming linked to brands such as *The Times* or *The Sun* on licensed TV services, but can stream video material linked to those brands over the internet without comparable restriction.
2. The need to micromanage advertising will be substantially reduced in a world of channel abundance, where different advertising models can flourish and consumers can choose-away from channels if the form or content of advertising displeases them. In particular, we believe that concern about such a relaxation will be attenuated so long as the BBC, and other subscription channels, continue in an advertising-free programming environment.
3. If one of the major sources of finance for new programme production in the UK is to be retained, the TV and advertising industries will increasingly need to be freed to explore and develop new forms of advertising as technological changes weaken the role of the traditional commercial spot model.
4. Properly enforced, the existing nexus of laws on defamation, obscenity, data protection, consumer credit, the sale of goods, race discrimination and the privacy requirements of Human Rights Act, along with the Office of Fair Trading's power to act in the case of misleading advertising, offer an effective basis for keeping the system in check.

6.2.34 Inevitably, such a relaxation of the rules will have positive and negative consequences. On the positive side, we believe that the eventual effect of the new technology will be to increase not decrease the amount of funding available for programme making across the audiovisual content industry as a whole, as emerging technologies increase the efficiency and effectiveness—and, perhaps also, to some degree the public utility—of advertising. On the downside, although some might see it as a step forward as well, it will place greater responsibility on individual viewers to make mature and informed judgements for themselves about the advertisements that seek to catch their eye.

6.2.35 We have listed below some examples of the kinds of things viewers might expect to see under such arrangements:

- A “branded” channel or programme that openly refers to other associated commercial activities.
- Sponsored programmes may be openly referred to as “brought to you by”.
- A (masthead) programme or channel may be identical in content or share the same editorial control with a print or web-based publication.
- A product named in a programme, or associated with a programme, is’ advertised by a spot adjacent to a programme.’
- A programme refers viewers to an internet address, or e-commerce sites, where products may be purchased, or services such as club membership offered.
- An advertiser may invest in, or create, programmes, receiving credits or sponsorship, or spots in programme breaks.
- Single episodes in a series may sponsored.
- Product placement defined as the inclusion of, or a reference to, a product or service within a programme in return for payment or other valuable consideration to the programme maker or broadcaster will be allowed.[78]
- Companies will be able to receive credits for goods supplied to, and visible within, programmes—as with the use of IKEA furniture in the US version of *Big Brother*.
- The type of breakfast cereal visible on the kitchen table in an episode of, say, *Friends* will be changed digitally to reflect the different preferences of different territories and different types of viewers.
- Donors of prizes or competition sponsors will be able to receive on-screen mentions in game shows.

6.2.36 For many this will be an uncomfortable prospect, but it is important to emphasise two key points. First, to some extent the system is self-limiting—i.e. it is not necessarily in the advertiser’s, sponsor’s or the programme maker’s interests to exploit the full possibilities of the relaxed system of regulation. It should be remembered, in this context, that other forms of commercial media without specific prohibitions on these practices have not necessarily adopted them, and where they have done so, they have usually wished to be very clear with their viewers or readers on the relationship between editorial and commercial content. Advertiser-supported features are rare in print journalism, and most papers, when dealing with commercial products, are keen to demonstrate their editorial independence.

6.2.37 Second, as already noted, this liberalisation should unfold in the context of a post-digital switchover environment in which, unlike the historically prevalent broadcasting market, viewer choice is not limited to a handful of channels. The greater the number of channels available—and particularly so long as the BBC, and other subscription channels, continue to provide an advertising-free programming environment—the easier it will be for viewers to switch away from overly intrusive advertising that displeases or disturbs them and for other channels to provide alternative models for them to switch to.

[78] In the US, the Spelling operated website AsSeenIn.com already offers viewers of its TV programmes the opportunity to purchase, for example, the clothes warn by the stars of it shows.

6.2.38 Finally, we recognise that one implication of the greater responsibility placed on individual viewer choice by the proposed liberalisation, is that there may well be good grounds for retaining an additional layer of regulation governing advertising and sponsorship in and around children's programmes. Though, again, this line will be increasingly difficult to draw meaningfully.

Talent Agreements

6.2.39 It is extremely difficult to do proper justice to the complex area of talent rights negotiations in the context of such a wide ranging inquiry; particularly at a time when new digital technologies—that allow works to be reproduced exactly and cheaply, easily incorporated in other works, and quickly distributed worldwide—are raising fundamental questions about the traditional structure of intellectual property law and placing a greater administrative burden on talent unions and collecting societies.[79] As a result, we have confined ourselves to a few specific observations.

6.2.40 The move from a residual to a royalty based system appears to have opened up new markets for exploitation of programmes, improved the economic prospects of all parties, and should encourage both sides to explore further win-win opportunities in the future. While we have sympathy for directors' current campaign to secure rewards for their work in line with those enjoyed by other talent groups—albeit recognising the variations in role played by directors across different types of production—we believe that this issue, like all others associated with talent agreement negotiations, is fundamentally an issue for the market to decide. It is perhaps worth emphasising though, in this context, that provided that the result is not oppressive or anti-competitive, we see no cause for concern about groups of rights holders seeking to act collectively to strengthen their negotiating positions. Where any of the talent groups—or the broadcasters, for example, in the case of the conflation of roles between agents and producers—have cause for concern about abuse of market power in negotiations, systematic evidence should be presented to the appropriate competition authorities.[80]

6.2.41 There are, however, some issues relating to talent agreements where the Government does have a role to play. This is the case, for example, with authors' and performers' moral rights[81] because Governmental decisions, relating to the ratification of international treaties, establish the legal framework within which commercial negotiations take place. Authors' moral rights are already recognised in the UK under the terms of the Berne Convention,[82] but UK performers' are currently

[79] See for example: *The Digital Dilemma: Intellectual Property in the Information Age*, Computer Science and Telecommunications Board of US National Academies, November 1999. See also the current legal cases in the US involving, for example, Napster and Scour.com.

[80] For example, BACS has repeatedly expressed concerns about the power of broadcasters and production companies to insist that a composer assigns his or her publishing rights in commissioned music as a condition of the commission contract.

[81] In essence, moral rights give authors and performers (i) the right to be identified as the author or performer, and (ii) the right to object to derogatory treatment of a work or performance that is prejudicial to honour or reputation. See also Footnote 82 below.

[82] Article 6 of the Berne Convention states that "*Independently of the author's economic rights, and even after the transfer of said rights, the author shall have the right to claim authorship of the work,*

pressing for their moral rights to be recognised as well. Moral rights for performances recorded in sound recordings will be introduced by the Government as part of the ratification of the 1996 WIPO Performances and Phonograms Treaty (WPPT), which, as things stand, seems likely to occur around 2003 in parallel with a wider harmonisation of UK and EC law following the eventual adoption of the draft EC Copyright Directive. The WIPO Diplomatic Conference taking place this December, organised with a view to concluding a new international treaty on performers' rights in the audiovisual area, will consider the possible extension of performers' moral rights beyond sound recordings—though the likely outcome is not yet clear.

6.2.42 Sharply opposed views about the issues relating to moral rights were expressed in the industry interviews conducted for this inquiry. Inter alia, producers broadcasters and distributors are concerned that moral rights can be used as an extra economic lever by authors and performers, and talent groups are concerned that the policy adopted by the UK of allowing moral rights to be waived, though permissible under the terms of the Berne Convention, leaves many individual authors with little practical option but to waive the rights when put under commercial pressure to do so. We understand that these issues will be reviewed as part of a wider consultation process in preparation for the ratification of the WPPT and we would encourage all interested parties to present their cases in this context.

6.2.43 Another role for the Government in the area of talent rights agreements is in the provision of information to all parties; a role that the Government has already begun to play via the Creative Industries Intellectual Property Rights Group [CIIPRG]. Untangling the intricacies of the various talent agreements is a challenging enough task for the relatively well-resourced rights and business affairs units of the broadcasters and one with which, it has been suggested to us, many small independent production companies struggle. The intellectual property portal web-site, recommended by CIIPRG, and being developed under the guidance of the Patent Office could well offer a platform for further knowledge management tools in this area. Possible developments suggested in the course of the inquiry include a detailed map of all the rights associated with audiovisual productions and an interactive, intelligent-expert interface that identifies the salient issues associated with a particular programme and guides producers to the appropriate contacts. The existing Government support in this area is welcome, but more ambitious developments of the site are likely to be contingent on greater support from the industry.

6.2.44 Finally, we would urge the Government to continue to press overseas collecting agencies to respect and, where appropriate commit to, international agreements on the transfer of payments between territories to ensure that UK talent receives its due reward for overseas transmissions of UK-produced programming.[83]

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and to object to any distortion, mutilation of, other modification of, or any other derogatory action in relation to, the said work, which would be prejudicial to his honour or reputation."

[83] Many societies especially in the larger European states are resistant to paying British performers via the normal route of a collecting society in the performer's country of normal residence; the principle reason for withholding payment being a lack of reciprocity in rights and remuneration between the UK and other member states. UK performers are legally entitled to the remuneration collected by these societies, but collection is frequently blocked by technical issues and, where payments are made, deductions to support the indigenous industries often reduce the sums available for UK authors and performers.

The failure of some overseas societies to do so currently constitutes a barrier to trade in intellectual property.

Documentary & Features	A relatively small category of Factual Entertainment Programmes such as *Rolf's Amazing World of Animals* and *30 Years of Billy Connolly*.
Drama: Long Running Series	The Soaps. A drama programme shown throughout the year, with a consistent set of characters and some plot continuity—e.g. *Coronation Street*, *EastEnders* and *Brookside*.
Drama Other	All drama other than long-running series and films. The genre includes single plays, series and serials—e.g. *Inspector Morse, The X-Files* and *Playing the Field*.
Entertainment	This genre includes Game, Quiz and Panel shows, Sit-coms and Sketch shows, Adult Animation, Variety Shows, Chat Shows and Special Events.
Films	This genre poses special problems for producer classification. Many recently made UK films have received finance from the BBC, Channel 4 or BSkyB. The involvement of the broadcaster varies, from merely pre-buying a licence to show the film on UK television to having a substantial stake in the profits or losses from production. This raises the question whether they should be considered to have been acquired or commissioned when they are shown on television. We have been guided by the attributions to production companies in the credits, with the result that most films were counted as acquisitions. Attribution of nationality to films is also problematic: films may be produced by a company that is based in one country and made in another, with funding from several countries. Further, the film may be owned by a company in yet another country. Again, the credits have been used as the guide. For example, an Ealing comedy will be classified as made by a UK non-broadcaster, although the rights to it might not be owned by a non-UK company.
First Run	The first time a programme is shown by its commissioning (q.v.) broadcaster/channel, we call it First Run, regardless of the type of material—i.e. most new programmes are First Run. At the extreme, even MTV programming comprising frequently shown music videos with live or pre-recorded links is classified as First Run because it has been put together specifically for the transmission.
Hirschman-Herfindahl Index	The H-H Index is calculated by summing the squares of the market shares of all firms within the market. For example, if company “X” enjoyed a market share of 8%, its H-H Index value would be 8^2 or 64. While competition policy is a far more complex subject than can be compressed into a single indicator, competition authorities have traditionally regarded an H-H Index of less than a 1,000 as one signal that a market may be predisposed to perform competitively.
Independent	A company that produces material broadcast on television, and is not a broadcaster or controlled by a broadcaster.

In-House	A programme made by the company that will first transmit it.
Lifestyle Programme	Cookery, DIY, Gardening and other Hobby/Leisure Activity programmes, such as *Ground Force, Antiques Roadshow*, *Masterchef* and *Changing Rooms*.
NAR	Net Advertising Revenue.
Pre-sale	The purchase by a broadcaster of a licence to broadcast a programme which has not yet been made. Typically, a lesser spend than on a commissioned programme, but more than on a purchase after a programme has already been broadcast in its principal market.
Profit	Profit before tax and financing charges.
Repeat	A programme shown for the second or more time by the broadcaster that commissioned it—e.g. when *EastEnders* is rebroadcast on a Sunday, that is a repeat.
Viewer Hours	The duration of a broadcast multiplied by the average number of viewers. Often referred to informally as “eyeball hours”.

Shaun Williams	PACT
Kris Jones	PACT
Diane Freeman	PACT
Judith Sullivan	The Patent Office
Roger Knights	The Patent Office
Rod Hastie	PIRS
John Axon	PRS
Eileen Gallagher	Shed Productions
Cathy Payne	Southern Star
Griff Rhys Jones	Talkback Productions
Peter Fincham	Talkback Productions
Patrick Robinson	Telewest
Peter Bennett-Jones	Tiger Aspect
Larry Chrisfield	TWI
Simon Hochauser	Video Networks / Homechoice
Hugh Williams	Video Networks / Homechoice
Sophie Balhetchet	World Productions