

## Channel 4's response to Phase 2 of the second Ofcom PSB Review

1. Ofcom's second review of Public Service Broadcasting (PSB) comes at a key time for the UK's creative industries. The fundamental and irreversible structural changes in UK media have opened up a range of opportunities for consumers and citizens to access content however and whenever they want. However, these same structural changes have also undermined the foundations of the UK's historic commercially-funded PSB system and now threaten the UK's world-leading position in the creative economy.
2. Given the scale of these changes, Channel 4 believes there is a need for a radical re-think of how to fund and deliver public service content in the digital age. While it will be important to embrace the opportunities provided by the new digital world, Channel 4 believes that there should still be a policy focus on ensuring that high quality, UK-produced content is delivered to audiences. UK-produced content drives significant economic and social benefits in its own right, and the provision of compelling content for digital platforms is a key enabler of growth in broadband take-up and next generation access.
3. These challenges and opportunities have been recognised by the Government, Ofcom and industry alike. In March 2008, Channel 4 published *Next on 4*, a strategic blueprint for its role and purposes in the digital age: it set out a vision for the future in which Channel 4 develops to become a public service network, providing public service content on a range of platforms. In April 2008, Ofcom commenced its second PSB review. In September 2008, at the RTS London conference, the Secretary of State for Culture, Media and Sport recognised the growing need for urgent action and committed to speed up the Government's policy processes and make decisions early in 2009.<sup>1</sup> Subsequently, in October 2008, the Government announced its Digital Britain Review process, with an absolute focus on delivering policy solutions that ensure Britain is best placed to take advantage of the digital future. In the light of this accelerated timeline, and rapidly worsening market conditions, Channel 4 urges Ofcom to make clear recommendations to the Government for urgent action to provide for a sustainable and future facing digital landscape in which public service content outside of the BBC can thrive.

### The importance of plurality

4. Channel 4 believes that a reinvigorated PSB system—characterised by a plurality of public service content providers and high levels of UK-produced content—should be a key policy priority. The arguments around plurality have been subject to years of intensive debate. Despite the advancement of some tentative views that the BBC's output in some areas exhibits high quality without competition (and therefore plurality is not necessary to drive quality), an overwhelming consensus has emerged that action needs to be taken now to secure a plurality of public service providers to compete with the BBC:

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<sup>1</sup> This point was reinforced in a Parliamentary statement on 26 November 2008: "The Government has therefore brought forward its timeline for decisions and is now committed to take a more comprehensive view on the future institutional and financial framework of public service broadcasting, including the future of Channel 4, early in 2009 within the framework of the Digital Britain project."

- Ofcom, in its Phase 2 consultation on the PSB Review, said “virtually nobody favoured [the BBC] becoming the only provider of public service content” and added that “there remains a need to ensure alternatives to the BBC in a range of areas of public service content”.
  - Andy Burnham, Secretary of State for Culture, Media and Sport, said in September 2008 that “we need a new era of sensible collaboration between our PSBs” and added that “healthy competition will always be essential. But our four PSBs all have different roles. It’s time to enhance that sense of distinctiveness”.
  - Jeremy Hunt, Shadow Secretary of State for Culture, Media and Sport, said in October 2008: “I do endorse the underlying analysis behind [Ofcom’s PSB Review], not least the vital importance of plurality of provision for both popular and public service broadcasting”.
  - Sir Michael Lyons, Chairman of the BBC Trust, said in October 2008 that “the future of UK public service broadcasting cannot be left just to the BBC and Channel 4” and added that “we absolutely need all the existing PSBs to remain in the game”.
5. Nonetheless, it is worth revisiting in brief the importance of plurality. First, plurality in public service institutions—the BBC, Channel 4, ITV, Five and S4C—has benefited the wider creative economy, creating a television industry that produces content that is the envy of the world. The competition between broadcasters has led to greater quality and innovation in content. In news, for example, innovations from Channel 4 and Five have resulted in the BBC modernising its news presentation. In light entertainment, ITV reinvented Saturday evening with shows like *X Factor* and modern quizzes such as *Who Wants to be a Millionaire*—the BBC and other channels have had to catch up. In factual entertainment, Channel 4 has consistently innovated with programmes like *The Big Food Fight*, *Wife Swap*, *Faking It*, and *Embarrassing Bodies*—formats which the BBC and other channels have imitated. In addition, the strength and depth of international coverage on *Channel 4 News* and *Unreported World*, and the award-winning current affairs strand *Dispatches*, has forced the BBC’s current affairs and international news output to stay sharp.
  6. Competition for quality between the UK’s public service broadcasters also brings dramatic and significant benefits for the UK’s wider creative economy, delivering a huge amount of international award-winning content that provides a showcase and launch pad for emerging writing, directing and acting talent in the UK, as well as for the UK’s independent production sector. At the recent International Emmys, for example, the UK won seven out of 10 available awards. While the BBC took three awards, Channel 4 took four, an incredible achievement given Channel 4’s relative size. The breadth of these awards also demonstrates the value of cross-genre plurality, with Channel 4 winning in comedy for *The IT Crowd*, documentary for *The Beckoning Silence*, arts for *Strictly Bolshoi* and drama for *Forgiven*. These latest awards follow a period of unprecedented success for Channel 4, which won more BAFTA television awards and RTS programme awards than any other channel in 2007, and which has won five Oscars in the last four years. This critical acclaim is a tangible recognition of the high quality and distinctive output from independent producers that Channel 4 commissions and distributes for free to UK audiences.
  7. In a similar vein, competition for ideas and talent in the film industry between the BBC, Film4 and others drives quality and innovation and helps the UK to punch well above its weight internationally. Film4’s investment leverages significant

additional sums into the UK film industry and its backing and nurturing of distinctive voices and talent delivers films of major cultural and social importance to UK audiences. Just as importantly, many of these films make a significant contribution to promoting British cinema and film talent around the globe. In Channel 4's case, Film4 also provides an important talent ladder for UK drama producers, writers and actors. For example, Dev Patel, the lead actor in Danny Boyle's *Slumdog Millionaire*, had his first break acting in E4 drama *Skins*. Steve McQueen, a former Turner prize winning artist whose debut feature film about Bobby Sands, *Hunger*, won the Camera d'Or in Cannes, started his collaboration with Channel 4 through Jan Younghusband, Channel 4's Commissioning Editor for Arts.

8. Second, plurality serves the public interest. The UK's plural broadcasting system has ensured the provision of a wide range of content which serves the broadest possible range of audiences. Channel 4 provides a distinctive offering to the BBC by covering different subjects and by innovating and taking risks across a range of genres, including current affairs, drama, documentaries and the arts. In news, for example, the provision of different news services from different public service broadcasters gives viewers a diversity of viewpoints and alternative perspectives on the day's events.
9. The existence of a plurality of public service content providers also helps to ensure that content is accessed by harder to reach audiences, such as younger viewers or ethnic minorities. Channel 4 is the leading broadcast brand for younger audiences—42% of 15–24 year olds nominate Channel 4 as their favourite PSB channel—putting the channel in a good position to reach these groups with a range of high quality content. Channel 4's role in this regard will become more important in future as younger audiences continue to turn away from the BBC—over the last six years, the BBC's portfolio share of 16–34 year olds has fallen by 19%, while Channel 4's portfolio share of 16–34 year olds has grown by 16%.
10. Channel 4 therefore believes that public service competition beyond the BBC will be essential in future, in order to ensure the delivery of a wide range of high quality, UK-produced content. Channel 4 believes that UK-produced content is crucial to the delivery of PSB and is valued highly by audiences: research from the BBC shows that UK-produced content accounts for only 16% of all television output but makes up 70% of all viewing.
11. It is clear that the market, left to itself, will not deliver the level of UK-produced content that audiences demand. Nearly 20 years after the introduction of satellite television in the UK, investment in UK-produced original programming (excluding film and sports rights) by digital channels not operated by PSBs is estimated by Ofcom to be only £200 million per annum—less than 8% of total investment in UK origination. Looking at arts programming, for example, while Sky Arts is a very good and welcome addition to the range of channels available to UK audiences, it is important that its contribution to investment in original UK-produced arts programming is put into perspective. Its output is overwhelmingly made up of repeats and acquisitions (in June 2008, for example, Channel 4 estimates that only 7% of Sky Arts programming hours were first run original programmes) and it predominantly focuses on broadcasting arts performances. This has value in its own right, but is lower risk and lower cost compared to the sort of arts broadcasting that public service broadcasters like Channel 4 seek to support, such as the original animation *Peter and the Wolf*, which went on to win an Oscar.

12. In addition, Sky Arts has very limited impact relative to the UK's public service broadcasters. It is a subscription-only channel that is not universally available and as a result, its audiences are extremely small. In 2007, for example, Sky Arts' average audience was only 1,000, while Channel 4 arts programming often achieves audiences of over one million. Scale, impact and reach are extremely important elements of the public service content equation. Another example of the limited ability of multichannels to deliver reach and impact is the programme *Not Forgotten*. This was the top rating show on the History Channel in 2007, achieving an audience of 52,000. However, this was a repeat of an original Channel 4 commission about the First World War, which achieved an audience of 2.4 million on Channel 4.

#### Future vision for Digital Britain

13. The remainder of this response sets out Channel 4's vision for how a reinvigorated PSB system, in line with the objectives set out above, will help drive the UK's creative economy and ensure that the UK maximises the opportunities for convergence for citizens and society. Channel 4 believes that a reinvigorated PSB system—with the BBC and Channel 4 at its heart, plus supplementary contributions in specific areas from ITV, Five and the wider market—will help deliver the key objectives of the Digital Britain Review:

- Ensuring “universal access to high quality, public service content through appropriate mechanisms for a converged digital age”.
- Ensuring that “empowered and informed consumers and citizens [are] fully equipped to take advantage of the opportunities convergence brings”.
- Ensuring that markets provide “investment, innovation and choice, at all levels of the value chain including infrastructure, service provision and the creation of content”. In particular:
  - “investment in content: exploring business models for content development in a digital age”.<sup>2</sup>

14. Channel 4 is key to the fulfilment of these objectives. As a publicly-owned organisation, Channel 4 will remain focused on the delivery of its public purposes, working in partnership with producers and others to guarantee plurality in the provision of high quality, innovative content with ambition, scale and impact. Channel 4 believes that it is essential for the Government and Ofcom to act now to ensure that Channel 4 can continue to deliver these benefits to the UK.

#### *Channel 4's content strategy*

15. In *Next on 4*, Channel 4 set out four core public purposes that capture in greater detail the value of its activities. The core public purposes are to:

- nurture new talent and original ideas;
- champion alternative voices and fresh perspectives;
- challenge people to see the world differently; and
- inspire change in people's lives.

16. *Next on 4* also set out Channel 4's vision for how it will deliver on these core purposes and play a key role as the main source of UK-wide competition and

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<sup>2</sup> Secretary of State for Culture, Media and Sport, Written Ministerial Statement, 17 October 2008

plurality in the provision of public service content alongside the BBC. Channel 4 provides a distinctive offering to the BBC by covering different subjects and by innovating and taking risks across a range of genres. *Next on 4* therefore outlined a number of proposals designed to ensure the provision of a wide range of UK-produced content which serves the broadest possible range of audiences, including groups the BBC is less successful at reaching, such as younger audiences or ethnic minorities.

17. Channel 4 believes it can do even more to stimulate content creation in the UK. It therefore intends to build on the vision set out in *Next on 4* to continue to be a creative force in the new Digital Britain. In particular, a future Channel 4 will play a leading role in providing and stimulating creative content in the following ways.

- *Content commissioning and creation.* Channel 4 will build on its *Next on 4* commitments and will commission and fund the best content ideas from producers across all nations in the UK, including digital content.
- *Content delivery.* Channel 4 will provide universal access to its content, free at the point of use and via digital platforms, driving significant reach and impact across the UK. In 2007, Channel 4's portfolio of channels reached over 92% of the population—and over 90% of 16–34 year olds—illustrating Channel 4's ability to deliver public service content to significant audiences.
- *Content exploitation.* Channel 4 will use its commercial expertise to generate maximum advertising and other revenues for reinvestment in the creative economy.
- *Creative and commercial catalyst* across the UK economy. As a publisher-broadcaster, Channel 4 will support and invest in the independent production sector, stimulating the creative economy in partnership with other companies. As Channel 4 is publicly-owned yet commercially-funded, it can focus all of its energies on content investment rather than on paying dividends to shareholders.

#### *Channel 4's contribution to the creative economy*

18. These four pillars will support Channel 4's contribution to the creative economy. Channel 4's unique approach to creativity has always been grounded in partnership. For example, Channel 4's focus on developing new talent means that it works with over 300 independent production companies each year, far more than any other broadcaster, including the BBC across its entire output. Ofcom data shows that Channel 4 invested more in the external production sector than any of the main network channels in 2007, including BBC1 and BBC2 combined. A recent report by PricewaterhouseCoopers (PwC) showed that the overall economic impact of Channel 4 could be worth up to £2 billion in Gross Value Added, and could support 22,000 jobs across the UK economy. In future, Channel 4 believes that it can make a substantially greater contribution to the UK's creative economy, by stimulating whole new areas of digital media.

19. The PwC report refers to Channel 4's contribution as a "mini 'industrial policy' for the benefit of the creative economy", which "permits a wider diversity of productive talent, [and] which generates new and innovative ideas which translate into high-quality on-screen programming". The report also concluded that Channel 4 acts as a form of "angel investor", providing a "talent escalator" that simultaneously nurtures creative talent and supports corporate development, including by developing content creators' management and business skills. In this

way, Channel 4 plays a key role in nurturing the next generation of talent to grow the UK's creative economy.

20. Channel 4 has the ambition to build on this to stimulate areas of the creative economy that other broadcasters have not reached, delivering greater benefits for Digital Britain. Through partnerships in digital media—illustrated by the 4iP innovation fund (discussed below)—Channel 4 will support creativity across a range of sectors, such as gaming, user-generated content, music and the arts. This strategy will enhance Channel 4's role as a creative and commercial catalyst in the UK, as Channel 4 partners with a wide range of institutions to deliver public service content on digital platforms. Channel 4 is currently developing a framework, to be published as part of its Annual Report and Financial Statements, to better measure Channel 4's creative and economic contribution to the UK.

#### A reinvigorated system for delivering public service content

##### *Institutional bedrock of the BBC and Channel 4*

21. To meet this vision, there is an urgent need to reinvigorate the UK-wide PSB landscape. Channel 4 believes the policy priority should be to secure both the institutional bedrock of the BBC and also Channel 4—to ensure sufficient scale to deliver content with reach and impact—but there should also be additional contributions from ITV and Five, plus the opportunity for the wider market to play a role.

22. As discussed above, the success of the UK's creative industries has been underpinned by a plurality of public service institutions—the BBC, Channel 4, ITV, Five and S4C—creating and commissioning content from a range of sources. This plurality has been vital to ensuring the provision of a wide range of high-quality content which appeals to a variety of audiences, and Channel 4 believes that public service provision beyond the BBC is a crucial part of Digital Britain in future.

23. Channel 4 believes that ITV and Five will be able to make a limited but focused contribution to public service content provision in future. The proposed adjustment of the Tier 2 regulatory quotas for these broadcasters will help to facilitate this contribution.

- ITV has received substantial amounts of regulatory benefits in the past few years, and Ofcom must ensure that this latest round of quota reductions is matched by meaningful public service commitments from ITV. If Ofcom was to give ITV further regulatory relief, any short term increase in ITV's competitive strength would directly impact on Channel 4's performance, further reducing the extent to which Channel 4 could deliver its public service remit.
- In relation to Five, there is clearly an ongoing net benefit to Five retaining its PSB status, and Channel 4 believes that Ofcom must maximise the public value derived from Five's privileged status and regulatory assets.

24. In this way, these broadcasters can continue to make a contribution to plurality in UK content creation and distribution. In addition, Channel 4 believes that for the full range of public service content needs to be met in future, new entrants are likely to be needed to fill specific roles. However, Channel 4, as a publicly-owned organisation dedicated to public purposes, will be the only guaranteed competition

to the BBC across a range of public service genres, and action must be taken to secure Channel 4's role in future.

### *Embracing digital platforms*

25. Channel 4 welcomes Ofcom's endorsement in each of its future models of Channel 4's role in providing and stimulating the creation of innovative, distinctive content on digital platforms.
26. Channel 4 believes that it is vital for it to provide content on a range of platforms—such as digital terrestrial, including HD, online and potentially mobile—in future. A multiplatform presence is not an optional extra for Channel 4—rather; it is absolutely core to Channel 4's role in distributing public service content to audiences in Digital Britain. While television will continue to play a central role in delivering public value, as the best way to reach mass audiences and deliver public service content with impact, Channel 4 must become a public service network to meet consumer preferences and continue to deliver its public purposes with significant reach and impact.
27. Channel 4 believes that it must embrace the potential of new digital media platforms with greater urgency. Channel 4's online presence currently includes a range of commercially-focused and public service offerings. These activities have enabled Channel 4 to maintain the reach and impact of its content. For example, the website accompanying the programme *Embarrassing Teenage Bodies* (which tackled sensitive health issues for teenagers) delivered over 4.2 million page views and nearly 650,000 online video views in the week of the programme's transmission. However, the scale of Channel 4's activities in new media to date is modest relative to the radical changes it must make in future. Fulfilment of Channel 4's creative vision has only been limited by a lack of funding.
28. To this end, Channel 4 has launched a major new innovation pilot fund, 4iP, designed to stimulate public service digital media across the UK. 4iP endeavours to re-imagine how Channel 4's public purposes are best met using the internet and digital networks to deliver new types of content in the digital space. The 4iP fund has already been a success in its early stages with key commissioning hubs already established in Scotland, the West Midlands and Yorkshire and an exciting line up of 100s of potential projects in areas such as the arts, news and democracy, education, grassroots sport and talent development. The 4iP fund aims to invest up to £50 million over the life of the pilot, but Channel 4's ambition to deliver public service content on digital platforms is much greater: Channel 4 believes that, with sufficient resources, it can stimulate the digital media sector in the same way that it kick-started the nascent independent production sector in the 1980s.
29. This strategy will also enhance Channel 4's role as a creative and commercial catalyst in the UK, as it seeks to partner with a wide range of institutions to deliver public service content on digital platforms. 4iP will, through partnership, stimulate the creative economy across the UK by supporting a rich mix of ideas, connecting people and organisations, and encouraging new business models for digital content creators and distributors. Channel 4's will also use the strength of its brand and distribution expertise to help to ensure that new public service digital content reaches a wide audience.
30. As a digital content provider, Channel 4 recognises the importance of the infrastructure networks that facilitate the delivery of that content. However,

networks alone will not deliver the objectives of Digital Britain. Through providing compelling content for digital platforms, Channel 4 will help drive take-up of digital technologies and will help stimulate demand for greater bandwidth. In this way, the content provided by Channel 4 and others will help create the right incentives for infrastructure companies to invest in next generation access. Channel 4 believes that the issues of content and infrastructure are intertwined: interventions that stimulate content production will also have a beneficial effect on the UK's network infrastructure.

#### *Channel 4's nations and regions strategy*

31. Channel 4's vision for content creation extends across the nations and regions of the UK. Through its major investment in the UK's independent production community, Channel 4 does more than any other broadcaster to support independent production in the nations and regions. In 2007, Channel 4 invested £125 million (35% of its UK originated first-run spend) out of London, including major returning series such as *Shameless*, *Deal or No Deal* and *Hollyoaks* as well as single films and one-off dramas.
32. Off-screen, Channel 4 undertakes a wide range of initiatives aimed at offering strategic support to companies based outside of London. This includes a ring-fenced £0.5 million development fund for out of London independent producers; training and development programmes, such as its feature film development strategy; and broader partnership initiatives, such as the Creative Cities programme, which links Channel 4's initiatives to regional development authorities and screen agencies.
33. Channel 4 will seek to build on these strong foundations and is committed to a major new nations strategy that will develop the measures set out in *Next on 4*, subject to receiving a new funding settlement. Channel 4 is a UK-wide broadcaster and does not—unlike ITV and the BBC—operate any nations opt-outs or therefore supply any dedicated nations content. However, Channel 4 believes it has a significant role to play in supporting the creative economy as a major investor in independent production, and in providing a UK-wide platform for content created in the nations.
34. As part of this strategy, Channel 4 has the ambition to substantially increase its production spend in the nations. Channel 4 believes that it should be possible for this investment to exceed Ofcom's proposal for a new Tier 2 out-of-England quota, subject to receiving a new funding settlement in the near future. In addition, Channel 4 is seeking to create key 4iP hubs in the nations, and will make a multi-million pound investment on 4iP projects in the nations during the life of the pilot, with the potential for greater investment through match funding. Channel 4 is also open to discussion with partners about new ideas that will help address some of the concerns raised by the broadcasting committees in Scotland and Wales. For example, Channel 4 recently won a joint bid with S4C for capacity to deliver HD services, demonstrating Channel 4's willingness to enter into meaningful partnerships with organisations in the nations now and in the future.
35. Channel 4 believes that, alongside other providers such as the BBC, S4C and STV, it can play a significant role in supporting and developing the creative economies of the nations. However, it is important that the structural and other obstacles to the achievement of this objective are acknowledged. It will require public investment; clear and coordinated public policies; and, in Channel 4's view, a range of public

service and commercial entities in the nations working together to create sustainable creative ecologies in the nations.

#### *Nations and regions news*

36. Channel 4 believes that the wider nations and regions model should also seek to secure news provision from organisations beyond the BBC. ITV's news services have long provided public service competition to the BBC, driving the benefits of competition and innovation, choice and a diversity of viewpoints for consumers. However, ITV is not immune to the severe financial challenges facing commercially-funded public service broadcasters, and its regional news services are therefore under pressure, in part due to the high costs of maintaining a regional production infrastructure.
37. Channel 4 relies on the regional production infrastructure provided by ITN for ITV. This gives Channel 4 access to newsgathering resources across the UK, allowing Channel 4 to increase the range and diversity of stories it covers on *Channel 4 News*. Given this relationship, Channel 4 believes that damage to ITV's regional newsgathering capability would have a negative impact on its own news service. It is vital that a new model for nations and regions news is agreed which ensures continued public service competition to the BBC: where possible this should build on the brand heritage and reach of ITV and ITN's regional production infrastructure.

#### *Children's content*

38. It will also be important to ensure that children's content is provided beyond the BBC. Given sufficient resources, Channel 4 believes it can contribute to this objective by making content for older children a part of its public service role in future—with a presence on the core channel and provision via digital media. Channel 4's brand resonates strongly with younger adults, putting it in an excellent position to reach older children. Channel 4 also speaks to younger adults with an authenticity of voice that other institutions find it hard to replicate.
39. In education, for example, Channel 4 has adopted a pioneering approach to schools output by focusing resources on digital content for 14–19 year olds and has shifted its £5 million annual budget for education programmes aimed at teenagers from linear television to multimedia projects. This initiative has led to exciting multiplatform projects such as *Year Dot*, which looks at how social networking can help young people achieve their ambitions, and *Battlefront*, which helps teenagers build individual campaigns on different platforms and reach new audiences. These projects further demonstrate Channel 4's ability to reach audiences through digital media, as outlined above.
40. Channel 4 can only be part of the children's content solution: there will be a key role for other organisations in creating and distributing content for younger audiences. In *Next on 4*, Channel 4 made a commitment to launch a pilot fund for children's programming. As part of this initiative, two projects are currently in production with a further project in development. However, in the light of the deterioration of Channel 4's financial situation, Channel 4 has had to delay the transmission of these programmes pending certainty on a funding solution.

## Funding urgently needed to deliver this vision

41. Channel 4 believes that urgent Government and regulatory action is needed to achieve this vision for Digital Britain. In particular, a new funding settlement is urgently needed to underpin the UK's creative economy and stimulate the success of the digital and communications sectors, estimated by the Government to be worth well over £52 billion per annum to the UK.
42. Ofcom's analysis from September 2008 is clear that the current model for public service content delivery and funding will not be sustainable in the digital age. Ofcom estimated that, due to structural changes in the market, between £145–£235 million will drain out of the commercially-funded public service content system as a whole by 2012. Ofcom also estimated that Channel 4 would require additional funding of up to £100 million per annum by 2012 simply to deliver its existing remit. Beyond that, Ofcom estimated that implementing the additional initiatives in *Next on 4* would increase Channel 4's funding requirement to up to £150 million per annum by 2012, and noted that there would be further incremental costs should Channel 4 be successful in its bid for DTT capacity for HD services.<sup>3</sup> Channel 4 believes that the vast majority of these new initiatives—such as online distribution and the move to HD—are not optional: rather, they are essential in the digital age.
43. Since September, the drastic deterioration of the UK economy has significantly worsened the outlook for commercially-funded public service broadcasters. The imminent prospect of the UK economy entering into recession, combined with financial sector failure resulting in the unprecedented nationalisation of financial institutions, has resulted in an advertising market where confidence is at an all time low. Consequently, the prospects for commercially-funded broadcasters are now even bleaker, and independent analysts have revised their advertising market forecasts downwards. Enders Analysis, for example, now forecasts television advertising revenue to fall by 10% in 2009 and to fall by a further 4% in 2010. This is significantly worse than Enders' advertising market forecast from August 2008, which predicted a fall of only 3% in 2009 and a flat market in 2010.
44. It is widely accepted that the depth of the current downturn is more than a cyclical trough. The magnitude of the downturn, combined with structural decline, means that there is no prospect of the market recovering to anywhere near its former levels. The cyclical downturn has accelerated the pace at which the structural problems will hit commercially-funded public service broadcasters, meaning that these broadcasters now face immediate financial problems. In addition, commercially-funded public service broadcasters will increasingly be at a competitive disadvantage to the BBC, as licence fee income is guaranteed to rise every year until 2012, while television advertising revenue is forecast to fall until 2010, potentially recovering only marginally in 2011.
45. Channel 4, along with the other commercially-funded public service broadcasters, is therefore in a much tougher financial situation than that forecast by Ofcom in September 2008. It is clear that recent events have accelerated the need for urgent action to support content creation and Channel 4, along with the other commercially-funded public service broadcasters, needs certainty now about its future funding model. Channel 4 is currently assessing the implications of the

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<sup>3</sup> On 17 October 2008, Ofcom announced that Channel 4, in partnership with S4C, had won its bid for one of the slots to broadcast HD services on DTT.

market deterioration for Channel 4's funding and forecasts and will be sharing this analysis privately with Ofcom and the Government over the coming weeks.

46. In addressing these problems Channel 4 believes that broadcasters should do all they can to help themselves. To that end, Channel 4 has implemented an aggressive series of self-help initiatives to mitigate the financial threat where possible. Channel 4 has achieved significant cost savings—exceeding the overhead and production efficiencies of competitor broadcasters in recent years.
47. Despite increasing business complexity, Channel 4 has managed the transition to become a multimedia organisation while also tightly managing headcount: by summer 2008 headcount had been maintained at below 2001 levels, with outsourcing plans in place for further reductions. Following completion of this outsourcing and a further radical restructure necessary as a result of the structural and cyclical changes in the market, by January 2009 Channel 4 will have one third less staff than it had in the summer. Following this, Channel 4 believes that headcount will have been reduced to an absolute minimum for its current activities, and in some areas cut to risky and potentially damaging levels. Channel 4 has gone substantially further than many other companies in the depth and speed of its restructuring and, going forward, Channel 4's overhead will represent only around 3% of its total spend each year.
48. While making savings and driving efficiencies are important, these actions alone cannot compensate for falling revenues. Channel 4 has therefore had to cut programme budgets—with an inevitable impact on public service content delivery—and Channel 4 has also had to cut investment in new activities and decrease its support for partner organisations such as charities and training bodies in order to manage a break-even position. Given that overheads have been cut to an absolute minimum, Channel 4 believes that any future pressure on its revenues will have to be borne by content and activity budgets. Public service provision from other commercially-funded public service broadcasters is also clearly under threat, illustrated by ITV's effective withdrawal from original UK children's content investment and its plans to reduce investment in regional content. This reduction in content creation will threaten many of the objectives of Digital Britain and jeopardise the UK's world leading position in the creative industries.
49. Channel 4 therefore believes that replacement funding is urgently needed to underpin the plural provision of high quality, UK-produced content. If clarity is provided on a funding solution early in 2009, Channel 4 may be able to draw on its existing cash reserves in mid to late 2009 to minimise the possibility of a further round of damaging programme budget cuts in 2010. However, as Ofcom observed in its last report, in the absence of certainty about future funding, planned draw down of reserves would be an irresponsible course of action for Channel 4 to pursue.

#### *Funding options*

50. Channel 4 believes that it is essential for it to remain a publicly-owned, commercially-funded public service broadcaster. Thanks to this status, Channel 4 is able to re-invest its profits in the creative economy, instead of paying out dividends to shareholders. The Channel 4 model has always ensured that public support—in the form of analogue spectrum—has been used to generate commercial revenue to subsidise the huge amount of loss-making public service content that Channel 4 provides. In future, Channel 4 believes that commercial

revenue will continue to be key to funding public service content. It will be essential for any new funding model to ensure that public service content providers maximise commercial revenue and maintain efficient ways of working, thus minimising the call on public funds. It will also be important to continue to build on creative partnerships that can sustain content production in the UK. There will still be residual regulatory assets in the system, and Channel 4 believes that the beneficiaries of these assets should focus on maximising the public value they deliver in return.

51. While commercial revenue and regulatory assets will continue to play a role, it is clear that a new system of public investment will also be needed to sustain UK content creation. Ofcom has set out a range of funding options, including additional direct public funding, industry levies and tax breaks for content production. Ofcom has also set out a range of options involving the BBC, which seek to leverage some of the £3.5 billion of public licence fee funding in the system for other content providers. Ofcom has suggested that the revenue from the licence fee dedicated to digital switchover or a stake in BBC Worldwide could help the creative economy. In addition, in June 2008 the BBC itself outlined some preliminary thoughts for how it could help the creative economy through partnership.
52. As Ofcom rightly identifies, it is ultimately for the Government to decide on most funding options. Channel 4 therefore welcomes the Government's commitment to bring forward its timeline for decisions and its commitment to "take a more comprehensive view on the future institutional and financial framework of public service broadcasting, including the future of Channel 4, early in 2009 within the framework of the Digital Britain project".<sup>4</sup>
53. Over the past few months, Channel 4 has carefully examined the options identified by Ofcom. In particular, Channel 4 has assessed all funding options against a range of criteria similar to that outlined by Ofcom, including scale, sustainability and certainty. Channel 4 has also assessed the options against important principles designed to maximise Channel 4's ability to take creative risks in content production, retain editorial independence, and engage in commercially entrepreneurial activity, while recognising potential governance and accountability issues. Above all, Channel 4 has considered each funding option's potential to help deliver the public service content vision for Digital Britain set out above.
54. On the basis of this analysis, Channel 4 is convinced that a basket of funding measures will be needed to support the wider creative economy in future. Channel 4 is encouraged that the BBC recognises that it needs to be a major part of the funding solution and has raised the possibility of partnering with other organisations. Channel 4 looks forward to seeing with urgency specific details of how the BBC's partnership ideas will deliver tangible financial benefits. From preliminary sight of the BBC's proposals, Channel 4's assessment is that, while some of the ideas have a strategic logic and may well be sensible, in some cases they do not apply to Channel 4 and where they may apply, it is hard to see how they will deliver significant tangible financial benefits.
55. Notwithstanding these proposals, Channel 4 continues to believe that a wider solution than partnership will be necessary to support content creation in the UK beyond the BBC. Channel 4 is in continuing discussions with Ofcom and the Government about the most appropriate funding solution for Channel 4, in the

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<sup>4</sup> Secretary of State for Culture, Media and Sport, Written Ministerial Statement, 26 November 2008

wider context of other issues that need to be addressed to secure overall public service content provision.

#### Concluding comments

56. The financial pressures Channel 4 has been forecasting for several years are here now and are being exacerbated by the exceptional economic times faced by the UK. Channel 4 urges Ofcom and the Government to take action early and agree a new funding settlement to support content creation and benefit the wider creative economy.
57. Channel 4's unique funding model has always ensured that any public support it receives—such as gifted analogue spectrum—delivers the maximum amount of public value. The commercial revenue that Channel 4 generates from its current subsidy is invested in creative content, which in turn generates further revenue for reinvestment in the creative economy. This builds public value in two key ways: by delivering public service content to audiences for free; and by stimulating businesses and job-creation in the wider creative economy.
58. Channel 4 is clear that it will maximise the public value of any support it receives in future. Going forward, support for Channel 4 should not be seen as a cost, but as an investment. Channel 4 is passionate about delivering public value and, as it has always done, will use any support it receives to deliver public service content while simultaneously supporting the UK's creative economy. In this way, Channel 4 will meet audience needs and help to maximise the contribution that the creative content industries can make to Digital Britain and its place in the global economy.

**5 December 2008**