

## **Small Screen: Big Debate – Public service broadcasters and the UK production sector**

### **Call for Evidence – ITV plc response**

#### **Market Context: Increasing competition, an online revolution and advertising restrictions**

Potential reform of the independent production quotas and terms of trade needs to be considered in context. Decades of UK industrial policy have been designed very successfully to increase competition to the PSBs at all levels of the value chain – through the creation of Channel 4 and the launch of Channel 5, the imposition of independent production quotas and terms of trade, the PSB must-offer provisions to encourage competition to analogue monopoly distribution, digital switchover facilitating universally-available multichannel television, tax incentives for UK productions etc. The arrival of a global online TV market in the UK at scale and the increasing consolidation as a reaction to that (Sky/Comcast/NBC, Disney/Fox etc) are the latest manifestations of this onward march of increased competition.

The result is that the PSM landscape today is characterised by fierce competition between national PSBs and global players, disintermediated increasingly by global online content platforms with powerful producer suppliers who, on Ofcom's numbers, now generate more revenue from outside the PSM system as they do from within it.

We would observe that, in the midst of this maelstrom of revolutionary change, one thing that has evolved relatively little since the early 2000s when analogue TV was still the norm, is the basic structure of the independent quota and terms of trade that apply to PSB commissions. These have been very successful interventions in helping to encourage more competition to vertically integrated PSBs and creating a TV production industry base for the UK that global players have recognised and are now using at scale. But clearly nearly 10 years after analogue TV was switched off, the world of TV and video is a very different one.

There is, of course, much to celebrate in more competition and innovation in the TV market – in the benefits it brings through expanding consumer choice beyond the former monopoly providers and investment in content for UK consumers these new providers bring. But increased competition has inevitably reduced the consumption of content from former monopoly PSBs and, as a result, impacted on their ability to pay for the things that the market does not provide. This was inevitable as viewing fell and as the regulatory assets (DTT spectrum and prominence) became progressively less valuable as a result.

Indeed, this tension is reflected in media policy where in recent years, far from relying more on the wider commercial TV and SVOD landscape, policymakers and regulators have actually wanted more PSM output – authentically representative of the UK – as a counterweight to increasingly global market provision. That's why we've seen increased PSB obligations, for instance in relation to children's television and stricter rules around regional productions.

However, the market is moving in a different direction – driving the roll out of global paid-for services, squeezing the visibility and viability of free to view national PSM content. This is adding more choice for those willing and able to pay but not replacing the public value delivered by the free, universal PSM. Indeed, increasing competition and disintermediation is reducing the value of commercial PSB licences and undermining the ability of the PSBs to deliver public value at the scale that they have in the past. This is reflected in the well-

documented decline in PSB investment in first run content over the past decade, now at £2.5bn versus a peak of over £3.2bn<sup>1</sup>.

Ofcom itself concedes that despite rapid technological evolution, the current PSB system and regulatory regime has seen little change since 2003 – when there was no YouTube or iPlayer, Netflix offered DVDs, and Facebook was called Facemash – and “urgently needs updating.” We welcome Ofcom’s conclusion that there is an urgent need for a new framework to support an effective transition to public service media, straddling online and broadcast TV.

These market trends will be dramatically intensified by the government’s decision to introduce a pre-9pm ban on HFSS advertising on TV which will further substantially reduce the value of the commercial PSB licences and hence the public value that the PSBs can deliver to the UK. [✂] This blow will be intensified should the government fail to ensure a level playing field between TV and online, as this will shift the balance of power further towards the likes of Google and Facebook.

Given these changes, however, it is appropriate in the context of the PSB Review to look carefully at our expectations of PSB players and the overall funding in the system for PSB outcomes. So, for instance, the historic assumption that each PSB should be all things to all people, delivering every PSM outcome needs careful examination. It is rooted in an age when such expectations could be paid for out of excess monopoly profits – redistributed in pursuit of both content policy and industrial policy objectives – without any serious impact on PSB licence holders who faced little competition.

In this context, Ofcom is therefore right to carefully consider the impact that the combination of market change and the current independent production interventions are having on the sustainability of PSM – and its ability to meet the needs of UK audiences, who increasingly expect to be able to watch whatever, whenever and wherever they like.

We’re hopeful that, however we get there (and our preference would be via a negotiated rather than a regulatory route), what can emerge is a new and modern partnership between PSBs like ITV and independent producers of mutual benefit, continuing to deliver a public good – culturally and economically – for years to come, with a framework updated for the consumption patterns and economics of the online TV era.

### **The existing independent production interventions are shifting increasing value from ITV to producers**

The existence of interventions in relation to independent production stemmed ultimately from concerns 20 years ago that independent producers were in effect simply ‘guns for hire’ – a way to outsource the physical production of a programme whilst the commissioning broadcaster retained all the underlying rights.

Instead, regulated Terms of Trade have sought to enable a PSB like ITV to fund the commissioning of UK content at scale while also ensuring that independent producers had more autonomy and ownership of the resulting IP. For decades the approach to independent production quotas and terms of trade have therefore rested on the (for many years broadly correct) assumption that there was a balance between ITV and the producer:

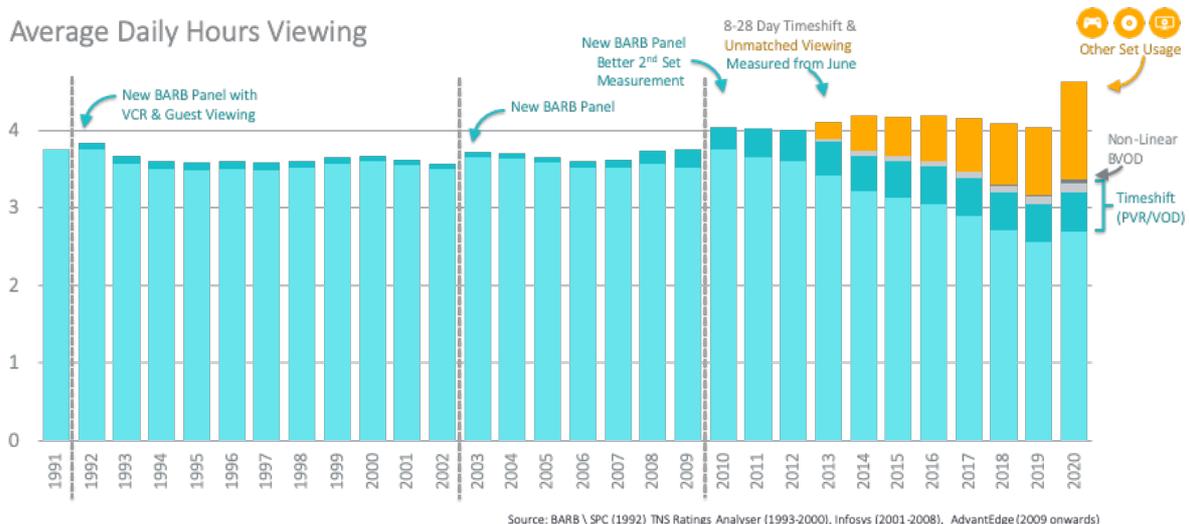
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<sup>1</sup> <https://www.smallscreenbigdebate.co.uk/what-is-ssbd/ssbd-five-year-review>

- ITV bore the majority of the risk and received sufficient value in the primary rights to cover that: ITV took the risk of commissioning and paying for content initially, with a high failure versus hit rate intrinsic in the creative process. ITV was committed to paying for commissions even if they failed to attract an audience. This relatively high risk and investment was offset by the substantial financial reward, via linear advertising revenues generated in the primary rights window, from those programmes that were successful; and
- The producer bore little risk and so retained the somewhat less-valuable secondary rights: reflecting the lower risk taken by the producer, who was guaranteed payment regardless of the success of the commission, versus ITV as set out above. But also ensuring producers were more than ‘guns for hire’ and able to use the rights they retained to build successful and sustainable businesses.

But the risk-reward balance has become increasingly out of kilter, as

- a) the risk for broadcasters in commissioning has increased, as competition for audiences means it is harder and harder to generate hit shows and viewing at scale;
- b) competition for advertising revenue has increased and regulatory intervention around broadcast advertising is mounting, so reducing the value of linear broadcasting; and
- c) more and more of the value in any given commission rests away from linear broadcast within the primary rights window, as the consumption data over time shows:



Despite this shift in the risk-reward balance, ITV still fully funds circa 85% of the totality of its commissions and yet the policy assumption remains that the secondary rights – which are of increasing value – belong to the producer, which often still takes little risk, particularly where programmes are fully funded. This reliance on ITV to de-risk productions has been particularly apparent during the Covid pandemic.

This is in contrast to the multichannel broadcasters and SVOD services with which we are competing, and which represent an increasing proportion of the market, who retain 100% of the IP globally from their commissions, much as PSBs used to pre-intervention. We are in effect seeing a return to ‘gun for hire’ commissioning.

Given the shift in value we have seen over time, one of the 'coping' mechanisms we have deployed so far – to maintain value on screen and serve audiences – has been vertical integration by ITV into production. This has allowed ITV to benefit from the increasing value in the secondary rights market. We have had to get our production business into a position to be fit to compete for commissions on a level playing field. We have also invested heavily in Hub and launched Britbox to ensure we are well placed to exploit the value of our content assets beyond the initial linear window. However, despite this, the regulatory framework currently (particularly in its underlying value assumptions and slow pace of change) acts as a brake on our ability to maximise returns in these areas.

### **Meeting Ofcom's challenge in relation to serving all audiences online**

Ofcom has rightly highlighted that PSB needs to adapt as consumption increasingly moves away from linear television. It has highlighted that its audience research suggests PSBs can struggle to compete with the scale of content catalogue offered by the likes of Netflix. In our main PSB Review response we set out in detail ITV's strategic vision to be a digitally led media and entertainment company that creates and brings our brilliant content to audiences wherever, whenever and however they choose. We also set out what this means for the way in which ITV will approach content commissioning and distribution in future.

ITV's traditional approach to content commissioning has been to commission programmes to fill individual channel schedules (with all the inherent conditions that come with that depending on the time of broadcast, the type of programme, its target audience, slot length, channel brand fit, impact on quota compliance), and then to subsequently seek to successfully exploit the secondary rights from the resulting programmes via Hub and, more recently, Britbox.

Such a strategy has been common across the broadcast industry – not least because linear audiences have held up more strongly than many people had predicted. Indeed, this approach to commissioning is exactly the structure envisaged in Ofcom's current guidance in relation to the commissioning of independent productions, which places heavy emphasis on the division between 'primary' rights (mostly linear) and 'secondary' rights.

The issue with this strategy is that it can mean commissions for a particular linear TV channel slot are prioritised even if the limitations of the slot (channel brand, watershed restrictions, minutage rules, quotas etc) mean there might have been more compelling alternatives outside those constraints. It can also limit the number of episodes of any given commission, as there are only so many available hours in a day. It is becoming clear that if ITV is to appeal to all viewers – particularly younger viewers – in a world where content discovery and consumption are increasingly non-linear, where people like to binge-view, to consume content whenever and wherever they choose, then such an approach is no longer viable, either commercially or in attracting and retaining audiences.

Instead, ITV needs to pursue more 'purposeful commissioning' – focusing on content that works for our audiences, at scale, and aligns with our key brands – and only then working out how to best use our full range of services, broadcast and online, to maximise the reach of that content. Our main PSM channel – delivered both by broadcast and, increasingly, streamed over IP – will continue to be critical for our delivery of public value for the UK for years to come. But its role will become even more focussed on delivering those programmes capable of achieving mass simultaneous reach, as we seek at the same time to better serve

all audiences by using our full suite of services and brands (particularly, but not exclusively, younger audiences) with a wider range of content.

Only through such an approach can we – and our independent production partners – ensure ITV as a PSM is sustainable for the long term both broadcast and online and so can continue to commission UK content at scale, to the benefit of both independent producers and UK audiences. We have a shared interest in modernisation.

In this context, the independent production interventions – with a requirement to commission from independent producers and to relinquish secondary rights as a default position – directly hamper the ability of ITV to retain the rights to the programmes we commission and fund for deployment in a range of on-demand services.

It is sometimes argued that if ITV wants such rights then it can pay for them – as Netflix does. But this misses three fundamental points: 1) that Netflix has been heavily loss-making as it overpays for content in order to build market position globally, distorting the costs of programmes and rights; 2) that the bulk of UK content, including that from independent producers, is not of interest to global SVODs and so Netflix rates are irrelevant; and 3) we have effectively paid for the rights, at least based on the original conception of the value distribution between primary and secondary rights when the terms of trade were established.

Ultimately, we are no longer receiving sufficient value from our current primary rights package either to sustain our levels of commissioning of new UK content nor to deliver the content to audience whenever, wherever they want, as they increasingly expect. Absent reform, we will need to either reduce the scale of our commissioning or seek to reduce our tariffs to reflect the diminishing value offered by the primary rights window. In this sense, the independent production interventions are inextricably linked with the broader challenges to commercial PSB economics as set out in our response to Ofcom's PSB Review.

Of course, we recognise that there have been some modest changes in the definitions of primary and secondary rights over time, but these have been modest, slow to happen and haven't disturbed the basic assumption about the primary and secondary division of value and rights.

It is therefore right for Ofcom to look carefully at whether the current approach to the regulation of ITV in relation to independent producers remains an appropriate or fair deal, particularly in an era of super indy producers in some cases part of groups far bigger than ITV itself.

### **Our Preference would always be to try to reach agreement ourselves with Pact for new terms of trade**

Producers should, in principle, have as much interest as ITV does in our remaining a major commissioner of original UK content in the UK, thriving both in TV and online. Nowhere is that more important than in serving UK audiences by building compelling VOD services in competition with players operating with huge scale advantages and who retain and fund 100% IP ownership.

We are therefore hopeful that we will be able to secure revised terms of trade through accelerated negotiations with PACT that support ITV's strategic vision and those of

independent producers from whom we will continue to commission at scale for years to come.

However, that is going to require a recognition about (a) the scale of the shift in value and risk shouldered by ITV that has occurred in recent years and (b) the extent to which serving audiences in new ways online is going to a central part of the way in which ITV will deliver for UK audiences in future and meet its obligations to the whole country. Such a shift would simply be returning the deal to a fair equilibrium, for ITV financially and for audiences in terms of their access to our content, rather than being a wholesale shift in value.

### **Terms of Trade need to be seen in the broader PSB context**

In our response to Ofcom's PSB Review, we set out in detail our proposals for how the overall PSM regime might be reformed. Such a system, with increased flexibility and clarity, would allow Ofcom to ensure that the system best serves audiences even as it continues to change at pace in coming years. As part of this, there is clearly some logic in considering reform to the current independent production. Equally, the UK has benefited from a thriving production sector and any reforms should ensure this is not lost. In any reform of the independent production quota and terms of trade, it will be important that the end result is not a further shift of value away from ITV to producers or further regulatory burdens or obligations on PSM players as they increasingly compete with competitors with no such obligations at all.

We recognise that even under a more flexible regime, there will continue to be a need for hard edged quotas and obligations to ensure a baseline delivery by ITV. Because of the likely continued centrality of our linear TV offer (broadcast and streamed) to our PSM delivery, we would envisage the main numeric quotas continuing to relate to our current PSB channel in future delivered by broadcast and IP. In other words, we would not see PSM obligations extending to other elements of the services provided by ITV as a PSM. This approach makes sense given the anchor that the main channel will continue to provide for ITV as a PSM and the vital importance of not tying up even more ITV services with detailed obligations and quotas, none of which apply to ITV's emerging commercial competitor set.

There may in future perhaps be an increasing distinction in policy terms between ITV and publicly owned PSBs where there may be more of a case for continuing intervention e.g. to ensure the licence fee is used to stimulate elements of the production market.

If there was to be intervention as part of the current PSB process around the terms of trade, however, it is not clear that legislation is necessarily required. Perhaps the most obvious intervention (in the absence of the preferred negotiated outcome mentioned above) could be to ensure a platform-neutral initial licence, giving the ITV flexibility to meet the needs of UK audiences in whatever way made sense in that window with some or all rights then reverting to the producer after that point.

Such terms might well also vary depending on the scale of funding from and enabled by ITV (to reflect the risk/reward distribution referred to above, particularly in relation to high-end scripted content), with greater rights retained by ITV the more we are responsible for direct funding or bringing on board third-party finance. Such a system would also ensure producers retained value commensurate to their role.