Competition issues in the UK TV advertising trading mechanism

Decision on a market investigation reference

This is the non-confidential version.
Confidential information has been redacted.
Redactions are indicated by [✂]

Decision

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Section 1

Summary

1.1 Earlier this year Ofcom launched a competition review of the TV advertising trading mechanism[1]. We believed it was the right time to conduct a competition review given that the sector appeared to have stabilised following a protracted period of revenue decline and significant changes of ownership. In addition, a number of developments in viewing and content delivery had occurred over the last decade or so. We also noted that there had been concerns expressed by observers periodically about the structure and operation of the TV advertising trading model.

1.2 We published a consultation document in June (the Consultation), in which we set out our potential concerns that some features of the market may prevent, restrict or distort competition in relation to the operation of the market for TV advertising in the UK. However, we recognised that the current system of trading may deliver efficiency benefits. We therefore sought stakeholders' views on where the balance of these potential detriments and benefits lay.

1.3 We commented that if we were to identify features of the market which prevent, restrict or distort competition, then we would need to consider whether to exercise our discretion to refer the market to the Competition Commission (CC) for investigation.

1.4 Having reviewed all the evidence and responses to the Consultation we have decided not to refer the market to the CC for a market investigation. In making this decision we have not concluded whether we have met the legal threshold for a market reference; we do not believe that this is necessary because we consider, in any event, that it would not be proportionate to refer the TV advertising market to the CC.

Analysis of prevention, restriction or distortion of competition

1.5 In the Consultation we identified potential areas of competition concern, and possible offsetting benefits, relating to:

- transparency of pricing signals;
- bundling of airtime combined with the possible market strength of market players; and
- limited evolution of the trading model and possible impact on innovation.

1.6 We also suggested that if there was a possible prevention, restriction or distortion of competition then two sets of consumers – advertisers and TV viewers – may be harmed as a result of possible adverse effects on: the price of advertising; the efficient allocation of advertising revenues across broadcasters; innovation by broadcasters; and the consumer experience in terms of access to content.

[1] By this we mean the way in which TV airtime is traded between broadcasters and media buyers and media buyers and advertisers, including share of revenue deals, station average pricing and media buyer umbrella deals.

1.7 On **price transparency** we have considered whether the combination of station average pricing, share deals and discounts mean that there are inadequate pricing signals to support efficient allocation of TV advertising expenditure, firstly by media buyers across broadcasters and secondly by advertisers across both media buyers and broadcasters.

1.8 In respect of media buyers and broadcasters, given their size and sophistication we found that media buyers understand the terms of their deal with broadcasters and there appears to be no basis for concern. This is consistent with responses from most broadcasters, media buyers and advertisers.

1.9 On the second point, i.e. whether pricing signals are transparent to advertisers, we also note that many advertisers are large sophisticated companies. However, some respondents argued that advertisers may not fully understand the terms of their advertising deals and as a result may not allocate their expenditure efficiently across media buyers and broadcasters, or be in a position to respond to changes in prices. Concerns were also raised that advertisers did not have sight of the deals struck between media buyers and broadcasters, and therefore could not judge how 'good' their own deal was relative to these agreements.

1.10 However, we found that advertisers have access to detailed information about the performance of their media buyers from media auditors. In addition, there is evidence of advertisers switching business to alternative media buyers in order to achieve better deals and we understand this happens fairly regularly. Indeed the process of putting their business out for tender enables advertisers to compare deals from a range of media buyers. Finally, we note advertisers are able to switch to line-by-line or advertiser specific contracts with either their existing media buyer or other media buyers, which would then give them absolute clarity about the terms of their deal.

1.11 On **bundling**[2] we have considered whether the combination of bundled airtime across a schedule and possible market strength of some broadcasters in the delivery of particular audiences may have a detrimental effect on the amount of switching by media buyers. We also questioned whether umbrella deals prevent media buyers from switching advertising revenue between broadcasters.

1.12 As set out in the Consultation, some respondents noted that bundling and umbrella deals may dampen switching, although others provided examples of when media buyers and advertisers have switched away from sales houses or specific channels. Most respondents referred to the benefits of bundling across a schedule, such as the efficiency benefits associated with the optimal scheduling of adverts, and argued that a rule to restrict bundling across schedules would impose significant costs on buyers and broadcasters.

1.13 We were provided with a number of examples of media buyers/advertisers reducing or switching spend between broadcasters, indicating that umbrella deals do not prevent advertisers from switching away from broadcasters or individual channels. In addition, we believe that there is clear evidence that bundling offers efficiency benefits in terms of the costs savings to broadcasters, media buyers and advertisers. For example, it is estimated that around 2.5 million advertising slots are aired each month and trading these on an individual basis would potentially incur significant

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[2] In our Consultation we observed that advertising airtime (in the form of impacts) is bundled across a channel's schedule and advertiser will receive impacts from a mixture of programming and dayparts, As a result, mass audience impacts are bundled with other impacts, peak-time impacts with off-peak and weekend impacts with weekday impacts, and so on.

transaction costs. Bundling combined with other aspects of the current trading model also provides media buyers, advertisers and broadcasters with the ability to reduce uncertainty around the performance of a particular programme or campaign.

1.14 However, we conclude that we are not able to dismiss completely the proposition that bundling could prevent, restrict or distort competition, but note that we have not received any evidence or analysis to lead us to conclude that there is actually a detrimental impact on competition.

1.15 On **innovation,** we have considered whether the apparently limited evolution of the trading model could inhibit innovation in the way airtime is bought and sold and could therefore adversely affect the nature of deals available to advertisers and the choice of programmes available to viewers. We also asked respondents to comment on whether CRR has frozen the market, further limiting the potential for innovation.

1.16 The majority of respondents argued that there are no significant barriers to innovation and the trading model had broadly endured because of the efficiencies it delivered. Although several respondents agreed that CRR did still influence negotiations, on the whole they argued that CRR did not fundamentally prevent changes to the training model.

1.17 Several respondents provided examples of innovation which had occurred within the existing trading model. On this basis, we conclude that the trading model has not remained completely static and indeed continues to evolve at the margins. In particular, we note that the structure of trading appears to have been able to adapt to significant changes in content distribution and consumption that have occurred in recent years.

Should we refer the market to the CC?

Legal threshold

1.18 Having reviewed the evidence and submissions, we are not convinced that there is clear evidence to suggest there are reasonable grounds for suspecting that any feature, or combination of features of the market prevents, restricts or distorts competition. We identified some potential residual concerns, for example around the interaction of bundling and market strength of broadcasters, but we noted that we received no evidence or analysis to demonstrate that these concerns were material or enduring.

1.19 However as we noted in our Consultation, the legal threshold – that there are reasonable grounds to suspect that the features of the market adversely impact on competition – for making a market investigation reference is low. In light of this it is possible that the legal threshold has been met.

1.20 Even if this threshold were met, Ofcom has to consider whether to exercise its discretion to refer the market identified to the CC for an investigation. We must be satisfied that it would be proportionate to do so. In this case, we believe that we do not need to decide whether we have met the legal threshold because, as outlined below, we do not believe it is proportionate to exercise our discretion to refer the market to the CC.

Criteria for exercising discretion

1.21 In reaching our decision that it would not be proportionate to refer the market, we have referred to the OFT's Guidance, which outlines four criteria that, in the OFT's view, should be met before a reference is made[3], namely that:

- it would not be more appropriate to deal with the competition issues identified by applying CA98 or using other sectoral powers;
- it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference;
- the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response to it; and
- there is a reasonable chance that appropriate remedies will be available.

1.22 A reference would impose significant costs on the TV advertising sector and public sector, both in terms of resourcing required to conduct and respond to a CC investigation, as well as the potentially destabilising effects of uncertainty about the outcome.

1.23 Having reviewed the evidence and submissions we do not believe there is a strong case to suggest that there is a significant detriment to consumers – whether TV viewers, advertisers or end users of products advertised on TV – as a result of the way airtime is traded. Most respondents argued that consumers were not being harmed by the operation of the trading model. In particular, advertisers, one of the key consumers of TV advertising, did not consider that there were sufficient concerns to warrant a reference to the CC. Respondents also provided examples to demonstrate that broadcasters are able to experiment with programming and delivery of advertising and that the level of originated content has remained relatively stable.

1.24 Overall, very few players in the market who responded to our consultation supported a market reference. However, of those that did, none provided any further analysis or evidence of the competition concerns raised or impact on consumers.

1.25 While a number of respondents have identified potential issues about why the trading model may not be operating as effectively as it might, they generally concluded that, in light of possible developments in the sector and in light of the offsetting benefits associated with the model, it would be disproportionate to refer the market to the CC for a market investigation. Some stakeholders have also argued that the market is capable of adapting to address some of the concerns identified, and that this market-led approach was preferable to regulatory intervention. In addition no party presented any proposals for intervention to address concerns raised.

1.26 Finally, we have considered whether the overwhelming lack of desire for a market reference could be indicative of a shared interest between broadcasters, media agencies and advertisers (a concern raised by some observers). If so, it could suggest that players are working together (explicitly or implicitly) to reject a market reference. However we believe it is highly unlikely that advertisers would have any incentive to behave in this way, Advertisers are the group most likely to suffer as a result of higher prices if there are significant and enduring barriers to competition and

[3] OFT 511: Market investigation references – Guidance about the making of references under part 4 of the Enterprise Act (OFT) March 2006 (the 'OFT's Guidance'), paragraph 2.1.

it may not be possible for advertisers automatically to pass on higher advertising costs to end users[4]. We would therefore expect much more support for a reference from advertisers than we have received, if there were features of the trading model which prevent, restrict or distort competition in the TV advertising market.

Conclusion

1.27 While we have a residual concern about the potential impact of broadcasters bundling across a schedule we have no evidence that the problem is significant or that it imposes a significant cost on advertisers. We have evidence which suggests that advertisers have access to detailed pricing information and information about the performance of their media buyers and we believe that advertisers are able to (and do) exercise their ability to switch to alternative media buyers or deal direct with broadcasters. We are also satisfied that features of the market do not prevent the trading model from evolving or create barriers to innovation. In addition, we do not believe there is a strong case to suggest that there is a significant detriment to consumers – whether TV viewers, advertisers or end users of products advertised on TV – as a result of way airtime is traded.

1.28 Given these factors, and the significant costs that a market reference would impose on the public and private sector, we do not think it is proportionate to refer the market to the CC for a market investigation.

[4] This is discussed further at paragraphs 7.16 – 7.17.

Section 2

Introduction and legal framework

Introduction

2.1 In this document we set out our decision not to refer the market for TV advertising to the CC for further investigation. We have concluded that even if there are grounds to suspect that features of the TV advertising market might prevent, restrict or distort competition we do not believe that it is proportionate to refer the TV advertising market to the CC under Section 131 of the Enterprise Act 2002 (EA02).

2.2 In making our decision and assessing the potential competition concerns identified, we have applied the the Office of Fair Trading's (OFT) guidance on market investigation references (the 'OFT's Guidance')[5]for making a market reference, which include assessing whether a referral is a proportionate response to the problems identified.

Background

2.3 In spring of this year we launched a review of the TV advertising trading model to assess whether the structure of the sector and the way airtime is traded gives rise to competition concerns. We believed this was appropriate for a number of reasons. In the Consultation on the potential reference to the CC we summarised the conclusions of a number of reviews since 2000 which have involved analysis of aspects the way UK TV advertising is bought and sold[6]. We noted that in concluding these reviews a number of concerns were raised about possible anti-competitive effects associated with the way airtime is bought and sold, or the 'airtime trading mechanism'.

2.4 Although we have never received any evidenced complaints from the industry, we considered it was appropriate to undertake this review given that the sector appears to have stabilised following a period of substantial declines in revenue and changes in ownership. In light of this, and wider developments, such as changes in viewing patterns and developments in content delivery (e.g. video on demand), we considered it was now appropriate to assess whether the underlying trading mechanism gives rise to competition concerns and whether features of the market are having an adverse effect on sector evolution.

Legal powers

2.5 As noted in the Consultation we have a concurrent power with the OFT to make market investigation references to the CC under s131 EA02 in relation to commercial activities connected with communications matters.

2.6 Section 131 provides:

> "(1) [Ofcom] may…make a reference to the Commission if [Ofcom] has reasonable grounds for suspecting that any feature, or

[5] OFT 511: Market investigation references – Guidance about the making of references under part 4 of the Enterprise Act (OFT) March 2006.
[6] Further details of these reviews can be found at paragraphs 2.9 – 2.18 of the Consultation.

combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.

(2) For the purposes of this Part any reference to a feature of a market in the United Kingdom for goods or services shall be construed as a reference to:

(a) the structure of the market concerned or any aspect of that structure;

(b) any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or

(c) any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.

(3) In subsection (2) "conduct" includes any failure to act (whether or not intentional) and any other unintentional conduct."

2.7 A 'feature' of a market for the purposes of EA02 has a broad meaning. In cases where the s131 EA02 test has been met, we have discretion on whether to make a reference. We have exercised that discretion having regard to the OFT's Guidance.

2.8 Amongst the factors we consider in deciding whether or not to make a reference are our competition and sectoral powers. We have concurrent Competition Act 1998 (CA98) powers under s371 Communications Act 2003 (CA03) in relation to activities connected with communications matters. We also have competition powers under s316 CA03 in relation to licensed and connected services.

The Consultation

2.9 On 10 June, we published a consultation document seeking views on whether there were features of the UK TV advertising market which may restrict, prevent or distort competition and therefore whether a market investigation reference to the CC would be appropriate. The issued identified in the Consultation were based upon analysis undertaken in previous reviews and our own sectoral expertise.

2.10 The Consultation outlined potential concerns that features of the TV advertising market may be restricting, preventing and distorting competition, leading to adverse effects for advertisers, consumers in the related downstream markets and TV viewers. However, we also recognised that these features may also deliver efficiency benefits. We therefore invited views and evidence from stakeholders to assist us in establishing where the balance of these potential detriments and benefits lay.

2.11 We received 21 written responses to the Consultation and, where available, we have published the non-confidential versions of these submissions on our website[7]. In

[7] http://stakeholders.ofcom.org.uk/consultations/tv-advertising-investigation/?showResponses=true
Although we could not publish 13 confidential responses, we have referred to the comments contained in these response in this decision. In most cases we have been able to include the comment without attributing it a particular respondent, while in others we have had to redact the comment in its entirety. Redactions are clearly marked throughout this document.

addition, we undertook a number of meetings with individual stakeholders who did not submit responses: several TV advertisers; a major advertising auditor and two media buyers which predominately manage line-by-line deals, i.e. advertiser-specific contracts with broadcasters.

Structure of this document

2.12 The remainder of this document is structured in the following way:

- In Section 3 we consider the comments made by respondents in response to the overview of the TV sector in the Consultation;
- In Section 4 we outline our conclusion on market definition in light of the responses to the Consultation;
- In Section 5 we consider the comments made by respondents in response to our review of the key features, which characterise the sale and purchase of TV airtime in the UK, identified in the Consultation;
- In section 6 we consider how key features of the market may potentially prevent, restrict or distort competition; and
- In Section 7 we outline the factors we have considered in deciding whether to exercise our discretion to refer the market to the CC.
- In Annex 1 we provide a brief overview of the advertising and broadcasting sectors and outline key sector developments over recent years.

Section 3

TV sector overview

Introduction

3.1 TV is a powerful and important medium for advertisers, as it combines visual imagery, sound and movement; is able to reach a large number of consumers rapidly; and allows advertisers to mass market goods and services to target demographic groups. It can have a role in informing consumers of the key features of new products or services and be used as a way of differentiating one product or brand from another in a particular economic market. Ultimately, advertising is aimed at shaping consumer preferences. TV advertising accounts for a substantial portion of all UK advertising (26%), and represents the single largest category of display advertising.

3.2 In 2010, approximately £4bn was spent on TV advertising in the UK[8]. TV advertising revenues are critical for financing TV content for many broadcasters and are the main source of revenue for commercial Public Service Broadcasters (PSBs). The costs and revenues associated with TV advertising can be expected to affect consumers in two main ways: as viewers of commercial programming; and as consumers of products advertised on TV.

3.3 In this Section, we provide a summary of the key developments identified in the Consultation and consider whether the responses we received alter our position.

The Consultation

3.4 In our Consultation we noted that there had been a number of key developments in the sector in recent years, including the rapid increase in digital TV uptake, emergence of new channels and a corresponding shift in TV viewing from the main PSB channels toward digital channels. We considered that this had a number of implications for the sector, including:

- **greater fragmentation of TV viewing** – more viewers now watch content delivered over a wider range of digital channels and viewing of analogue channels and their simulcast digital versions has declined. Multi-channel viewing, as a proportion of television viewing in all homes, all day, has almost doubled since 2003. However, while the main PSB channels[9] have lost share, this has been offset by gains in share by their affiliated digital channels.

- **an increase in the volume of commercial impacts** – viewer fragmentation, in particular, shifts in viewing away from the BBC channels to non-PSBs has lead to an increase in the overall number of impacts available to advertisers.

- **changes in the market position of the main sales houses** – the main commercial PSB channels have seen a decline in both their share of commercial impacts (SOCI) and share of net advertising revenues (NAR), with viewers/revenues shifting towards the digital channels. However, in respect of the

[8] Advertising Association/Warc Expenditure Report
[9] BBC1, BBC2, ITV1, Channel4/S4C and Five)

ITV, Channel 4 and Five sales houses, this decline has again been offset by gains in share amongst their affiliated digital channels.

- **falling advertising prices** – the overall cost per thousand impacts (CPT) has been declining over the last decade.

3.5 In addition, the Consultation highlighted a number of future developments, such as video on demand (VOD) and digital video recorders (DVRs) which may influence how viewers consume TV and other audio-visual content in the future. These technologies have the potential to affect how viewers watch TV, the number of viewers watching linear TV (and therefore impacts achieved by broadcasters), the level of engagement in the advertising shown and advertisers overall demand for TV advertising. However, at this stage, these developments do not appear to have had a significant impact on the demand for TV advertising or the number of impacts delivered. The sale of advertising across different media (e.g. newspapers and TV) was also identified as a potential future development in the sector.

3.6 We also noted recent forecasts for the TV advertising sector suggested that it was likely to see limited real growth in revenues during 2011 and 2012.

Stakeholders' views

3.7 As a whole, respondents agreed that our overview of the TV advertising sector adequately captured the relevant market developments which might have an impact on competition in the sector.

3.8 A few respondents noted that the data we used to calculate market shares did not fully take into account the most recent rounds of consolidation amongst sales houses. Whilst others raised some points of detail regarding our description of the sector (e.g. the existence of smaller sales houses, the impact of the BBC). One respondent also noted that, whist there remained uncertainty surrounding the economic growth in the UK, it was important to acknowledge the strength of the TV sector in continuing to outperform the total media market.

3.9 A number of respondents also emphasised a range of market developments which they considered may be relevant to our assessment of the sector, including:

- The expansion of VOD[10], and the potential for it to be traded within the current TV advertising trading model (i.e. in the form of impacts);
- Developments in digital technology which may see the emergence of behavioural advertising technology similar to that used in the online sector;
- Increased penetration of domestic high speed broadband and the subsequent changes in media consumption patterns, via online viewing and the likely expansion of 'connected' TVs;
- The potential for significant players such as Google and Apple to expand their presence in the TV sector – Apple through iTunes, VOD apps on its devices and connected set-top boxes, and Google by using its strength as an online provider as a 'springboard' for future developments elsewhere (e.g. Google TV has been launched in the US).

[10] [✂].

3.10 ITV also submitted analysis from Oliver & Ohlbaum which considered the 'challenges and threats to the UK television advertising trading mechanism' in detail[11], which suggested that TV advertising could drop by 25% over the next decade as advertisers switch online.

Ofcom's view

3.11 We consider that our overview of the TV advertising sector provides a robust foundation for our analysis of the features and competition issues identified in the Consultation. While stakeholder responses have served to shed further light on the nature of key developments which may affect the TV advertising sector in future years, they do not suggest that a fundamental shift is expected to occur in the sector within the short to medium term. Nor do the additional points identified during this investigation or raised by stakeholders lead to any material changes in our analysis or perspective, as set out in the Consultation.

3.12 Annex 1 provides an overview of the TV advertising sector which has been updated from our Consultation in light of more recent data and stakeholder comments.

[11] The fast pace of change in UK media, a report by Oliver & Ohlbaum Associates for ITV plc. http://stakeholders.ofcom.org.uk/binaries/consultations/tv-advertising-investigation/responses/ITVAttachment.pdf

Section 4

Market Definition

Introduction

4.1 The test for making market investigation references to the CC under s131 EA02 requires the consideration of reference markets for the goods or services involved. In making a reference to the CC, the OFT's Guidance says that it is necessary to give 'some consideration for the definition of the relevant market','[12]. Market definition has a role to play in identifying the competition constraints that individual firms face, although it is not an end in itself.

4.2 Most recently, in May 2010 the CC concluded a review of the CRR Undertakings[13] in which it considered the relevant market to be the UK TV advertising market. In the Consultation we considered whether and to what extent any market developments since then might cause us to depart from that market definition.

4.3 In this Section we provide an overview of the comments we received in relation to market definition and our conclusions.

The Consultation

4.4 In the Consultation we reached the view that the relevant market for the purposes of our assessment was the market for the supply of TV advertising airtime in the UK. This was consistent with previous conclusions reached by the CC regarding the sector[14].

4.5 In reaching our conclusion, we considered both recent market developments as well as foreseeable future trends. In particular, we acknowledged that while internet display advertising had the potential to become a more significant constraint on TV advertising in the future, it did not appear to represent a sufficiently close substitute at this point in time. For instance, it was the case that internet display advertising represented a relatively small proportion of all internet advertising and did not yet offer the reach and coverage that TV did. In addition, TV advertising benefited from relatively sophisticated measurement system (BARB[15]) providing greater confidence for advertisers regarding the nature of the audiences achieved for a particular TV advertisement. This combination of factors, along with limited evidence of actual switching behaviour between the two sectors, led us to conclude that the scope for substitution between TV and internet display advertising was not sufficiently close to suggest that the two formed part of the same product market at this point in time.

4.6 We noted that over time other media could emerge as new sources of competition to TV advertising (e.g. mobile advertising or VOD) and potential changes or developments in the way different media are sold together may influence how TV advertising is traded in the future. While these developments were sufficiently new or

[12] OFT's Guidance, paragraph 4.8.
[13] Review of ITV's contract rights renewal undertakings, Competition Commission, 2010 http://www.competition-commission.org.uk/rep_pub/reports/2010/557ITV.htm
[14] See paragraphs 4.7 – 4.17 of the Consultation.
[15] British Audience Research Board (BARB) is the organisation responsible for providing the official measurement of UK television audiences.

uncertain to justify a change in the definition of the relevant market, we acknowledged that they may impact on market definition in the future.

Stakeholders' views

4.7 The vast majority of respondents across media buyers, broadcasters and advertisers agreed with Ofcom's proposed definition of the relevant product market as being the market for the sale of TV advertising airtime in the UK although a number went on to suggest that on-line display advertising could in the future exert more of a competitive constraint. Some of the specific points that were made by respondents are set out in more detail below along with a more detailed discussion of the comments by the one respondent (ITV) that did not agree with Ofcom's market definition.

Views of Media Buyers

4.8 The industry trade body (IPA) argued that – at this point in time – internet advertising was a complement to TV advertising rather than a substitute. It also argued that internet measurement systems were not yet standardised. For instance, in its submission the IPA estimated that only around 5% of brand awareness campaigns were on the internet and argued that this did not yet justify expenditure to develop specific research systems to measure shifts in awareness for those campaigns. The IPA indicated that the industry was working to develop common systems so that it was sure that systems would emerge over time. However, it also argued that TV advertising was likely to retain its unique ability to deliver fast, mass audience. Taking these various factors into account, the IPA agreed with Ofcom's proposed market definition.

4.9 Responses from individual media buyers supported the IPA submission. Two of the respondents argued that internet advertising was not likely to be a competitive constraint on TV advertising for some time to come but another respondent did suggest that the internet was a growing threat to TV advertising and suggested that the roll-out of high-speed broadband could pose a significant threat to broadcast TV. It therefore suggested that Ofcom's market definition was too "static".

4.10 The responses from media buyers did suggest that the development of measurement systems for internet advertising was an on-going issue. The responses from suggested that the absence of standardised measurement systems for on-line advertising and uncertainty about the ability to capture what they termed "full data" on reach and frequency was a barrier to complete substitution between on-line and TV advertising, even if on-line usage were to develop to reach the same levels of "consumption" as TV. The response from the other media buyer also indicated that media buyers were developing their own proprietary systems which suggested that it may still be some time before a standard trading "currency" for internet advertising emerged.

4.11 Finally, we note that while one of the media buyers agreed with the market definition proposed by Ofcom, it stated that we had underestimated the importance of regional advertising on both ITV1 and Channel 4.

Views of Advertisers

4.12 The advertisers that commented on this issue currently regarded on-line display advertising as a complement to their TV advertising rather than a direct substitute. Reckitt Benckiser commented that it did not yet have the same confidence in the existing measurement systems for tracking on-line advertising as it did in BARB. It was also wary of the fact that the data that did exist tended to come from the media owners. It argued that the BARB system for TV advertising had the advantage of being a "tri-partite" system (i.e. in the sense that it involves broadcasters, media buyers and advertisers[16]). Given these issues around measurement of on-line advertising, Reckitt Benckiser felt that internet advertising only exercised a limited competitive constraint on TV advertising although it did recognise that the market definition was likely to evolve over time.

Views of Broadcasters

4.13 Most broadcasters accepted Ofcom's proposed market definition but a number of them did anticipate that on-line display advertising was likely to exert more of a competitive threat in the future.

4.14 However, ITV specifically argued that Ofcom had not given sufficient weight to the constraint already imposed on TV advertising by other media (in particular the internet). It argued that it did not think it was possible to make a clear distinction between internet search and internet display advertising and went on to argue that, in any case, internet display advertising had grown significantly in recent years and was already a significant competitor to TV advertising i.e. it was equivalent to a quarter of the size of TV advertising.

4.15 The ITV submission put forward a number of arguments as to why it considered that TV and internet advertising were already part of the same market. It argued that:

- As consumers were moving on–line so advertising would follow;
- in spite of previous findings by the CC, the on-line advertising constraint of TV was strong and was growing;
- the internet offered sophisticated and targeted measurement systems;
- internet advertising could be used for brand building and product information;,
- snapshot assessments of the top advertisers on both TV and the internet told us little about substitution between media; and,
- that Ofcom had been too quick to dismiss supply–side substitution and that it was already taking place.

Ofcom's analysis of market definition

4.16 Ofcom was very clear in the Consultation that it recognised the significance of the growth of internet advertising and that internet display advertising was becoming increasingly important in its own right. However, for the purposes of market definition, the key issue is the competitive pricing constraint imposed by internet advertising on TV advertising and specifically the impact of internet advertising on decisions about advertising expenditure at the margin.

4.17 We acknowledge ITV's point that internet display advertising does not have to reach a particular scale relative to TV advertising in order to constitute a competitive constraint. For instance, it could be possible that expenditure on internet display

[16] Advertisers are represented on BARB's Joint Industry Committee.

advertising being 25% of the size of expenditure on TV advertising is already sufficient to exercise a competitive constraint on TV advertising. However we would emphasise that our assessment was based on taking a number of different factors into account rather than relying on any one particular factor.

4.18 We note the arguments that ITV made about advertisers following consumers on-line (and in particular comments by Sir Martin Sorrell of WPP and Marc Pritchard of P&G in 2010 and 2009 respectively)[17]. We also note ITV's comments about companies such as HSBC, Vodafone and Nissan restructuring their marketing departments to integrate brand and direct response marketing teams and the emergence of on-line firms such as Google and Facebook[18]. However, we note Ofcom research which suggests that the increase in time spent on-line has not reduced the time spent watching TV which perhaps might have been expected if the two media were competing directly for viewers' exclusive attention. In the most recent Ofcom Communications Market Report (2011) it was found that viewers were in fact currently watching just over 4 hours a day, up by approximately 18 minutes over ten years.

4.19 Furthermore, we note in ITV's own submission, the conclusions of the a study commissioned by ITV from Oliver & Ohlbaum on the pace of change in UK media:

> "While the TV advertising sector remains robust, forces for change are enabling the internet to make further, just as profound, changes to the media industry writ large. ... Advertiser behaviour is altering as online video becomes a viable medium and the targeting the internet offers can improve the efficiency of advertising. *These changes are only just beginning to take effect – but as other sectors have seen, their long-term impact could be significant, however difficult to predict*." [Emphasis added]

4.20 Therefore, Oliver & Ohlbaum themselves stopped short of arguing that internet advertising was already substituting for TV advertising. However, we would not disagree with the proposition that the long-term impact of these developments around on-line advertising are difficult to predict but could be significant.

4.21 We note ITV arguments that the internet is already capable of offering sophisticated and targeted measurement systems to advertisers and the fact that "the rich data sources available from the internet have been warmly welcomed by advertisers and agencies." However, ITV's response did not provide any examples of such a response to internet measurement systems and, furthermore, ITV's position appeared to be in contrast with comments from other stakeholders, particularly media buyers. As indicated above, media buyers have reported that they do not yet have the same degree of confidence in internet reporting systems that they do in the established systems for TV. For instance, the fact that the BARB system involves both sides of the market (i.e. broadcasters and media buyers) means that media buyers are involved in the operation of the measurement system and therefore have confidence in its results. One criticism of on-line measurement systems that exist is that – at present – they belong to the media owner and thus media buyers remain sceptical about their independence.

[17] ITV Response, paragraph 5.7.
http://stakeholders.ofcom.org.uk/binaries/consultations/tv-advertising-investigation/responses/ITVresponse.pdf
[18] ITV Response paragraph 5.9.

4.22 Linked to this point, we note ITV's reference to a speech by the CEO of Channel 4[19] in which he made the comment that:

> "One of the reasons TV advertising has held up so well in recent years is that it has a *measureable and credible currency.* [Emphasis added] "

4.23 That comment sets out a contrast between TV and other media where he implies that measuring systems for other media are not as credible as the one for TV advertising.

4.24 We also note that in the same speech, the CEO of Channel 4 anticipated that two-thirds of all TV audiovisual content would be tracked intelligently *by 2020*. ITV's submission also referred to the efforts by BARB to roll out a web-TV viewing meter in the second half of 2011 and that it was piloting a non-linear database to accommodate viewing data from non-linear sources that fall outside the core BARB service[20]. We also note ITV's reference to Google being in discussions to launch a "cross-media" (i.e. TV, internet and mobile) panel in the UK by mid-2012. What struck us about these references is that they are anticipating developments that have yet to take place. We therefore regard these examples as being indicative of the medium- to long-term evolution of the sector, not as indicating that internet advertising is currently a competitive constraint on TV advertising.

4.25 ITV argued that in our consultation we implied that the internet is largely used for product information rather than brand building with TV retaining its stronghold over the latter function. ITV then went on to provide a number of examples[21] of the internet being used for brand promotion. We do not see that these examples contradicting what we said in the Consultation: we did not imply that internet advertising was never used for brand building – simply that, as reported by other stakeholders[22] the internet had been used more for product information. As indicated above, we do not rule out the possibility that this could also change over time.

4.26 In terms of ITV's criticism of the comparison that Ofcom used between the top 20 advertisers on TV and the internet, we agree that this was a snapshot at a point in time. We also agree that while there are six advertisers which appear on both lists, if the lists were completely different it would still be consistent with substitution between the two media formats. However, in the Consultation we were using the comparison to make a different point. We commented that there was a significant difference in the amounts being spent on the different media and, given that firms rarely focused just on one advertising medium[23], we considered that that this suggested that firms were still placing more emphasis on TV advertising over internet advertising.

4.27 For instance, BT and Proctor & Gamble (P&G) are two firms that appear on both lists. A comparison of the two tables indicated that in February 2011 P&G and BT committed £8.9m and £4.3m to TV advertising (respectively) as against £1.2m and £0.6m to internet advertising (respectively). We were thus suggesting that the

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[19] David Abraham, CEO of Channel 4, 24th May 2011 Royal Television Society.
[20] Para 5.24, ITV submission.
[21] Old Spice, Marmite, Burger King Whopper and Kitkat.
[22] For instance, in its submission the IPA noted that while internet display advertising (including pop-ups, banners etc) accounted for 23% of online advertising in 2010, internet *branding* campaigns (ie audio-visual activity) currently accounts for only 5%.
[23] That is, advertising campaigns will typically make use of (say) TV, press and radio or, increasingly, TV, press and on-line.

difference in amounts indicated that TV and internet advertising were being used in a complementary fashion rather than being close substitutes.

4.28 Finally, in terms of supply-side substitution, ITV argued that Ofcom had been quick to dismiss the notion of supply-side substitution. ITV argued that it was important to remember that traditional broadcasters were increasingly facing competition from global digital companies and referred to:

- the launch of internet connected TVs (by Sony and Samsung);
- Amazon's acquisition of Lovefilm which offers connected VoD;
- Google's expansion into internet display advertising; and
- Apple and Google's rapid expansion in the TV space.

4.29 We consider that ITV is mistaken in suggesting that we have dismissed the notion of supply-side substitution. As set out in the Consultation, we are aware that TV advertising is likely to come under increasing pressure in the future and we noted that market studies suggested that a major impulse to the growth of online display advertising is expected to come from the rise of social media, and specifically Facebook and Twitter. Nonetheless, we noted that market sources forecast internet search advertising to remain the main growth engine of overall internet advertising expenditure, at least over the next 5 years.

4.30 In the Consultation we also recognised that the streaming of TV content over the internet was likely to increase over time and could well increase with the take-up of higher speed broadband networks. We noted that with the growth in on-demand and IPTV services, an increase in the scope for downloading TV and film content etc, consumers would be likely to regard television content delivered by different platforms as increasingly interchangeable. It was also possible that other technologies – e.g. mobile telecommunications – would become effective platforms for delivering audio-visual entertainment and with that could come the ability to impose a competitive constraint on TV advertising.

4.31 We thus did not dismiss supply-side substitution: indeed we explicitly recognised that the role of supply-side substitution could increase in the future. We regard the main difference between Ofcom and ITV on this issue to be one of timing: ITV's position is that there is already evidence of supply-side substitution whereas our position is that we do not see evidence it is happening on a sufficient scale to broaden our definition of the relevant market, but we do recognise that it could play an increasing role in market definition in the longer-term.

Conclusion

4.32 As set out in our Consultation, we recognise that there are likely to be important developments in relation to internet advertising which could mean that the scope for demand-side substitution between TV and internet advertising will increase over time. We expect measurement systems to become more sophisticated so that the effectiveness of internet advertising can be tracked more effectively. We also expect the penetration of new high speed broadband internet to grow so that a wider range of audiences will have access to internet display advertising.

4.33 Furthermore, changes or developments in the direction of cross-media selling[24] might create, through the establishment of chains of substitution between different media, competitive constraints on TV advertising and therefore impact on the definition of the relevant market. There is also the potential for developments in the measurement of TV, VOD and online viewing to lead to a more common 'currency' across these mediums, which may therefore influence substitution between media.

4.34 We thus recognise that in the medium- to long-run, TV and internet advertising has the potential to become part of the same relevant product market as TV advertising. However, in the short-run, the evidence we have been presented with and our own analysis does not suggest that internet display advertising is able to exercise a sufficiently strong competitive constraint on TV advertising for the two to be considered part of the same relevant product market in the UK for the purposes of our assessment of whether to make a market reference.

[24] Discussed further at Annex 1.

Section 5

TV advertising: features of the trading mechanism

Introduction

5.1 As noted in Section 2, a 'feature' of a market for the purposes of EA02 has a broad meaning. For the purposes of a market investigation reference, a feature of a market may be either structural or conduct-related, although in practice there may not be a clear division between these[25].

5.2 In the Consultation, we explained our understanding of the underlying mechanics of the way TV advertising is traded, which included a description of the key features of the trading mechanism and how the mechanism appear to have evolved over time.

5.3 In this Section, we summarise our description of the way advertising is bought and sold in the Consultation and provide an overview of the views of respondents on these features.

The Consultation

5.4 In the Consultation we described the operation of the UK TV advertising trading model and identified a number of key features, including[26]:

- On the whole 'impacts', rather than slots are traded. Sales houses sell, not minutes of advertising, but commercial impacts associated with viewing on commercial TV channels. This focus on impacts, rather than slots, is likely to result in lower transaction costs for advertisers, media buyers and broadcasters since they do not need to estimate impact delivery over a series of slots.

- Annual bespoke negotiations take place, in which media buyers, on behalf of advertisers, commit a share of their advertising expenditure (share of broadcast or 'SOB') in exchange for a discount from broadcasters' price (i.e. station average price or 'SAP') along with other terms and conditions.

- Negotiations tend to focus on SOB, given the uncertainty surrounding the number and types of commercial impacts likely to be delivered on each channel, and the amount of TV advertising which will be demanded by advertisers in the forthcoming year.

- The vast majority of advertisers use media buyers to negotiate TV advertising deals. Agency or 'umbrella' deals are prevalent, with the majority of annual deals negotiated by media buyers on behalf of a portfolio of advertising clients. Some media buyers also negotiate 'line-by-line' deals on behalf of each individual advertising client.

[25] OFT's Guidance, paragraph 4.4.
[26] Additional detail of our analysis on the way in which the market operates and the features identified can also be found in Section 5 of the Consultation

- In-year campaign negotiations are based on delivery of impacts for particular demographic groups. Sales house and media buyers must ensure that the impacts traded throughout the year, via individual campaigns, are consistent with the overall annual deal (and discount) agreed.

- SAP is a clearing 'price' used during the advertising year, calculated after an advert is aired, on the basis of revenue received and impacts delivered[27].

- Airtime is a differentiated product, and therefore we would expect the prices of different impacts across channels to vary. For example, ITV1 attracts a price premium over other channels; at least in part, due to its ability to deliver mass audiences quickly. Similarly, Channel 4 is valued for its ability to deliver relatively young, affluent audiences.

- Impacts are bundled both across a channel's schedule and across different channels. This provides sales houses with the flexibility to schedule advertisements in such a way that optimises traded impact delivery. Bundling also allows advertisers flexible access to the schedule and avoids transaction costs that would be associated with planning campaigns on a slot by slot basis.

- The market is highly concentrated on both the sales house and media buyer sides of the market. Following recent consolidation, four sales houses now account for the vast majority (96%) of advertising revenues[28]. Similarly, 83.2%[29] of TV expenditure is accounted for by the top six media buyers.

- ITV1 continues to hold a strong market position, particularly in the delivery of mass audiences. ITV's market position also seems to influence the way airtime is traded, with other broadcasters adopting similar metrics, and media buyers often concluding negotiations with ITV first, ahead of final negotiations with other broadcasters.

- The UK model evolved from a slot trading model, but has largely stayed the same since the early 1990s.

- There is no consistent model of trading in other countries.

5.5 We asked for comments on our understanding of the way TV advertising is traded and how it evolved to the current system. We also asked stakeholders to consider whether we had captured all the likely benefits associated with the trading mechanism and whether it would be possible to draw any conclusions about whether the features prevent, restrict or distort competition by comparing our model with models of trading in other countries.

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[27] SAP is determined by the level of advertising expenditure committed and the volume of impacts actually achieved. The SAP for ABC1 Men, for example, is calculated monthly as:

$$\underset{\text{(ABC1 Men)}}{\text{SAP}} = \frac{\text{Total Revenue committed to station by all advertisers/ buyers for all audiences}}{\text{Total ABC1 Men impacts delivered}}$$

[28] See paragraph 5.51 of the Consultation

[29] Source: Ofcom, calculated from Nielsen data – see Table 5.1 of the Consultation.

Characterisation of how TV advertising is bought and sold and sector evolution

Stakeholders' views

5.6 On the whole stakeholders agreed with our description of the way advertising is bought and sold, and with the way that the sector has evolved, although some respondents provided additional details and clarifications[30].

5.7 One broadcaster disagreed with our representation of the evolution of the trading model; what is traded, i.e. airtime, has not changed but how it is traded has changed substantially, along with the development of multi-product, multi-media broadcasters. The IPA noted that the current system has evolved in response to increasing complexity in the TV market and another respondent ointed out that the market place is becoming more complex with the growth in commercial TV applications, such as product placement, sponsorship and advertiser-supported programming.

5.8 In a similar vein, a media buyer and an advertiser suggested that although the TV market has remained broadly unchanged since the 1990s, some sales practices have changed and sales houses have begun to develop their own way of trading rather than setting price relative to ITV1 SAP. Likewise the IPA and several broadcasters noted that participants are not constrained to trade in a particular way, although it seems in broad terms that the pattern of trading is similar to our description. For example, one broadcaster explained that it can operate flexibly with media buyers and advertisers and as a result [✂].

5.9 In addition a media buyer suggested that we did not cover two variations to the trading model, shared risk/reward transactions and 'barter' system[31], although it was noted that these represent less than 5% of TV airtime traded.

5.10 Respondents also made comments about our analysis of the role of media buyers. For example one stakeholder suggested that we underplayed the extent to which media buyers act as brokers of airtime, selling airtime to advertisers once they have already made deals with broadcasters. Another pointed to the growth of the role of media buyers, noting that the number of line-by-line deals has fallen over the last 10 years.

Benefits of the current system

Stakeholders' views

5.11 Respondents outlined a number of potential benefits associated with the current trading mechanism, which were broadly consistent with those presented in the Consultation. These benefits identified included:

- sharing the risks of impact delivery from specific programmes between advertisers and broadcasters;

[30] We welcome the clarification of points of detail provided by respondents, however, we do not propose to address each of these points made individually in this document given these clarifications do not change materially the analysis of the features of the trading mechanism outlined in the Consultation.

[31] Where an advertising client may trade airtime communication in return for valued assets to the sales house which may be part payment in lieu of cash.

- economies of scale, derived from selling airtime across the whole schedule;
- efficiencies associated with optimisation of the schedule which delivers the efficient allocation of advertising spots across a channel's schedule, and lower transactions costs for advertisers, media buyers and broadcasters; and
- flexibility for advertisers with uncertain budgets and campaign requirements.

5.12 Most broadcasters, media buyers and advertisers agreed that there are a number of benefits associated with the current trading system for buyers and sellers, although Reckitt Benckiser suggested that the benefits largely accrue to media buyers and broadcasters rather than advertisers.

5.13 In addition to the benefits we outlined, COBA noted that the trading model enables advertisers to purchase across broadcasters' schedules at reasonable prices and it enables broadcasters to invest in a range of content which delivers quality and diversity of programming for viewers. Reckitt Benckiser believed that the system delivers stable prices, although noted that these may be higher than would be expected in a 'looser' system.

5.14 One media buyer suggested that one of the benefits of the trading model was that it allowed the trading of late money[32] which offers some value to advertisers. Furthermore this media buyer, along with several other respondents also stressed the ability of the model to be able to adapt to considerable changes in the TV sector, rather than it being static as we proposed in our Consultation. This is considered in more detail in Section 6.

5.15 A number of stakeholders acknowledged that the trading model may appear complex to outsiders, although it was well-understood by players in the market and has operated successfully for a number of years.

International comparisons

Stakeholders' views

5.16 On the whole respondents did not comment on international comparisons and few thought that there was any significant value in Ofcom drawing conclusions from different trading mechanisms, although it was noted by a number of respondents that the UK trading model offers a number of benefits compared with overseas models. One respondent pointed to the German system where umbrella deals are banned as being noteworthy.

Conclusion

5.17 Ofcom believes that many of the responses are consistent with our broad understanding of the way TV airtime is traded and the benefits of this system. However we note the clarifications that have been offered. We understand that participants are not constrained by the model of trading that we have presented but we also believe that the vast majority of trading does fit within this description. We have been presented with examples of different types of trading and deals but we understand that these changes are occurring at the margin.

[32] That is, advertising campaigns that are booked after the broadcasters' advanced booking deadline (around 2 months before transmission).

5.18 We acknowledge that the trading model appears to have evolved with developments in the wider TV sector, as picked up by a number of respondents. We return to this issue in Section 6.

5.19 Virtually all respondents either declined to comment on whether we can infer anything from making international comparisons about whether the interaction of features of the UK trading model prevent, restrict or distort competition, or suggested that there was no value in making such a comparison. As we noted in our Consultation, and supported by responses, there is no ‘standard’ international model for trading airtime. Given this, we are not inclined to draw any firm conclusion about the implications of different features of trading in different countries.

Section 6

Competition issues

Introduction

6.1 We interpret the phrase “prevent, restrict or distort” competition broadly, to encompass any reduction or dampening of actual or potential competition[33].

6.2 Where there are features of the market that prevent, restrict or distort competition then there is likely to be a negative impact on consumers, both as advertisers and as viewers. The consumer detriment could take the form of: higher prices; poorer quality of service; a lack of innovation or a distortion of consumption patterns.

6.3 In the Consultation, we set out our concerns that some features of the market may prevent, restrict or distort competition in relation to the operation of the market for TV advertising in the UK under section 131 EA02. However, we also recognised that the current system of trading may deliver efficiency benefits. We therefore sought stakeholders’ views on where the balance of these potential detriments and benefits lay.

6.4 In this Section, we provide an overview of the concerns raised in the Consultation and assess the views of respondents on the competition issues raised, before considering whether there are reasonable grounds to suspect that there is a feature or combination of features which prevent, distort or restrict competition in the market for TV advertising in the UK.

The Consultation

6.5 In the Consultation we considered that there might be justifiable concerns that features of the TV advertising market could potentially prevent, restrict or distort competition in the sector. In particular we identified the following issues:

- The transparency of pricing signals;
- The bundling of airtime combined with high concentration of market players; and
- The limited evolution of the trading model and possible impact on innovation.

6.6 However, we also noted that under each of these issues there may be efficiency benefits associated with the features identified. We believed it was important to establish where the balance of these detriments and benefits lay, and therefore invited the views of stakeholders on these issues.

6.7 The analysis we set out also suggested that any possible prevention, restriction or distortion of competition might in turn have an adverse effect on two different sets of consumers: advertisers[34] and TV viewers. This is due to the two-sided nature of TV advertising; television channels offer programming to attract viewers on one side of the market while on the other side of the market they sell access to those audiences to advertisers. Prevention, restriction or distortion of competition might therefore

[33] OFT’s Guidance, paragraph 4.2.
[34] We also recognised that it was possible that an adverse effect on advertisers (e.g. higher prices) could also feed through for the final customer of the products being advertised.

adversely affect the efficient allocation of advertising revenues across broadcasters, innovation by broadcasters and the consumer experience, both in terms of higher prices and access to content.

6.8 In addition, given the potential barriers to evolution of the trading model, we raised concerns that it was possible that, absent intervention, the way in which TV advertising is traded will not change. If this is true, then any possible concerns may be expected to persist.

Transparency of pricing

6.9 In the Consultation we took as our starting point the suggestion that media buyers did understand the terms of the deals they had struck with broadcasters. However, we identified a potential concern in relation to price transparency for advertisers and whether that could impede advertisers' ability to make informed decisions about the allocation of their advertising spend. At the same time, we noted that many of the companies advertising on television were sophisticated companies who should understand the trading mechanism and/or had access to media auditors to assess whether a media buyer's performance and terms are 'competitive' relative to the market. In addition, we recognised that there could be certain offsetting benefits to trading arrangements such as umbrella deals.

Stakeholders' views

6.10 A significant majority of the respondents to the Consultation were of the view that the current trading mechanism did not have a detrimental impact on price transparency and that participants in the market were able to make informed decisions.

6.11 There was an acceptance that the pricing mechanism was not necessarily transparent to observers who were unfamiliar with this sector but respondents went on to argue that complexity did not prevent the market from operating effectively. Respondents from across the value chain argued that the people making the actual decisions about the buying and selling of television airtime either already had access to the requisite data to make informed decisions or would be able to access such data relatively easily if they wished to secure greater transparency of the operation of the trading mechanism.

6.12 Respondents also pointed to the fact that advertisers were regularly able to 'test the market' by putting their business out to tender at the end of their contract period. The fact that media buyers competed with one another for this business meant that advertisers had a degree of transparency as to what other media buyers were prepared to offer to win their business: not just in relation to the scale of discount 'off SAP' but also other contractual terms and conditions.

6.13 Below we have summarised the views expressed by the different groups of stakeholders who responded to the Consultation.

6.14 Most broadcasters argued that the pricing in the market was transparent for media buyers and advertisers. A number of broadcasters also made the point that advertisers made extensive use of auditors to assist them in evaluating the performance of their media buyer relative to their contractual terms. They argued that this meant that advertisers had information on price/quality issues or were able to access such information as required.

6.15 ITV pointed out its monthly advertising revenues and SAP were published which meant that media buyers and advertisers had easy access to an obvious market benchmark.

6.16 Other broadcasters made the point that advertisers were not required to contract with media buyers as part of an umbrella deal. If advertisers were significantly concerned about transparency, they had the option of opting for a line-by-line arrangement with a media buyer.

6.17 Media buyers took a similar stance to the majority of broadcasters, namely that the current system offered a high degree of price transparency to practitioners but that advertisers did also make use of auditors to review the performance of media buyers and to make sure that media buyers were meeting their contractual terms. Media buyers argued that advertisers were able to make meaningful comparisons between not just between sales houses but also between individual channels.

6.18 One media buyer did comment that transparency would be improved if all broadcasters were required to publish their revenues and SAP for each channel on a monthly basis.

6.19 Finally, most of the advertisers we spoke to directly argued that they had sufficient pricing information to make informed decisions. In addition, the advertisers' industry trade body ISBA acknowledged that the existing system was complex but that – by and large – its members felt that there was sufficient transparency. ISBA was keen to emphasise that it was not arguing that the existing system operated perfectly and there were no issues at all. However, ISBA was clear that in its opinion any issues were first and foremost a matter for the industry to work out for itself and, in particular, the onus was on advertisers to make sure that they have access to the information they needed. ISBA argued that the operational efficiencies of the current system outweighed any potential problems with transparency.

6.20 One advertiser echoed the suggestion that transparency would be improved by requiring all broadcasters to publish data on their monthly revenues but it did accept that the market was fairly transparent to those who operated in it on a regular basis.

6.21 An industry observer argued that there was a lack of transparency in relation to pricing. It argued that a reduction in the in-house buying expertise over time meant that advertisers were more distant from the evaluation of pricing and this affected their ability to assess how well they are treated. It was also more sceptical about the efficacy of media auditors, suggesting that the "pools" which auditors used were not necessarily representative and querying the qualitative nature of assessment by auditors.

6.22 Another respondent raised concerns about the degree of price transparency. It argued that advertisers did not have access to information about the deal they were offered by the media buyer relative to the media buyer's overall umbrella deal with particular broadcasters or sales houses. It argued that this meant that media buyers did not necessarily act in the best interests of their clients.

Ofcom's analysis of transparency of prices

6.23 We consider that the responses to our consultation broadly endorse the position that advertisers do understand the trading mechanism and that they are able to make informed decisions about the allocation of advertising expenditure between different sales houses. It therefore does not appear to be the case that the way in which advertising is priced per se is likely to lead to a misallocation of resources.

6.24 Industry practitioners generally acknowledge that the pricing of TV advertising is complex and could be regarded as opaque by external observers. It is also the case that advertisers do not necessarily focus solely on price when making decisions about advertising campaigns. That is, advertising is not a homogeneous good across different TV channels and that advertisers will also take into account other aspects of campaign delivery when making decisions about allocating advertising expenditure.

6.25 However, it is clear that industry participants either understand how the price mechanism for TV advertising works, and are thus able to make decisions based on that information, or they have access to media auditors who can review the data for them and advise them about the performance of their media buyer. We have reviewed the reporting information that media auditors are able to make available to advertisers and confirmed that such information is available at a relatively low cost. Auditors will assess a media buyer's performance on a number of measures, including whether a campaign could have performed better or cost less using a different mix of channels, and the price paid relative to other advertisers within the auditors 'pool' of clients. We also sought information about the pool of clients against which comparisons are drawn and noted auditors can typically draw on a pool comprising several hundred campaigns and accounting for several hundreds of millions of pounds of advertising spend. That would appear to indicate that media auditors would be able to generate meaningful comparisons.

6.26 We understand that if media buyers do not deliver the price/terms agreed contractually then advertisers can invoke certain penalty provisions e.g. withholding of bonuses or in an extreme case even terminate a contract at relatively short notice (e.g. 3-6 months). In addition we understand that auditors will typically have a role to play when advertisers put their business out to tender e.g. in terms of comparing the prices and terms on offer from the media buyers competing for their client's business.

6.27 We also note that, contracts come up for renewal every 2-3 years which presents advertisers with a regular opportunity to switch their business between media buyers. As a result of this review process, we are aware of a number of examples where advertisers have switched their business as a result of this review process. We thus consider that the current pricing arrangements do not impede switching behaviour in the market. We also recognise that advertisers can use a re-tendering process as a means of gathering information to check the terms of their current deal or to look to improve the terms being offered by their existing media buyer. We do note comments from some individual advertisers and also the ISBA response which suggested that there were some issues about price transparency. However, we note their view that, in the first instance, it was the responsibility of the advertiser to pursue this with its media buyer in order to evaluate the service it is receiving.

6.28 We note that this position – namely that advertisers do have the ability to look after their own interests – is broadly in line with recent findings of OFT's Outdoor Advertising review.

6.29 In its review of the Outdoor Advertising market, the OFT identified a number of concerns including the limited ability of an advertiser to monitor buyer's prices to ensure it was getting a good deal[35] and the potential for rebate arrangements to give buyers an incentive to concentrate spend within individual campaigns towards certain

[35] Paragraph 1.22, "Outdoor Advertising: An OFT market study". OFT 1304 - February 2011.

large media owners[36]. The OFT also noted that a significant proportion of campaigns were not audited.

6.30 In order to address these concerns, the OFT made a number of recommendations for advertisers and provided guidance as to steps they (advertisers) could take to protect themselves against adverse effects from asymmetry of information. Those measures included encouraging advertisers "to engage more directly with the media buying process and to seek greater transparency of rebates and how their campaigns are bought"[37]. The OFT also went on to suggest that advertisers should seek greater visibility for themselves and their auditors of rebate payments and media owner invoices and suggested that advertisers should consider negotiating clauses that explicitly required the pass on of any rebates from media buyers. The OFT also reported that ISBA and the IPA had already worked together to add a new clause into the IPA Outdoor Charter in respect of clarity of remuneration terms.

6.31 Our review indicates that a significant proportion of TV advertising campaigns are already audited and at least some advertisers are already making use of performance bonuses to guard against media buyers not acting in their best interests. This suggests that there is not the same scale of issues in respect of price transparency/distortion of incentives as there was in the Outdoor Advertising market. However, the OFT's recommendations for advertisers in that context could still be relevant to the TV advertising market in general. That is, advertisers could - if they are not already doing so – mitigate potential distortions to buyers' incentives with bonuses for performance on prices and/or campaign effectiveness. Some advertisers could also consider changes to contracts in which media buyers became 'agents at law'. The latter would place media buyers under an obligation to act in the best interests of the advertiser. There are thus a number of steps that advertisers can take to improve transparency and to reduce the potential for a distortion of incentives if that is an issue for them.

6.32 Finally, we note that if pricing transparency was a very significant specific issue for a particular advertiser, it would either have the option of moving away from an umbrella deal to a line-by-line arrangement or it could look to secure specific pricing guarantees. The response from ITV provided a number of examples where advertisers had switched from umbrella deals to line-by-line deals (and also a similar number of examples where advertisers had switched from line-by-line deals to umbrella deals). The response from Sky also indicated that they deal direct with a number of advertisers. This suggests that advertisers do have a considerable degree of flexibility about the arrangements they have with media buyers (or indeed broadcasters) and can adjust the terms of those arrangements according to their needs.

Conclusions

6.33 Taking into account the above analysis and especially our direct discussions with advertisers, we consider that advertisers are in a position to make informed decisions within the current trading mechanism and to guard against distorted incentives i.e. to make informed decisions about the allocation of advertising expenditure, and that there thus appears to be sufficient transparency to enable the effective operation of the TV advertising market in the UK. Even if that were not the case, there would be various steps that advertisers could take could take to protect themselves against the adverse effects from asymmetry of information.

[36] Paragraph 1.24, op cit.
[37] Paragraph 6.1 op.cit.

Bundling and market concentration

6.34 In the Consultation we considered whether the combination of bundled airtime and possible market strength of broadcasters in the delivery of particular audiences could have a detrimental effect on the amount of switching by media buyers. In the context of a differentiated product market, we believed it was likely that different types of impacts are valued differently by media buyers and advertisers and some broadcasters may have a particular strength in the delivery of specific types of impact (whether by time of day or in particular programmes etc). In addition we considered whether recent consolidation was likely to have had any impact on this.

6.35 Our hypothesis was that, given that impacts are bundled across the schedule, it is possible that broadcasters are able to use market strength to leverage from less competitively supplied impacts to more competitively supplied impacts. The effect of this could be that smaller broadcasters may face barriers to attracting revenue and may have to offer very low prices in order to attract revenue which would mean that switching of advertising revenues across broadcasters is inhibited.

6.36 However, we also recognised that the sale and purchase of packaged impacts across a broadcaster's schedule not only enables broadcasters to optimise the scheduling of adverts, which may have efficiency benefits, but is also likely to reduce transactions costs in the sale and purchase of airtime for both broadcasters and media buyers/advertisers.

6.37 We also considered whether the predominance of umbrella deals in the market combined with annual share deals potentially limits the ability of media buyers and advertisers to switch expenditure to different broadcasters and whether these features give rise to misaligned incentives between advertisers and media buyers. That said, we also outlined a number of potential benefits associated with umbrella deals and asked respondents to comment on the balance of potential detriments and benefits.

Stakeholders' views

6.38 Most respondents commented on the benefits of bundling rather than the potential problem that bundling of impacts could reduce the amount of switching that took place, suggesting that bundling offers considerable efficiency benefits to broadcasters, media buyers and advertisers.

6.39 In terms of the bundling of impacts by broadcasters, the overwhelming response was that bundling of impacts across a schedule was not only necessary given the sheer volume of advertising airtime sold each year but also delivered significant efficiency benefits to advertisers and broadcasters. A number of different respondents across the value chain – advertisers, media buyers and broadcasters – agreed that it would be impractical and very expensive to manage advertising sales on a slot by slot basis. One broadcaster noted that some 2.5m slots are traded in the UK each month[38]. Similarly, an advertiser noted that it first bought over a million TV spots in 2006 and had done so in each year since then with the exception of 2010. Moreover, the date by which this advertiser had reached its millionth spot had tended to get earlier each year, with the earliest date achieved so far being in July. The degree of

[38] For example, if we were to assume that there are 200 channels each broadcasting on average 9mins of advertising per hour per day, that would generate something in the region of 2.5m 30-second slots broadcast each month.

complexity combined with the sheer volume, according to advertisers, would make it impractical to manage advertising on a slot basis.

6.40 In a similar vein, broadcasters argued that bundling of impacts across schedules had implications for staffing. [✂].

6.41 Other broadcasters argued that unbundling the schedule would tend to drive up peak prices, such that some advertisers would not be able to access the peak schedule. Another broadcaster proposed that bundling of airtime within a schedule and across channels could help deliver a targeted campaign. Discovery also suggested that removal of bundling could have a detrimental effect in terms of reducing transparency because of the significant volume of individual deals which would have to be undertaken instead.

6.42 Finally, ITV noted that although bundling delivered efficiency benefits, particularly in the form of optimisation of advertising requirements across the broadcast schedule, and could offer some flexibility, advertisers and media buyers were also able to specify numerous parameters which would ensure that they received the outcome they required for specific campaigns.

6.43 In terms of the impact of umbrella deals, several advertisers and media buyers stressed that umbrella deals delivered benefits because media buyers negotiated on a much larger scale and were therefore able to achieve better deals and more flexibility for less management overheads (and therefore lower costs to advertisers). A number of advertisers also claimed that they were much less exposed or vulnerable to the market strength of broadcasters in negotiations when they have the protection of umbrella deals compared with operating on a line-by-line basis. This was specifically mentioned with respect to negotiating access to January airtime, which some advertisers require in order to be able to promote their January sales.

6.44 In addition, one advertiser proposed that umbrella deals were in fact well suited to accommodating “niche” advertisers and actually worked to the advantage of small advertisers and advertisers with specific needs. The example given was that an umbrella deal would be easily able to accommodate, for example, a small beer manufacturer looking to advertise in sports programmes: that is, it would be possible to manage the needs of the smaller advertiser within an umbrella deal, around the needs of larger advertisers, without disrupting the main elements of an media buyer’s agency deal.

6.45 In terms of whether a combination of the bundling of airtime and umbrella deals could create barriers to switching, several respondents across the value chain noted that it was possible for media buyers and advertisers to switch advertising spend. In addition, we were given a number of examples where media buyers and advertisers have moved away from sales houses (e.g. [✂]) or reduced the amount of money spent with specific sales houses (e.g. [✂]). We also heard from a smaller advertiser, that it believed that it would be able to exclude specific channels from their media plan if it wished to do so (it gave an example of not buying an ITV digital channel in a particular month if it didn’t like the price being offered). That is, it would not be constrained by the combination of bundling/umbrella deal to having to advertise on specific channels.

6.46 Another media buyer argued that bundling did not constrain switching and this was in part due to the way that annual spend is planned; bottom up planning ensures that channel mixes are already accounted for.

6.47 However, a number of respondents did raise some concerns about the impact of bundling, although very little analysis or evidence was provided to support the comments that were made. Most respondents said that the benefits generally outweighed any concerns presented in their responses. The exceptions to this were Reckitt Benckiser and another respondent, with Reckitt Benckiser suggesting that there were no benefits to advertisers from bundling or umbrella deals. However, neither respondent provided further analysis, examples or evidence to support their conclusion.

6.48 A number of advertisers, broadcasters and media buyers did note that bundling, particularly when combined with umbrella deals and concentrated sales houses, might dampen switching and make it difficult to switch completely away from one of the three main sales houses, ITV, Channel 4 and Sky sales. Although one media buyer went on to suggest that this created an onus on media buyers to develop bespoke deals to pick up the specific requirements of clients.

6.49 One respondent also agreed with our proposition that bundling may make it difficult for small broadcasters to attract revenue, although it did not present any additional analysis or evidence to support its position. Another respondent also agreed with the proposition we presented in the consultation that unbundling the schedule could help increase the possibility of switching.

6.50 Some respondents argued that another aspect of bundling, conditional selling across channels, could be a problem. It was suggested that ITV and Channel 4 could be able to conditionally sell and leverage their strength across their portfolio of channels. In a similar vein a broadcaster raised concerns that vertically integrated sales houses may be able to leverage cross media market strength,

Ofcom's analysis of bundling and market concentration

6.51 Ofcom believes that there is clear evidence that bundling offers efficiency benefits in terms of the cost savings to broadcasters, media buyers and advertisers compared with a system where airtime was sold on a slot by slot basis or on a more unbundled basis. For instance, there is evidence from advertisers that these costs savings could be significant[39]. In addition, respondents have pointed to a number of other benefits associated with bundling, such as schedule optimisation and the way bundling across a schedule enables small advertisers to access peak-time slots, which might not occur in a system of slot trading. Almost all respondents stated that there would be significant problems and much higher costs if there was a move to a slot trading system.

6.52 We also recognise that bundling combined with other aspects of the current trading model (such as SOCI/SoB deals) provides media buyers, advertisers and broadcasters with the ability to reduce the uncertainty surrounding the performance of a particular programme or campaign. For example, a slot trading model would increase risk for both advertisers and broadcasters. On the one hand, a slot might not perform as well as expected meaning that the advertiser has not reached the audience it was expecting to and thus potentially damaging the effectiveness of an advertising campaign. On the other, if a slot performs significantly better than expected, then the broadcaster has sold that slot 'too cheaply' and/or it would have been more efficient to 'sell' the audience for that slot to a different set of advertisers.

[39] For example, as discussed earlier, respondents noted selling £2.5million slots individually each month would be impractical and likely to be significantly more expensive than a system where impacts are sold on a bundled basis.

In contrast, the bundling of impacts in the context of umbrella deals, means that the broadcaster is in charge of ensuring that the advertiser receives the impacts it requires for an effective advertising campaign and at the same time optimising the delivery of those impacts across different times of the day/days of the week.

6.53 On the issue of whether bundling and umbrella deals constrain switching, responses were more mixed. However, we note that where respondents did raise concerns, there was no evidence, further analysis or examples to support the proposition that bundling and umbrella deals offered no benefits to advertisers and limited switching. Conversely, a number of examples of switching were provided, where either media buyers and/or advertisers had stopped spending with broadcasters and/or sales houses or reduced spend with broadcasters and/or sales houses. In addition, advertisers told us that whilst media buyers might plan a TV advertising campaign to include certain channels or groups of channels, it would be possible for them – as clients – to switch away from the use of particular channels if they wished to.

6.54 Furthermore, we understand that a line-by-line option is always available to advertisers in the event that they believe that they are being pressured into accepting an umbrella deal that is not optimal for them. Indeed we heard this argument from both advertisers and broadcasters who negotiate directly on a line-by-line basis and from media buyers who negotiate on a line-by-line basis on behalf of advertisers.

6.55 The examples of switching that were provided, the ability of advertisers to move to line by line deals and the views of the majority of advertisers we spoke to suggest to Ofcom that there is no significant concern about the adverse effects of umbrella deals.

6.56 We note that few respondents commented on the specific issue we identified in relation to small broadcasters having to offer very low prices (i.e. high discounts) to attract revenue. We hypothesised that small broadcasters may have to set very low prices in order to attract revenue, particularly if larger broadcasters are able to leverage a degree of market strength from less competitive supply of impacts to the competitive element of their supply. Some respondents suggested that it might be increasingly difficult to switch away from broadcasters as concentration increased but only one respondent commented specifically on the problem facing small broadcasters. However, the respondent did not develop this argument and did not discuss how a small broadcaster particularly might be disadvantaged as a result of bundling e.g. by indicating what terms would have to be offered to attract revenue. Similarly, no advertisers presented a case to suggest that they would prefer to move to smaller channels, but are prevented from doing so a result of the way airtime is bundled across the schedule.

6.57 In terms of the concerns raised about conditional selling across a portfolio of channels, we have considered this issue before in the context of its Review of Airtime Sales Rules[40]. We concluded that it was appropriate to consider possible anti-competitive bundling of airtime across channels on a case by case basis: only if a sales house has market power could conditional selling lead to negative outcomes and even then, these negative outcomes could be outweighed by certain efficiency benefits from the bundling. As a result, we concluded that specific rules to address this potential problem were not required[41]. We note that since the lifting of these rules no stakeholders have raised concerns, even informally, about individual incidents of anti-competitive bundling by sales houses.

[40] Ofcom, Airtime Sales Rules Review – Statement, 28 July 2010.
[41] It is the case of course that the CRR Remedy prevents the conditional selling of ITV1.

6.58 As noted above, one response raised a potential concern about cross-media selling as a form of bundling. As with the issue of cross channel selling we consider that this issue would be best tackled on a case by case basis.

Conclusion

6.59 Although it is possible that there is a potential concern about the interaction of bundling and market strength in the delivery of impacts, we have not identified any actual evidence that this is a significant problem. In addition we have been given a number of concrete examples to show that switching away from channels and sales houses does take place. Even where potential concerns were raised most respondents argued that the benefits of bundling outweigh any costs. The only exceptions were Reckitt Benckiser and another respondent. However neither response provided any analysis or evidence beyond agreeing that the issue we had presented in the consultation was a potential concern.

6.60 We note that we cannot completely dismiss the proposition that bundling, particularly when combined with market strength in the delivery of certain types of impacts, could theoretically prevent, restrict or distort competition but we have not identified any evidence or analysis to that this actually does lead to a prevention, restriction or distortion of competition in TV advertising or that it imposes a significant cost on advertisers.

Innovation in the TV trading mechanism

6.61 In the Consultation we noted that the limited evolution of the trading model may have potentially resulted in a lack of innovation in the way airtime is bought and sold and could therefore adversely affect the nature of deals available to advertisers and on the choice of programmes available to viewers.

6.62 We also considered that the trading mechanism could create a problem in terms of tackling ITV's market strength in the delivery of mass audiences. For instance, the CRR remedy is applied to ITV1's entire schedule, despite the fact that the CC has identified the source of ITV's market strength as being its unique ability to deliver mass audiences. It appeared likely that the structure of the trading model, and in particular the bundling of impacts, made it difficult to design a more targeted remedy. Moreover, CRR effectively constrains any changes in the way ITV1 airtime is traded and this in turn could limit evolution across the whole sector.

6.63 As a result, we were concerned that the trading model appeared to be effectively frozen in time and may not be able to evolve in response to commercial pressures and sector-wide developments.

6.64 On the other hand, we recognised that it could also be the case that the trading model had not evolved because the current airtime trading system was already reasonably efficient; delivered what advertisers wanted; and was sufficiently flexible to accommodate changes going forward whilst perhaps also allowing innovation at the margins.

Stakeholders' views

6.65 An overwhelming majority of respondents were of the view that the current trading model did not in fact inhibit innovation in the TV advertising market, although views on whether CRR has had an effect on contract negotiations and/or innovation were more mixed. A number of respondents considered that CRR had in no way inhibited innovation, whilst others supported the view that CRR had contributed to the way in which negotiations were now conducted and a lack of change in the existing trading model since CRR was introduced. Below we have summarised the views expressed by the different groups of stakeholders who responded to the Consultation.

6.66 Most broadcasters responded that the trading model had not hindered evolution and would not inhibit future innovation. Channel 4, Sky and others provided a number of examples of how the trading mechanism had developed recently including

- Per Inquiry (PI) deals—where revenues are shared with advertisers based on results;
- Five's proposed integrated sales proposition including its newspaper, magazines and online services;
- the development of the Sky View audience measurement system which attempts to measure and demonstrate the accountability of television advertising, with a view to being better able to compete with the tools available online; and
- the development of a functionality that will enable the delivery of "targeted substitutional advertising" (Sky AdSmart), with a view to improving the effectiveness of television advertising to the benefit of advertisers.

6.67 Sky also indicated that it retained the flexibility to offer deals outside of the traditional SOB/umbrella deal mechanism and provided examples of alternative types of deals offered to advertisers[42].

6.68 Channel 4 also argued that the current trading model had not inhibited advertisers and broadcasters from experimenting with new forms of TV advertising, such as advertiser-funded programming and live-advertising[43].

6.69 Viacom noted that rather than inhibiting innovation, the stability and efficiency of the current trading model, combined with the protection offered by CRR, may have enabled risk taking and investment in new forms of advertising technology.

6.70 In addition, several respondents noted that the trading model has weathered considerable changes in consumption patterns and content delivery and is continuing to evolve, for example to accommodate advertising in VoD programming. Several also argued that the model has been relatively stable because it worked and delivered what users wanted.

6.71 Most broadcasters, including ITV, believe that CRR did not unduly restrict market development and that the trading model would be largely the same even if CRR was removed. However, it was acknowledged by some broadcasters that CRR may have cemented in current trading practices. Some broadcasters also suggested that it might be appropriate to refine CRR, although ITV and Channel 4 have argued that a market investigation reference based solely on issues associated with CRR would be disproportionate[44].

6.72 The overwhelming response from media buyers was that the current system has not inhibited innovation, the market was able to adapt and had and would continue to

[42] Sky submission, paragraph 16 (e) – (f).
[43] Channel 4 submission, pp 9-10.
[44] Channel 4 submission, p 23; ITV submission, paragraph 10.35.

evolve with changes in content distribution. For instance, one media buyer considered that “the system has proved hugely adaptive to structural change, capable of dealing with additional inventory, and is equally capable of measuring new delivery methods such as on demand viewing”.

6.73 Media buyers also noted the importance of CRR in constraining ITV’s market strength and suggested that, although CRR might influence negotiations, it had not frozen the market.

6.74 As with media buyers, advertisers were generally of the view that, while CRR had influenced the way negotiations are conducted, the current trading model did not inhibit innovation and had not changed because it worked well for broadcasters, media buyers and advertisers.

6.75 However, Reckitt Benckiser and ISBA did express concerns that deals have become increasingly complex as new methods for the distribution and consumption of content (e.g. product placement) are often rolled into existing umbrella deals[45].

6.76 One observer considered that CRR may well be limiting evolution in the market and that the competition concerns identified by the CC continue to exist, so that any adverse effect which might flow from CRR would continue unless and until the trading mechanism is referred to the CC. Another respondent noted that while they supported the maintenance of CRR while current market mechanisms are in place, it also accepted that one major consequence of CRR has been to freeze the current way of doing business.

Ofcom’s analysis of innovation in the trading mechanism

6.77 As noted in the Consultation, the fact that there had been a lack of innovation in the trading mechanism would not automatically give rise to a competition concern if it was the case that the airtime trading system was already reasonably efficient, delivered what advertisers want and was sufficiently flexible to accommodate changes going forward whilst perhaps also allowing innovation at the margins.

6.78 Based on the responses received, the majority of stakeholders argued that the current system had not inhibited innovation, the market was able to adapt, and the absence of change was a reflection of a model that was efficient and delivered what the market needed. We are aware of a number of specific examples of innovation in the market, such Sky Ad Smart, although we note that the examples provided seemed to represent innovation at the margins rather than fundamental change to the system. The trading mechanism has also been able to cope with significant changes in volumes together with audience fragmentation following the expansion of the digital channels in recent years.

6.79 With respect to CRR, several respondents supported our concern that the CRR might have changed the way in which other broadcasters competed with one another, particularly with respect to how negotiations are conducted. CRR has meant that contracts struck for ITV1 airtime over 8 years ago are still in place today. It is therefore inevitable that CRR has an influence on how TV advertising is currently traded.

6.80 However, several respondents indicated that the removal of CRR would not lead to any significant alteration in the way TV advertising was traded. This would tend to

[45] Reckitt Benckiser submission, response to question 22.

support the idea that the current trading model has not changed because it remains the most effective mechanism for trading television airtime.

6.81 In the Consultation we raised concerns that CRR was potentially a blunt tool, and there was some support from respondents that a more targeted remedy might be appropriate. However, none of the respondents argued that CRR was such a significant constraint that it actually prevented, restricted or distorted competition in the market as a whole to such an extent that it needed to be reviewed again.

Conclusion

6.82 Our investigation found that while it would appear that there has not been a fundamental change in the way TV advertising is traded, the trading model has not remained entirely static, and has evolved at the margins. Furthermore, we believe that the market is capable of adapting to change and market led change is preferable to regulatory intervention.

6.83 While CRR is likely to have influenced on the way in which advertising is traded we recognise that CRR has an important role to play in constraining ITV1's market strength. Any constraints imposed by CRR on the trading mechanism do not appear to be sufficient – on their own – to justify a market reference to the CC. In addition, a process exists for the CC to review the CRR remedy if, by reason of any changes of circumstance, existing undertakings are no longer appropriate.

Innovation in TV Advertising and Programming

6.84 In the Consultation we considered whether there might be a lack of programme innovation due to a number of factors, including:

- A distortion in the efficient allocation of TV advertising revenues;
- The focus on SOCI and SOB during negotiations may result in broadcasters being more risk adverse when commissioning, sticking with programming that is more predictable in terms of size and composition of audience rather than trying new or innovative programing;
- That the lag between commissioning and seeing a return on that investment may act as a deterrent to new entrants significantly increasing their investment in content; and
- Features of the current trading model may prevent media buyers/advertisers from experimenting with new marketing approaches.

6.85 In terms of the impact on programming, broadcasters did not consider that the current trading model restricted their ability to invest in innovative programming or led to significant harm to viewers. Broadcasters cited a number of examples of new innovative programming, such as Channel 4's *Million Pound Drop*, *One Born Every Minute*, *Seven Days*, along with original, high cost drama such as ITV's *Downton Abbey*. Several broadcasters believed that the current model delivered significant benefits to viewers by providing broadcasters with strong incentives to invest in programming and to innovate in order to attract and maintain audiences.

6.86 ITV provided analysis on the importance placed on UK originated content by viewers and the competitiveness of the market for UK viewers, in particular, the competitive pressure faced by commercial PSBs from the BBC and other broadcasters such as

Sky. They considered that this provided strong incentives for commercial PSBs to invest in content (and in particular UK content) to compete effectively and meet the expressed wishes of viewers, and also therefore advertisers.

6.87 Analysis by Oliver & Ohlbaum[46] for ITV submitted that, compared to other major developed markets, the UK has a high number of major broadcast network owners and a greater number of indigenous channels than all other markets. In addition, they found that the UK is one of the world's largest indigenous content markets in terms of total investment, and has a greater spend per capita than all other major markets, apart from Japan and Canada. On this basis, Oliver & Ohlbaum concluded that there was no evidence of consumer harm arising from the current model of airtime trading and the practices of major broadcast sales houses.

6.88 Channel 4 also provided a number of examples of innovation and experimentation with in TV advertising itself, including live adverts (e.g. Honda), the 'hijacking' of breaks by Jimmy Carr and other comedians during Channel 4's Comedy Gala, as well as contextual advertising, advertising special events and narrative campaigns.

6.89 One broadcaster did raise concerns that CRR restricted innovation not just for ITV but the whole market, as ITV market strength meant that the risks of innovation for smaller players outweighed the potential upsides.

6.90 There was a general consensus amongst media buyers that the trading model did not make broadcasters significantly more risk adverse when commissioning new programming. Several respondents pointed to the stable level of spend on UK originated content over the last decade as evidence of this.

6.91 Media buyers did not consider that the current trading model prevented advertisers and media buyers from experimenting with new marketing approaches, although one media buyer did consider that the emphasis on price and quality did not stimulate or encourage the search for other marketing approaches. Another media buyer provided a number of examples of innovation in the TV advertising which had occurred under the current trading system, including:

- Flighting methods – the ability to creatively buy airtime to create 'roadblocks' across a schedule or to buy entire advertising breaks.
- Ad serving technology such as Sky Ad Smart – enabling the targeting of individual geo-demographically audiences.
- Affinity advertising, where complementary products are booked in the same advertising break, for example a 'motors' break with brands involving cars, car insurance, petrol etc.
- Associative Advertainment, where advertising spots tie in editorially to programme content.

6.92 Some media buyers also noted that the relationship between performance and the type of content commissioned was an important one, and would continue to persist even under alternative trading models.

[46] ITV submission, Attachment 2 – Oliver & Ohlbaum comparison of international television advertising markets.

6.93 Of the advertisers which directly commented on the potential impact on viewers and consumer, one considered that viewers had more choice, quality and control than ever before, while ISBA refuted the proposition that CRR had stifled programme innovation or made ITV risk adverse.

6.94 One industry observer commented that an alternative trading model might, amongst other things, provide advertisers with greater transparency and ability to switch, and competition between broadcasters would provide a stronger incentive to produce better and more innovative programming. However, it did not explain what the alternative model would actually look like.

Ofcom’s analysis of innovation in TV advertising and programming

6.95 Given that TV advertising is a two sided market, any distortion, restriction or prevention of competition has the potential to impact on two sets of consumers: advertisers and viewers. In our Consultation, we raised concerns that the competition issues identified could affect both viewers and advertisers in terms of lack of programme innovation and higher prices for TV advertising than would have otherwise been the case.

Effect on Viewers

6.96 Over the last decade, we note that there has been a significant growth in the number of channels available to viewers, suggesting an increase in viewer choice. At the same time, investment in UK originated content, generally considered to be highly valued by UK viewers, has remained steady. It is also the case that broadcasters such as Sky are significantly increasing their investment in original UK productions and, as noted above, innovative programme formats - such as *Million Pound Drop* and *One Born Every Minute* – are also continuing to be developed and commissioned. All of these developments have occurred in the presence of the current trading model, indicating that it has not prevented broadcasters innovating and commissioning new programming.

6.97 Similarly, respondents to the Consultation have indicated that the trading model has not prevented advertisers or media buyers from experimenting with new marketing approaches. This was supported by examples of advertising innovation such as live adverts, affinity advertising, associative advertisements and Sky AdSmart.

Effect on Advertisers

6.98 Reckitt Benckiser was the only respondent to suggest that prices might be lower under an alternative ‘looser’ system. However, it did not provide any evidence to support this proposition nor did it explain what it meant by a ‘looser’ system. While a different system of trading may result in a different set of prices, it is not clear whether or not this would result in overall prices to advertisers being lower. For instance, in the case of a model where peak and off-peak airtime was traded separately, there would be the potential for the price of high-demand peak airtime to increase significantly, possibly pricing some existing smaller advertisers out of the market.

Conclusion

6.99 We have not seen any clear evidence that the current TV advertising mechanism has resulted in a lack of programme innovation which could have harmed viewers. In fact the general thrust of the responses is that channels compete with one another for viewers and one way they do this is through offering viewers new or different types of programming: there is thus a commercial pressure to continue to innovate and develop the programmes offered to viewers.

Section 7

Decision on whether to make a market reference

Introduction

7.1 In the previous Section, we outlined the possible problems associated with of features of the market we identified in the Consultation. We reviewed the evidence and stakeholders responses about the significance and scale of the possible problems and benefits of the trading model.

7.2 We have decided not to make a market investigation reference to the CC. We conclude that we do not believe it is necessary to decide whether we have met the legal threshold to make a reference because, as outlined below, we do not believe, in any event, that it is proportionate to exercise our discretion to make a market reference.

Legal test and criteria for exercising our discretion

7.3 In the previous chapter we concluded that, having reviewed the evidence and submissions, we are not convinced that there is clear evidence to suggest whether there are reasonable grounds for suspecting that any feature, or combination of features of the market interact to prevent, restrict or distort competition. We identified some potential residual concerns, for example around the interaction of bundling and market strength of broadcasters, but we noted that we received no evidence or analysis to demonstrate that these concerns were material or enduring.

7.4 However as we noted in our Consultation, the legal threshold – that there are reasonable grounds to suspect that the features of the market adversely impact on competition – for making a market investigation reference is low. In light of this, despite the uncertainty surrounding our residual concerns, it is possible that the legal threshold has been met.

7.5 Even if this threshold were met, Ofcom has to consider whether to exercise its discretion to refer the market identified to the CC for an investigation. We must be satisfied that it would be proportionate to do so. In this case, we believe that we do not need to decide whether we have met the legal threshold because, as outlined below, we do not believe it is proportionate to exercise our discretion to refer the market to the CC.

7.6 In reaching our decision that it would not be proportionate to refer the market, we have referred to the OFT's Guidance, which outlines four criteria that, in the OFT's view, should be met before we decide to make a reference[47], namely:

- Alternative powers: that it would not be more appropriate to deal with the competition issues identified by applying CA98 or using other sectoral powers;
- Undertakings in lieu: that it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference;

[47] OFT's Guidance, paragraph 2.1.

- Proportionality: that the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response to it; and

- Availability of remedies: that there is a reasonable chance that appropriate remedies will be available.

7.7 In response to the Consultation, a number of respondents raised issues in respect to the third criterion, proportionality of a reference. As a result, the issue of whether a reference is a proportionate response to the concerns identified is considered in detail below, before considering the remaining three criteria later in this section.

Proportionality and scale of the suspected problem

7.8 According to the OFT's Guidance, we should only make a reference where we have reasonable grounds to suspect that the adverse effects of the features on competition are significant. In order to assess this we considered whether the suspected adverse effects are likely to have a significant detrimental effect on consumers through higher prices, lower quality, less choice or less innovation[48].

7.9 A reference to the CC would involve significant costs to both the TV advertising sector and the public sector in the form of resourcing, but would also impose a a further substantial burden on stakeholders associated with the potentially significant and destabilising effects of uncertainty to the sector. As a result we need to be confident that a market reference is a proportionate response to possible problems identified. The OFT Guidance states:

"*The OFT will only make a reference when it has reasonable grounds to suspect that the adverse effects on competition of features of a market are significant. In making this assessment it will consider whether these suspected adverse effects are likely to have a significant detrimental effect on customers through higher prices, lower quality, less choice or less innovation. Where it seems likely that this effect is not significant the OFT will normally take the view that the burden on business, particularly in terms of management time, and the public expenditure costs of an investigation by the CC are likely to be disproportionate in relation to any benefits that may be obtained from remedying the adverse effects*."[49]

Stakeholder's views

7.10 Very few respondents argued that there are sufficient concerns to warrant a market reference to the CC. In addition most respondents stressed the costs of such an investigation to the sector and/or the potential destabilising effect of an investigation on the industry.

7.11 None of the three respondents who appeared to support a market investigation reference provided any further analysis or evidence of the competition concerns we raised in our consultation. Furthermore, no respondents provided evidence or further analysis about the significance of the impact of problems identified on consumers. For example two respondents generally agreed with our hypotheses about potential problems in the market as set out in our Consultation, but did not provide any further

[48] OFT's Guidance paragraph 2.27.

[49] Paragraph 2.7, OFT 511: Market investigation references – Guidance about the making of references under part 4 of the Enterprise Act (OFT) March 2006.

supporting evidence or analysis to confirm our hypotheses. In both cases the respondents did not comment on the potential benefits of the trading model.

Ofcom's views

7.12 Having reviewed the evidence and submissions received we do not believe there is a strong case to suggest that there is a significant detriment to consumers – whether TV viewers, advertisers or end users of products advertised on TV – as a result of way airtime is traded. Most respondents argued that consumers were not being harmed by the operation of the trading model. Respondents provided examples to support the case that broadcasters are able to experiment with programming and delivery of advertising and the level of UK originated content has remained relatively stable.

7.13 A number of respondents identified potential issues about why the trading model may not be operating as effectively as it might. However these responses have generally concluded that, in light of possible developments in the sector and the offsetting benefits associated with the model, it would be disproportionate to refer the market to the CC for a market investigation. Some stakeholders have also argued that the market is capable of adapting to address some of the concerns identified[50], and that this market-led approach was preferable to regulatory intervention. In addition, no party presented any proposals for intervention to address concerns raised.

7.14 We are mindful that there could be a concern that the players in the market may have an incentive to align their positions (explicitly or implicitly) to dissuade us from making a market reference. That is, whether the overwhelming lack of desire for a market reference could be indicative of a shared interest between broadcasters, media buyers and advertisers, which was a concern raised by some industry stakeholders and observers. If this was the case, end consumers (e.g. consumers of retail products which have been advertised on TV) could be harmed if higher advertising costs were passed through in the form of higher retail prices.

7.15 Although we cannot rule it out absolutely, we did not find any evidence to support this concern and considerate does not appear that media buyers and advertisers have the incentive or are likely to engage in such behaviour. The market structure and competitive conditions do not appear to be conducive to this kind of behaviour. For example the bespoke nature of deals between broadcasters and media buyers would be expected to limit the degree of price visibility to the market which would severely constrain the ability of the participating parties to monitor and police firms' behaviour. At the same time, evidence from advertisers suggests that there is active competition from media buyers for their business which would also tend to suggest a lack of co-operation between media buyers. Furthermore, we note that the firms most likely to be adversely affected by any sort of co-operation between media buyers and broadcasters – i.e. advertisers – do not argue that they are facing high prices/poor quality of service and they are not in favour of a reference.

7.16 Even if we accepted that some form of collusion between broadcasters and media buyers was taking place, advertisers would only have the incentive to participate in such an arrangement if, as noted above, they were able to pass on the higher advertising costs through to end consumers i.e. the consumers actually purchasing

[50] For example, where an advertiser wished to take a more active role in the monitoring of its contract and prices paid, it could seek to review their terms & conditions to improve transparency and/or obtain more detailed, bespoke auditor reports examining their 'deal' and performance of their media buyers.

their products[51]. However, pricing decisions are complex and will depend on a range of factors e.g. not just the direct costs of production that a firm incurs but also the competitive conditions in the market in which the firm operates (e.g. does the firm have market power), the willingness to pay of its customers etc. The role of advertising is also complex. That is, it can fulfil a number of different purposes such as conveying information about the product to potential consumers (to increase the firm's share of the market) or representing investment in developing a brand (to try to reduce how sensitive demand is to price changes). In addition, not all firms in a market will use TV advertising or they will use TV advertising in different proportions.

7.17 As a result it may not be possible for advertisers to automatically pass on higher advertising costs to end users, in form of higher retail prices. In fact there may be examples where higher advertising costs lead to lower retail prices. For instance, it is possible that an increase in the price of TV advertising would reduce advertisers' demand for TV airtime. This in turn could lead to a contraction of retail demand for products being advertised (assuming advertising is effective at increasing the demand for a firm's products), which could have the impact of reducing retail prices despite an increase in the price of TV advertising.

7.18 In light of this we believe it is highly unlikely that advertisers would have any incentive to collude with media buyers and broadcasters, given that they are the group most likely to suffer as a result of higher prices. Hence, if there are significant and enduring barriers to competition in the TV advertising market, we would expect much more support for a reference from advertisers.

7.19 As a result we do not consider that the overwhelming lack of desire for a market reference on the part of advertisers suggests that they are part of a collusive arrangement.

Application of CA98 or alternative powers, undertakings and alternative remedies

7.20 Amongst the factors we consider when deciding whether or not to make a reference are our competition and sectoral powers. We have concurrent competition (CA98) powers under s371 CA03 in relation to activities connected with communications matters.

7.21 We also have sectoral competition powers under s316 CA03, which empowers and requires us to impose licence conditions to ensure fair and effective competition in the provision of licensed services. As a result these sectoral powers exist only in relation to licensed and connected services.

7.22 Following the OFT's Guidance, we need to consider whether the competition problem we have identified may involve an infringement of CA98 and, if so, we should only consider a reference to the CC in one of two circumstances:

- When we have reasonable grounds for suspecting that there are market features which prevent, restrict or distort competition, but do not breach the CA98 prohibitions; or

[51] It is also possible that advertisers will not be concerned about high airtime prices if they believe that all advertisers face the same high costs but it seems very far-fetched to believe that advertisers such as coca-cola will not resist high advertising prices because pepsi also face high costs.

- When action under CA98 has been or is likely to be ineffective for dealing with the competition issue identified[52].

7.23 As noted in the Consultation that Ofcom has power under s154 EA02 to accept undertakings instead of making a reference to the CC. Therefore, we noted that we would have to take account of possible undertakings that could be offered by media buyers, advertisers or broadcasters to address the possible concerns raised and so obviate the need for a market investigation reference.

7.24 Finally, in accordance with the OFT's Guidance[53], we need to take into account the likely availability of appropriate remedies in the event that suspected adverse effects on competition were found by the CC to exist.

Stakeholder's views

7.25 Given that the overwhelming view of respondents was that a market investigation reference would be disproportionate, very few respondents commented in any detail about these issues.

7.26 No undertakings were proposed and no respondents suggested that a CA98 investigation or use of Ofcom's sectoral powers would be appropriate.

7.27 No respondents undertook a systematic analysis of possible remedies which might be available to the CC. Some respondents did comment on alternatives to the current model of trading, but on the whole this was to point out the problems associated with a move away from the current model. For example, a number of respondent commented that a slot-based trading model would impose significant costs both in terms of the scale of the booking requirements, given the huge number of slots available, and the reduction in efficiency if broadcasters lost the ability to optimise across a schedule.

7.28 One respondent who supported a reference to the CC noted that it would be a challenge to the CC to find an alternative to the current model which was broadly acceptable to the industry as a whole and did not put forward any proposals for how the problems they identified should be addressed.

Ofcom's views

7.29 Given the lack of evidence we have received about the scale or enduring nature of competition problems in the sector and our conclusion that we do not think a market reference would be a proportionate response to the problems identified, we have not considered undertakings in lieu or the availability of remedies in any more detail.

7.30 In addition, given the lack of evidence and uncertainty surrounding our residual concerns, we do not consider it would be appropriate to attempt to address these issues under our CA98 or sectoral powers.

Conclusion

7.31 In light of our analysis we conclude that, although some potential competition concerns have been identified it is not clear that they are significant or necessarily enduring. In addition, we do not believe there is a strong case to suggest that there is

[52] OFT's Guidance, paragraph 2.3.
[53] OFT's Guidance, paragraphs 2.30 to 2.32.

a significant detriment to consumers – whether TV viewers, advertisers or end users of products advertised on TV – as a result of way airtime is traded. Given these factors, and the significant costs that a market reference would impose on the public and private sector, we do not think it is proportionate to refer the market to the CC for a market investigation.

Annex 1

TV sector overview

Introduction

A1.1 TV advertising is an important feature of many consumer-focused markets. It can have a role in informing consumers of the key features of new products or services and be used as a way of differentiating one product from another in a particular economic market. Ultimately, advertising is aimed at shaping consumer preferences.

A1.2 In this Section we examine how advertising in the TV sector generally has evolved in recent years. We provide an overview of:

- Different forms of advertising and recent trends in advertising spend;
- The key players involved in sale and purchase of TV advertising;
- The key developments that have taken place in terms of TV viewing and advertising revenues; and
- Likely future developments in the sector.

The UK advertising sector

A1.3 It is clear from the large sums of money spent on advertising in the UK (Table A3.1) that it is seen as an effective way of marketing goods and services.

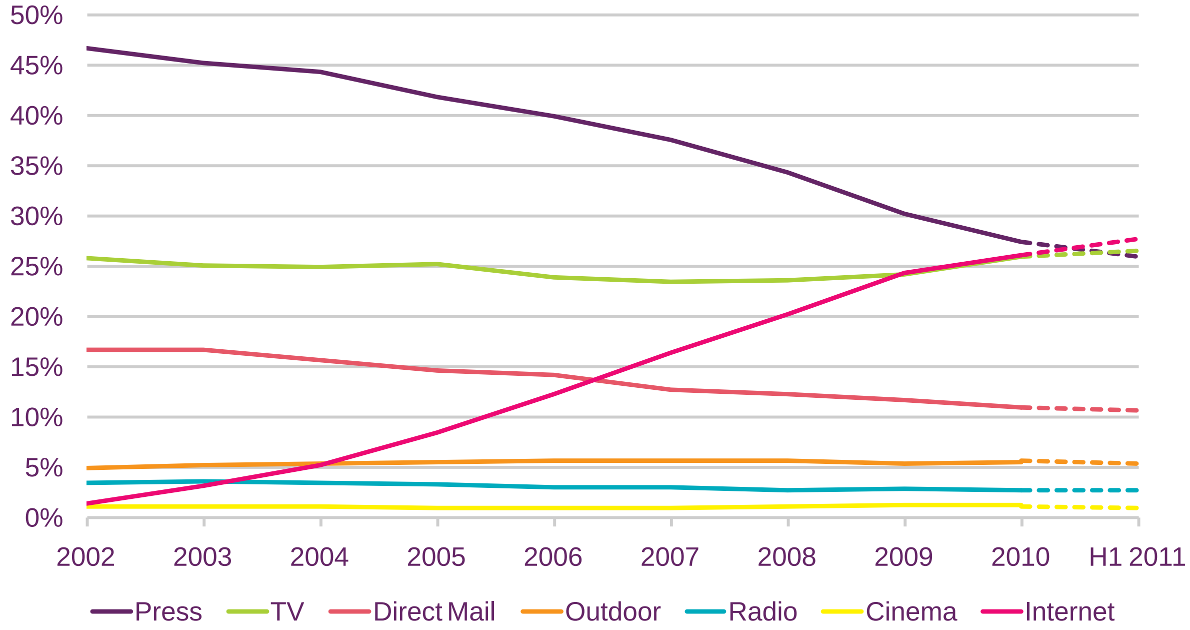
Table A3.1: Total UK Advertising Expenditure 2001 – 2010

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Current prices (£ million)	14,293	14,811	15,812	16,207	16,333	17,081	16,589	14,503	15,675
Year on year change (%)		3.6	6.8	2.5	0.8	4.6	-2.9	-12.6	8.1

Source: Advertising Association/Warc Expenditure Report

A1.4 Chart A3.1 provides an overview of the proportion of total advertising spend accounted for by each medium in both 2002 and 2010. This comparison shows direct mail and radio advertising expenditure has declined during the period, with spend on outdoor and cinema advertising remaining fairly constant. Spending on television advertising also experienced a decline between 2002 and 2009, but recovered slightly in 2010 and spending in the first half of 2011 has been marginally higher (compared to the same period in 2010). There has been significant growth in advertising on the internet, while press advertising (which includes all forms of advertising in newspapers, magazines, business & professional publications and directories) has fallen significantly. Even so, in 2010 press advertising still continued to account for the largest share with 27.5% of total UK advertising spend. Internet advertising accounted for the second largest share (26.1%), followed closely by TV advertising (26.0%) and direct mail (10.9%). The smallest proportions were accounted for by outdoor (5.6%), radio (2.7%) and cinema advertising (1.2%). In the first half of 2011 both internet and TV advertising overtook press advertising, with the internet accounting for 27.8% of advertising revenues, followed by TV with 26.6% and press with 26%[54].

Chart A3.1: Percentage of UK advertising spend across different media



Source: Advertising Association/Warc Expenditure Report

A1.5 Advertising can be split into display and classified advertising. Classified advertisements are generally grouped within a publication or featured on the internet under headings classifying the product or service being offered. These adverts are usually text-based and may just consist of the type of item being sold and contact details. Generally no pictures or other graphics are featured, though a logo may be included. Press (64.3%) and internet (30.5%) advertising account for a significant proportion of all classified advertising.[55]

A1.6 A sub-category of classified advertising is found on the internet: search-driven advertising, delivered by means of a keyword search. This accounts for the bulk of internet advertising (57.3%).[56] Search engines identify key words and use these as the basis for directing an advertising message to the ‘searcher’ or potential customer.

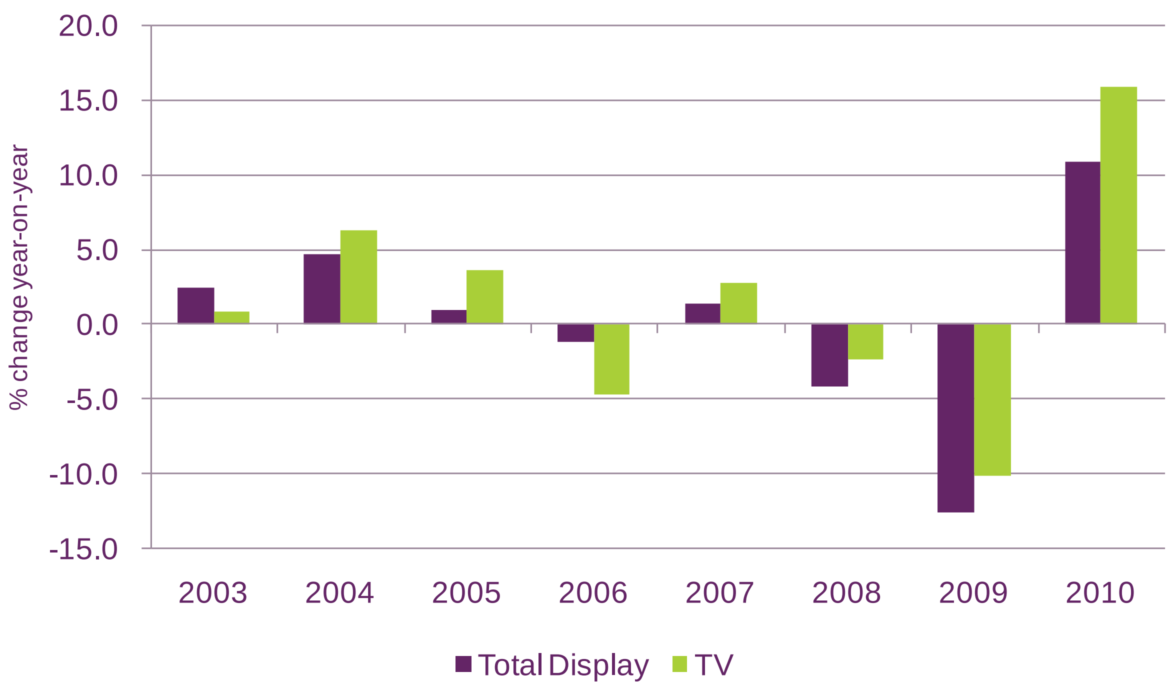
A1.7 Display advertising is advertising that combines text with other graphical information, such as logos, photographs, diagrams, moving images, location maps etc and may include audio elements. Over one third of display advertising revenues are accounted for by TV advertising and slightly less than a third (26.2%) of revenues arise from spending on press advertising. The remaining revenues can be

[54] Advertising Association/Warc Expenditure Report
[55] Advertising Association/Warc Expenditure Report, based on 2010 data.
[56] Advertising Association/Warc Expenditure Report, based on 2010 data.

attributed to other forms of advertising including direct mail (15.3%), Outdoor (7.8%), internet (8.9%), radio (3.7%), and cinema (1.6%)[57].

A1.8 With the exception of 2006, year-on-year growth for TV advertising has been faster (or the decline slower) than overall display advertising as Chart A3.2 demonstrates. Spend on TV advertising did not contract as significantly, following the economic downturn in 2009, and made stronger recovery, relative to total display advertising. TV advertising accounted for 36.4% of all display advertising in 2010, up from 34.8% in 2009. Internet display advertising also grew significantly over this period, however, it continues to represent a relatively small proportion of display advertising.

Chart A3.2: Year-on-year change in spend (%) – TV vs total display advertising

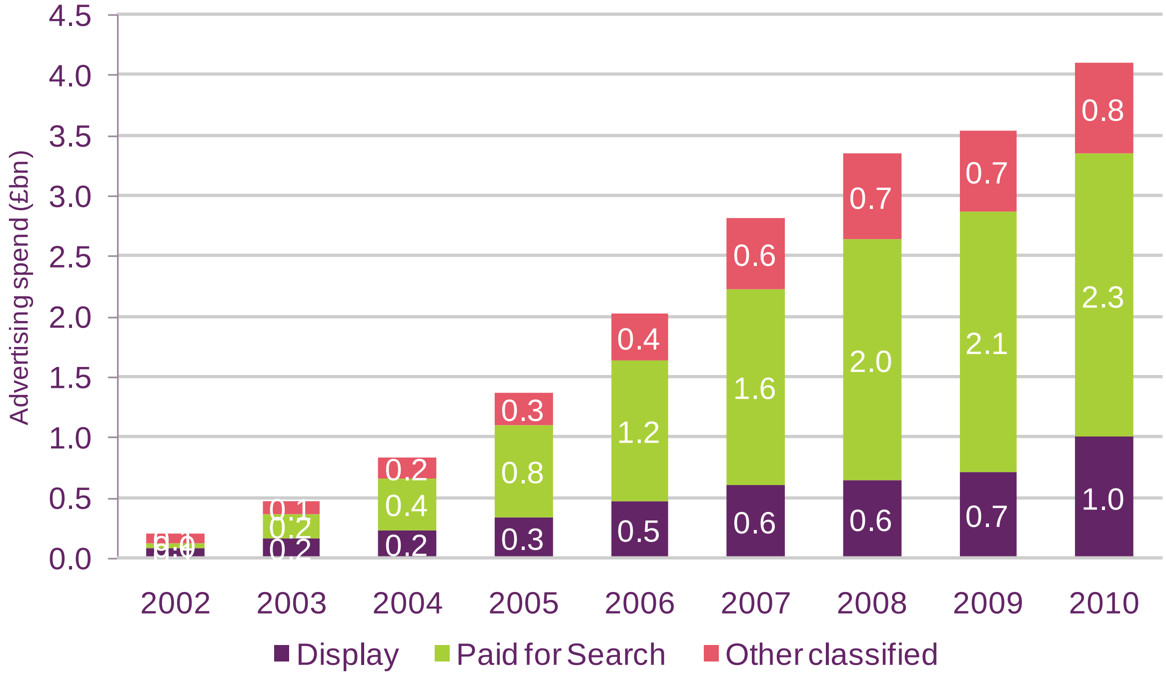


Source: Advertising Association/Warc Expenditure Report

A1.9 One of the key market developments over the last decade has been the growth of internet advertising. As demonstrated by Chart A3.1 above, internet advertising as a proportion of all advertising has risen rapidly from 1.2% in 2002 to 26.1% by 2010, and now attracts similar levels of revenue to that of TV and press advertising.

[57] Advertising Association/Warc Expenditure Report, based on 2010 data.

Chart A3.3: Distribution and growth of internet advertising spend



Source: PwC / Internet Advertising Bureau / Advertising Association / Warc
Note: All figures are nominal.

A1.10 This growth has predominantly been driven by the growth in search-based advertising. Chart A3.3 shows that the paid for search internet advertising comprises by far the largest share of internet advertising. In 2010, internet display advertising accounted for approximately 23.1% of total internet advertising[58]. The extent to which internet advertising might be substitutable for TV advertising is discussed further in Section 4.

TV advertising sector

The importance of TV advertising to advertisers

A1.11 Advertisers are able to advertise their products on TV via a number of methods, including advertising breaks, programme sponsorship and product placement. The bulk of TV advertising continues to occur during programme breaks.

A1.12 TV is a powerful and important medium for advertisers, both because it combines visual imagery, sound and movement and because television viewing is an extremely popular leisure activity[59]. As noted above, TV advertising accounts for a substantial portion of all UK advertising (26%), and represents the single largest category of display advertising. In 2010, approximately £4bn was spent on TV advertising in the UK (see Table A3.2 below), while a further £2bn was spent in the first half of 2011[60].

[58] PwC / Internet Advertising Bureau / Advertising Association / Warc
[59] CC 2003 Report, paragraph 3.12.
[60] Advertising Association/Warc Expenditure Report

Table A3.2: TV Advertising expenditure 2002 – 2010

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Current prices (£ million)	3,690	3,722	3,955	4,097	3,905	4,016	3,922	3,525	4,083
Year on year change (%)		0.9	6.3	3.6	-4.7	2.8	-2.3	-10.1	15.8

Source: Advertising Association/Warc Expenditure Report

A1.13 During the course of the OFT and CC's review of CRR, media buyers and advertisers re-iterated the importance of TV advertising in achieving brand awareness, sales uplift and reaching large proportions of the public. TV enables advertisers to combine moving images and sound to maximise audience engagement, with research suggesting that an engaged viewer is more likely to have a positive emotional association with the brand and is more likely to consider purchasing it in the future[61]. TV viewers also considered to have a higher level of emotional engagement with TV than any other media[62].

A1.14 Television is a popular form of advertising among advertisers wishing to market goods and services to consumers for a number of reasons, including:

- near universal reach, which is important for manufacturers of Fast Moving Consumer Goods (FMCG)[63], such as detergent, toiletries, paper products;
- the ability to reach a large number of consumers rapidly, which is important for goods that have a limited duration (e.g. newspapers, promotions and sales); and
- the ability to multiply and prolong the effect of TV advertising by using creative techniques and complementary media (such as the internet) to engage public interest; and
- allowing mass marketing to target demographics.

A1.15 Given these factors, the ability to advertise on TV is important to many businesses.

Two-sided nature of the TV advertising market

A1.16 The market for commercial broadcasting is a two–sided market, with broadcasters selling advertising airtime to advertisers on one side of the market and supplying programmes to viewers on the other side of the market. In other words, advertisers want access to airtime in order to advertise to viewers. Broadcasters attract viewers to their channel by broadcasting programmes. When viewers watch these programmes on a commercial channel, they will also watch advertising (thereby providing the advertising airtime for the broadcaster to sell to advertisers).

61 http://www.thinkbox.tv/server/show/nav.752
62 http://www.thinkbox.tv/server/show/nav.762#2
63 FMCG is a term generally used to describe frequently purchased consumer goods which are relatively low cost. They are often common items used daily for which there is a high demand. FMCG products contrast with durable goods or major appliances such as kitchen appliances, which are generally replaced less than once a year.

A1.17 The two-sided nature of the market means that changes on one side of the market can have implications for the other side. For instance, a broadcaster might attempt to increase the number of advertising minutes it sells to advertisers. However, this would be at the expense of an increase in the implicit 'price' faced by viewers in the form of programme interruptions caused by advertising breaks.

Advertising and the consumer

A1.18 The costs and revenues associated with TV advertising affect consumers in two main ways:

i) as viewers of commercial programming; and

ii) as consumers of the products which are advertised on TV.

A1.19 With the obvious exception of the BBC, most channels get some or all of their income from advertising. Chart A3.4 below provides an overview of the different sources of income used to fund television content. TV advertising revenues therefore have the potential to make a major contribution both to the choice and quality of the programmes available to viewers.

Chart A3.4: Total TV industry revenue, by source

Source: Ofcom/broadcasters
Note: Figures expressed in nominal terms and replace previous Ofcom revenue data for TV industry, owing to restatements and improvements in methodologies. 'Subscription revenue' includes Ofcom's estimates of BSkyB, Virgin Media, BT Vision, TalkTalkTV, Setanta Sports (until its closure), ESPN and Top Up TV television subscriber revenue in the UK (Republic of Ireland revenue is excluded). It also excludes revenue generated by broadband and telephony. 'Other' includes TV shopping, sponsorship, interactive (including premium-rate telephony services), programme sales and S4C's grant from the DCMS. The BBC restated licence fee revenue in 2008. Totals may not equal the sum of the components due to rounding.

A1.20 As a major source of many broadcasters' income, the level of advertising revenue earned may be expected to have an impact on the type of television programmes it is able to buy and/or commission. In effect, an interdependent relationship exists between investment in quality programming (which may be defined by a number of characteristics, including production values, the nature of content, its ability to attract different audiences etc.), number of viewers and advertising revenues earned. That is, other things being equal the higher the quality of programming invested in the more viewers a broadcaster is likely to attract and therefore the more advertising revenues it might be expected to earn and potentially re-invest into content.

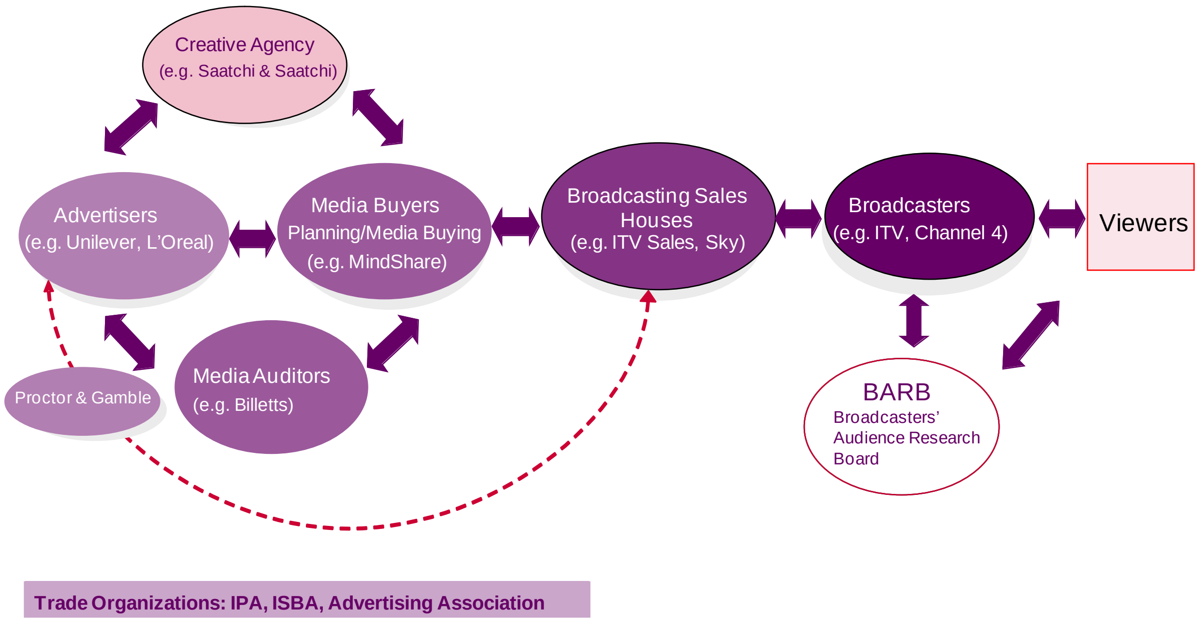
A1.21 It is worth noting that given commercial broadcasters also compete with the BBC for audiences; investment in quality programming will also be influenced by the degree of competition faced from the BBC for viewers. In other words, the greater the quality of programming on the BBC, the more commercial broadcasters will be incentivised to invest in their own quality programming to ensure viewers do not switch away.

A1.22 As purchasers of products advertised on TV, consumers can also be indirectly impacted by the nature and costs retailers/advertisers are charged for TV advertising. Given the role of advertising in shaping consumers' preferences the type of advertising on TV might be expected to have an impact on consumption patterns. In addition advertising represents an input cost into the production of goods/services, and therefore an increase (or decrease) in the cost of advertising could have an impact on the overall price charged for a product. However we note that, in practice, the relationship between advertising costs and end user prices is likely to depend on a range of factors (e.g. the extent of competition in the downstream market) which will influence the degree to which a change in the cost of advertising may affect the end price paid by the consumer.

Overview of the TV advertising supply chain

A1.23 Figure A3.1 below provides an overview of the various players and their roles in the TV advertising supply chain. The role of each of these different players is also described briefly below. The commercial relationships and how TV advertising is bought and sold is covered in greater detail in Section 5.

Figure A3.1: The TV Advertising Supply Chain



Source: Ofcom

Advertisers

A1.24 The advertising process is initiated by an advertiser. The advertiser may launch or run a campaign for a variety of reasons: for example, the organisation may wish to raise a product's profile, launch a new product or increase brand awareness. Working together with the creative agency/media buyer, the advertiser decides which advertising medium(s) it will use for a given campaign, and the length and scope of the campaign. Advertisers will then buy TV advertising airtime (usually via a media buyer) from broadcasters to enable them to meet their campaign objectives.

Creative Agencies

A1.25 Creative agencies are employed by advertisers to provide consumer insight and to develop brand strategies. They are also responsible for designing the advertising campaign and the adverts. At times, some (or all) of the services provided by creative agencies may alternatively be provided by media buyers, specialist companies (e.g. communications planning companies), or in-house by the advertiser itself.

Media Buyers

A1.26 Media buyers (or media agencies) are engaged by advertisers to act as a central point for negotiating the terms on which advertising is purchased from broadcasters. These negotiations may not only cover advertising airtime, but also sponsorship, product placement and advertising supported programming.

A1.27 As well as negotiating terms with the sales houses, media buyers plan and implement individual campaigns on behalf of advertisers. They collaborate with broadcaster sales houses on a daily basis, implementing campaigns and where necessary agreeing where specific advertisements will be placed on the programme schedule. Media buyers deal with all sales houses and other media providers – they do not limit their negotiations just to one sales house (or medium) for the delivery of all of its clients advertising needs.

Broadcasting Sales Houses

A1.28 TV advertising airtime is generally sold on behalf of broadcasters by broadcasting sales houses. Sales houses are responsible for managing the media buyer relationship, negotiating contracts and terms and conditions. The larger broadcasters have their own sales houses i.e. ITV, Channel 4, Five and Sky. Smaller broadcasters often contract to sell airtime through these larger sales houses, however some smaller broadcasters may also sell their airtime through smaller sales houses (e.g. Digital Media Sales) or through their own in-house advertising sales teams (e.g. Turner Media).

Broadcasters

A1.29 Broadcasters air programmes and adverts. Working with sales houses, broadcasters determine their schedule, where to include advert breaks and the length and number of those advert breaks. Sales houses then assist broadcasters to determine where best to broadcast adverts within this schedule.

Media auditors

A1.30 Media auditors are employed by advertisers to assess the effectiveness of advertising campaigns, and the performance of the media buyer. They assess a number of areas including but not limited to: the price paid per impact, coverage, frequency, and other quality elements of the campaign.

A1.31 Media auditors can also advise advertisers on when they might want to switch agencies and may also manage the switching process for the advertiser (e.g. arranging and assessing pitches from media buyers).

BARB

A1.32 BARB (Broadcasters' Audience Research Board) is the primary provider of television audience measurement in the UK. It covers all channels broadcasting across all platforms - terrestrial, satellite and cable in both analogue and digital[64].

Targeting and measurement of TV audiences

A1.33 Along with its ability to market products both visually and audibly to a large audience, TV advertising provides advertisers with the ability to target particular audience types. The audience measurement systems, along with strategic advert placement by broadcasters, provide advertisers with the means to target a desired demographic group of consumers. For example, if an advertiser is launching a new men's shaving product, it can ensure that the advert is broadcast at a time when adult males are more likely to be watching, and survey data will be available to measure how many individuals within the target audience have seen the advert.

A1.34 Television audiences typically comprise a range of different demographic groups which can be differentiated according to three main characteristics i.e. age, sex, and socio-economic status[65]. Demographic groupings are overlapping e.g. the 16-34 Men demographic is a subset of Adult Men and also a subset of 16-34 Adults and so on.

A1.35 The demographic profile of television audiences for particular programmes is measured by BARB. Viewing estimates are obtained from a panel of television owning private homes representing the viewing behaviour of the 26 million TV households within the UK. Each home represents, on average, about 5,000 of the UK population. This enables broadcasters and advertisers to identify what proportion of a particular demographic group is watching a programme. Experience of audience viewing habits enables broadcasters to predict what type of audience a programme will appeal to, and how many from each demographic group are likely to see it.

A1.36 The exposure of a particular demographic to an advertisement is measured in terms of 'commercial impacts' (or impacts). Each occasion an advert is seen by a viewer counts as one impact. The effectiveness of advertising in reaching a target

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[64] BARB is jointly owned by ITV, BBC, Channel 4, Five, BSkyB, and the IPA. More detail is available on BARB's website at http://www.barb.co.uk/.

[65] Audiences are conventionally divided into some 15 different demographic groups which form the basis for the trading of advertising airtime. These different demographic groups are set out below (based on descriptions used in the 2000 CC 's Report):
Broad Demographic Groups: Adults, Housewives, Women, Men and Children
Narrow Demographic Groups: ABC1 Adults, 16-34 Adults, ABC1 Men, Housewives with Children, ABC1 Housewives, 16-34 Men, 16-34 Women, ABC1 Women, 16-24 Adults, and 16-55 Housewives.

demographic group is measured in television ratings (TVRs). For a particular campaign, one TVR equates to reaching 1% of the target group with one 30 second advert[66]. Thus, an advert in a programme that reaches 25% of a particular demographic group delivers 25 TVRs. These commercial impacts or TVRs provide the ‘currency’ in which broadcasters and advertisers deal i.e. broadcasters and advertisers contract with one another for the delivery of a given volume of TVRs from a particular demographic group.

A1.37 Advertisers will have a number of objectives when planning a campaign. Often these are expressed in terms of coverage and frequency. Coverage, or ‘reach’, refers to the percentage of the target audience seeing the advert a minimum number of times. For example, if a campaign’s Adult coverage is said to be 80 or 80% then the advert was seen by 38.5 million of the 48.1 million Adults in the UK TV viewing population. Frequency is a method of describing the extent to which an advert in a campaign has been seen by the same person more than once. For example, if viewers have seen an advert 4 or more times, this is referred to ’4+’. As a result, ’4+ cover’ refers to the percentage of the target audience seeing the advert at least four times. The effective or optimal frequency will vary depending on the type of product being advertised and the objective of the campaign (e.g. product launch, brand building, promotion etc).

TV sector developments

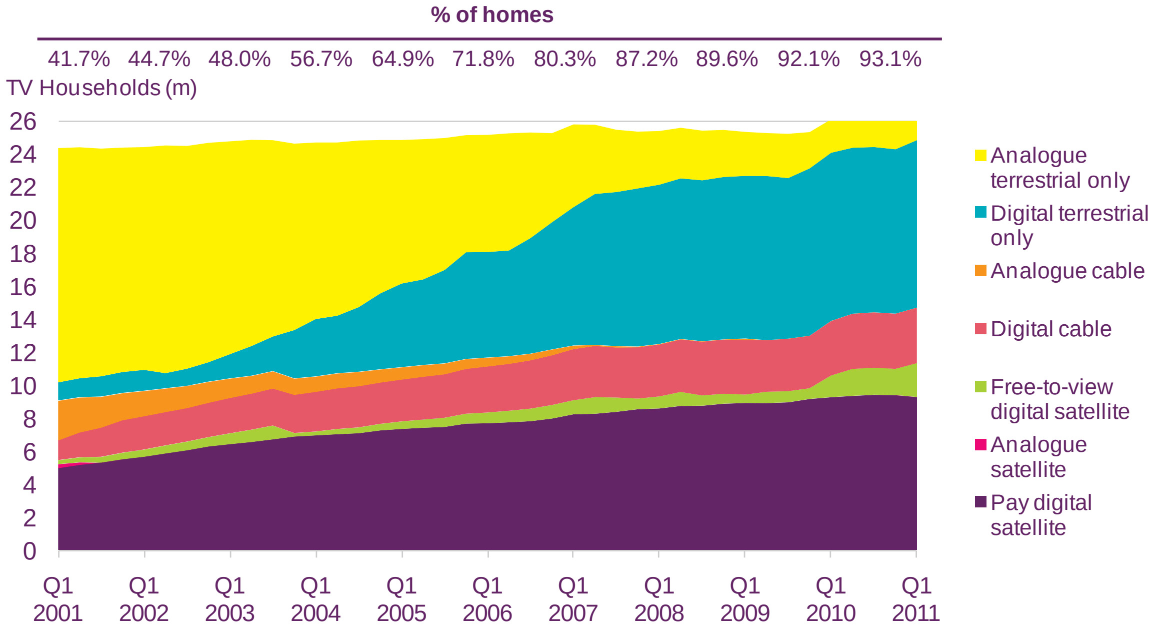
A1.38 There have been a number of key developments in recent years, including the rapid increase in digital TV uptake, emergence of new channels and a corresponding shift in TV viewing from PSBs toward digital channels. This has seen a corresponding increase in the volume of commercial impacts and a narrowing of the gap between the shares of commercial impacts for the largest and smaller sales houses. These developments and trends are discussed in more detail below.

Digital platform take-up has grown significantly

A1.39 The introduction of digital broadcasting has significantly increased the number and range of different channels available to TV viewers. Since 2002, the number of channels broadcasting in the UK has more than doubled, increasing from 236 to 510 in 2010. At the same time, there has been significant growth in the penetration of digital TV. As Chart A3.5 shows, by the end of 2010, 93.1% of UK households had digital TV, compared to only 41.7%) in 2001.

[66] While a 30 second advert is the general standard, adverts can often range in time length (for example 10 or 60 seconds). These will be converted into a 30 second equivalent TVR for the purposes of measurement.

Chart A3.5: Multi-channel television take-up by platform



Source: Ofcom, GfK NOP research from Q1 2007, previous quarters include subscriber data and Ofcom market estimates for DTT and free satellite
Note: Digital terrestrial relates to DTT-only homes.

A1.40 By June 2011, digital terrestrial television was available to 85% of the population[67], and the proportion of homes with digital television will continue to increase until Digital Switch Over (DSO) is completed in 2012. As the remaining 6.9% of UK households, who currently only access analogue TV services, take up digital television during this period, they are likely (as we explain below) to follow previous digital TV adopters and shift some of their viewing to non-PSB channels.

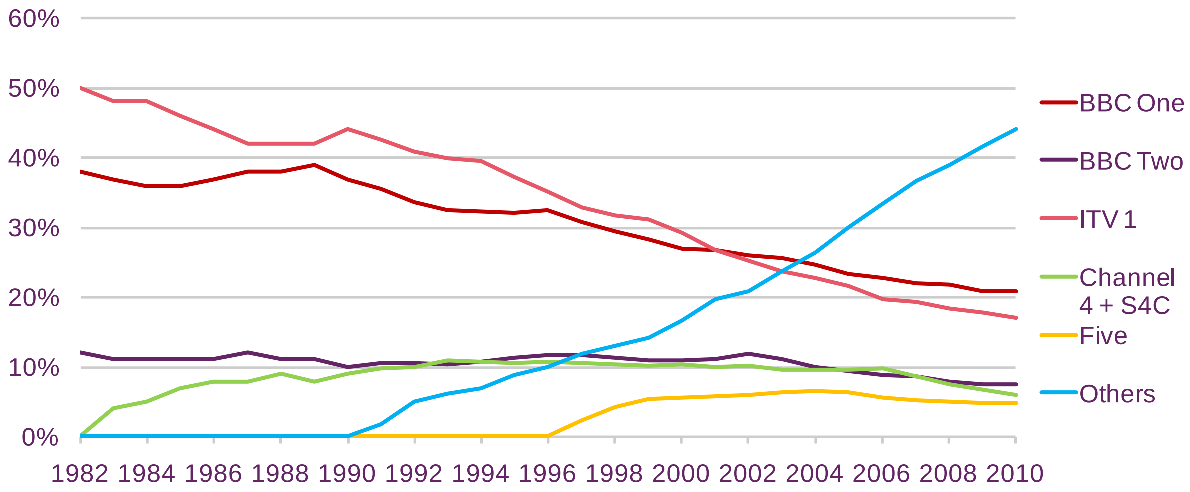
Fragmentation of TV viewing

A1.41 The growth in the number of digital TV channels and the increasing take-up of multichannel TV has resulted in increasingly fragmented viewing. More viewers watch content delivered over a wider range of digital channels and viewing of analogue channels and their simulcast digital versions has declined.

A1.42 Multichannel viewing as a proportion of television viewing in all homes, all day, has grown to 44% in 2010[68], almost double its level in 2003. As a result, the five main PSB channels (BBC1, BBC2, ITV1, Channel 4/S4C and Five) all experienced reductions in viewing share over the same period. The collective share of these channels has fallen by a quarter since 2003 to 56% in 2010[69]. Chart A3.6 below demonstrates the changing shares in viewing during the period 1983 to 2010.

[67] Ofcom Communications Market Report 2011.
[68] Ofcom Communications Market Report 2011.
[69] Ofcom Communications Market Report 2011.)

Chart A3.6: Audience shares in all homes, 1983 to 2010



Source: BARB, TAM JICTAR and Ofcom estimates
Note: due to a new BARB measurement panel from 2010 onwards, 2010 data are not directly comparable with previous years. Note: In 2010 Channel 4 and S4C became two separate channels following digital switchover in Wales. For the purposes of this report the two channels remain labelled together in relevant charts.S4C 2010 channel share = 0.1%.

A1.43 Prior to 2003, BBC1 and ITV1 experienced declines in their audience share – with the smaller PSBs either showing some growth or relatively stable audience shares.

A1.44 However, since 2003, the key difference is that all five main PSB channels have shown a decline in their respective audience shares. As noted above, both the individual as well as collective percentage audience share of the five main networks in all UK homes has fallen since 2003. The combined share of the commercial analogue channels - ITV1, Channel 4 and Five – fell over a quarter from 41% in 2003 to 28% in 2010[70].

A1.45 However we should note that the 'others' category includes audience shares of channels owned by PSBs as well as other broadcasters. As a result the decline in PSB audience share has been offset by gains in share on their affiliated channels. For example, the digital portfolio channels of ITV, Channel 4 and Five increased their audience share from around 4% to 20% over the period 2003 to 2010[71].

A1.46 As might be expected, this increase in fragmentation of viewing has had an effect on the market for TV advertising. Primarily, it has resulted in an increase in the volume of commercial impacts and changes in market shares of broadcasters both in terms of commercial impacts and advertising revenue.

Increase in the volume of commercial impacts

A1.47 As we outlined earlier, the fragmentation in TV viewing has occurred because of two developments: the availability of more channels and greater adoption of digital TV resulting in a shift in viewing from the BBC and commercial PSB channels towards commercial non-PSB channels.

[70] Ofcom Communications Market Report 2011.
[71] BARB/Kantar Infosys (based on all individuals).

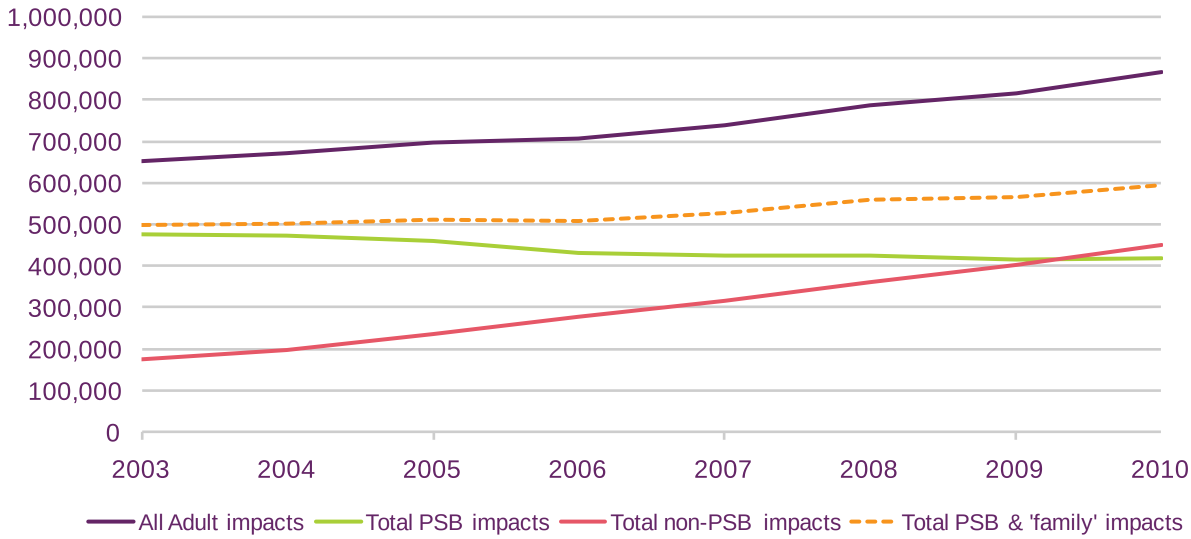
A1.48 Shifts in viewing from the BBC to non-PSB channels will increase the total number of impacts in the market substantially since viewers will be substituting from a channel with zero adverts to one with adverts.

A1.49 In addition, current advertising minutage regulations allow the commercial non-PSB channels to broadcast more advertising minutes than commercial PSB channels. Therefore any shift in viewing from the commercial PSB to non-PSB channels may also increase the overall viewing of TV adverts (and, hence, increase the number of impacts available).

A1.50 Consequently, viewer fragmentation in the UK in recent years, particularly shifts in viewing from BBC channels to non-PSBs, has led to an increase in total impacts available to advertisers.

A1.51 In aggregate terms, the overall volume of Adult commercial impacts increased by 32.7% from 654 million to 868 million between 2003 and 2010. This is shown in Chart A3.7 below. This overall growth is essentially attributable to the significant increase in commercial impacts from non-PSB channels whilst the total number of commercial PSB impacts has fallen relative to the 2003 level. As can be seen in the figure below, the proportion of Adult commercial impacts delivered by non-PSBs is now greater than that delivered by PSBs, although, as noted, a significant proportion[72] of these impacts will be delivered by channels which are owned by PSB broadcasters.

Chart A3.7: Total adult commercial impacts over time 2003 – 2010



Source: BARB/Kantar Infosys
Note: Total PSB & 'family' impacts includes all adult impacts attributed to both the PSB channels and non-PSB channels owned by the PSB broadcasters.

A1.52 Given that the increase in the volume of commercial impacts has been driven by increasing access to and viewing of digital television, it is likely that the number of impacts will continue to rise until digital switchover is completed in 2012.

[72] In 2003, approximately 12.5% of adult impacts attributed to non-PSB channels were accounted for by channels owned by PSB broadcasters (e.g. E4, ITV2). This proportion has steadily risen to approximately 39.4% of non-PSB impacts in 2010. Source: BARB/Kantar Infosys.

Changes in the market position of the main sales houses

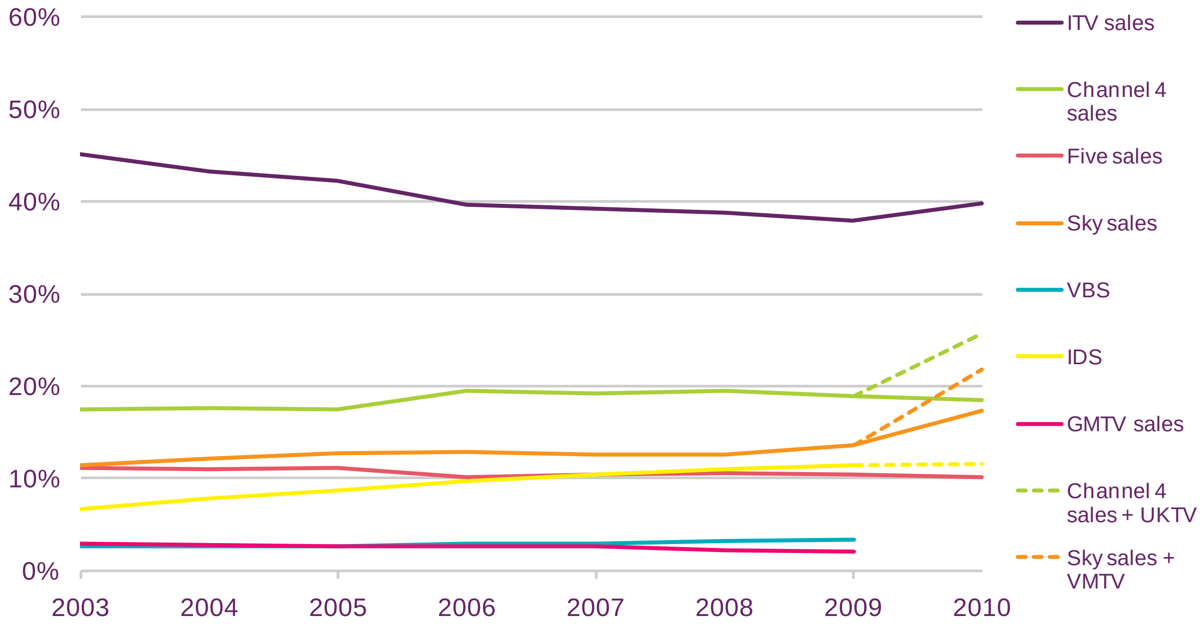
A1.53 The market shares and respective positions of the sales houses can be measured both in terms of volume, via their SOCI and value, via their share of net advertising revenues (NAR). Below we examine the changes in SOCI and NAR for the major sales houses and the effect of the fragmentation of viewing and increases in the number of commercial impacts over recent years.

<u>Changes in SOCI</u>

A1.54 The growth in commercial impacts supplied by non-PSBs has also led to a shift in the distribution of SOCI between the channels and sales houses. Chart A3.8 below shows changes in SOCI in the Adult demographic for each of the major sales houses. It shows that the SOCI of ITV's sales house has declined from 45% in 2003 to 39.8% in 2010[73].

A1.55 Over the same period, there have been some increases in the SOCI delivered by other sales houses, such as IDS and Sky[74]. Furthermore, Sky and Channel 4's relative share of SOCI is likely to increase further given recent consolidation in the sector.

Chart A3.8: Adult SOCI by sales house from 2003 – 2010

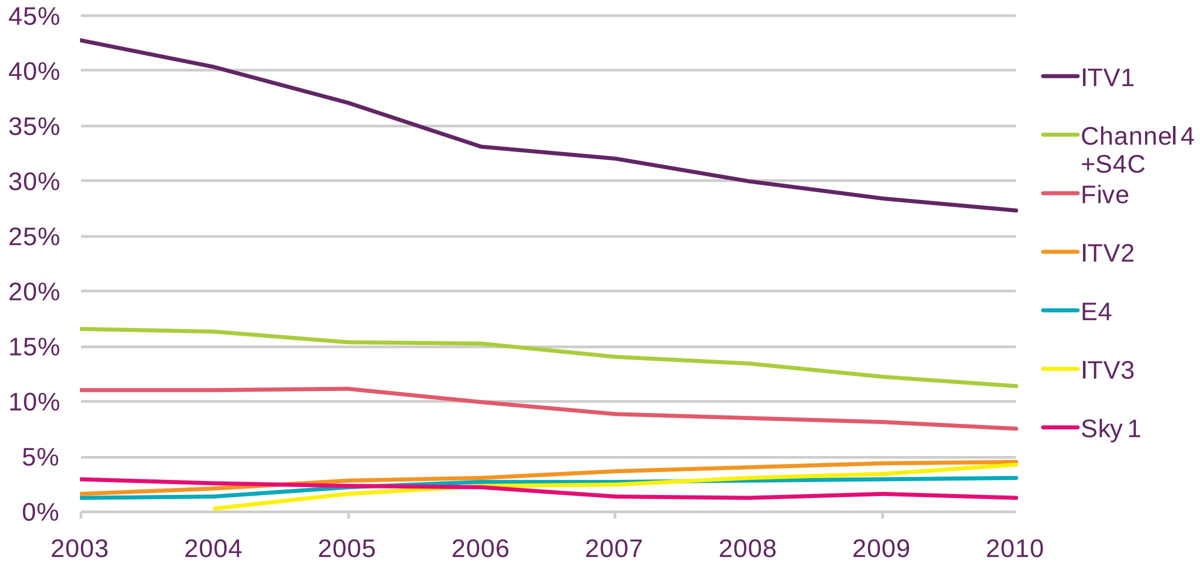


Source: BARB/Kantar Infosys
Note: In June 2011, Sky bought Virgin Media Television (VMTV) and Channel 4 won a 10 year contract to sell the advertising airtime on the UKTV portfolio of channels. As a result, the IDS sales house was shutdown. Both the Sky and Channel 4 sales houses did not formally take over the selling of advertising airtime on VMTV and UKTV until January 2011.

[73] The chart also shows historical figures for GMTV's and VBS sales houses. ITV assumed full control of GMTV in November 2009. Therefore GMTV's SOCI has been included within ITV's from 2010 onwards. Similarly, in November 2009 Sky acquired the contract to sell the Viacom portfolio of channels, and the VBS sales house was closed at the end of 2009.
[74] Shifts in sales houses' SOCI will reflect the changes in viewing and in commercial impacts achieved by the channels the sales house represents. This representation is not static however and some channels have been represented by different sales houses over recent years. A sales house can also increase its SOCI by selling advertising on behalf of a greater number of channels.

A1.56 It is also informative to examine SOCI in terms of the position of individual channels and how this has changed over time. Chart A3.9 below illustrates how the share of Adult SOCI for each of the main commercial analogue channels has fallen.

Chart A3.9: Adult SOCI by channel 2003 – 2010



Source: BARB/Kantar Infosys

A1.57 The lower shares of Adult SOCI for commercial analogue channels reflect the shift in viewing to non-PSB channels. Between 2003 and 2010, ITV1, Channel 4 and Five's combined share of Adult SOCI fell from circa 70% to 46%[75] – with the gains going to the non-PSB channels. The non-PSB channels increased their combined share of Adult SOCI from around 27% to 52% over the same period[76].

A1.58 Whilst ITV1, Channel 4 and Five have lost SOCI, it is important to recognise that the ITV and Five sales houses have not experienced as large a decline in SOCI as their main channels – and in the case of the Channel 4 sales house, there has actually been a slight increase relative to 2003. This is because the ITV plc, Channel 4 and Five digital 'family' channels have captured some of the loss in viewing on their main channel.

Changes in NAR

A1.59 The shifts in viewing and SOCI noted above may have impacted the revenues of broadcasters. Chart A3.10 shows the breakdown of NAR by type of channel between 2003 and 2010. Non-PSB channels experienced a growth in advertising revenues at the expense of the commercial analogue channels. In 2003, ITV1, Channel 4 and Five accounted for 79% of net advertising revenues compared to 61% in 2010, representing a decline of approximately 22e% (although, some care

[75] These figures do not include GMTV or S4C – however both of these channels also experienced significant declines in their channel SOCI over the same period.
[76] However, as already noted, the increase in non-PSBs' SOCI includes gains achieved in SOCI by PSBs' digital 'family' channels.

needs to be taken when interpreting changes in NAR for ITV1 as it is influenced in part by the CRR remedy[77]).

Chart A3.10: NAR by channel type 2003-2010

Source: Ofcom/broadcasters. Note: Figures expressed are in nominal terms and replace previous data published by Ofcom. Main commercial PSB channels comprise ITV1, STV, UTV, Channel Television, 1/DaybreakGMTV1/Daybreak, Channel 4, Five and S4C; Commercial PSB portfolio channels include, where relevant, ITV2, 3, 4, Men & Motors, CiTV, E4, More 4, Film 4, 4Music, Five USA and Fiver (and their '+1' channels). For previous years closed channels have also been included. Sponsorship revenue is not included. Totals may not equal the sum of the components due to rounding.

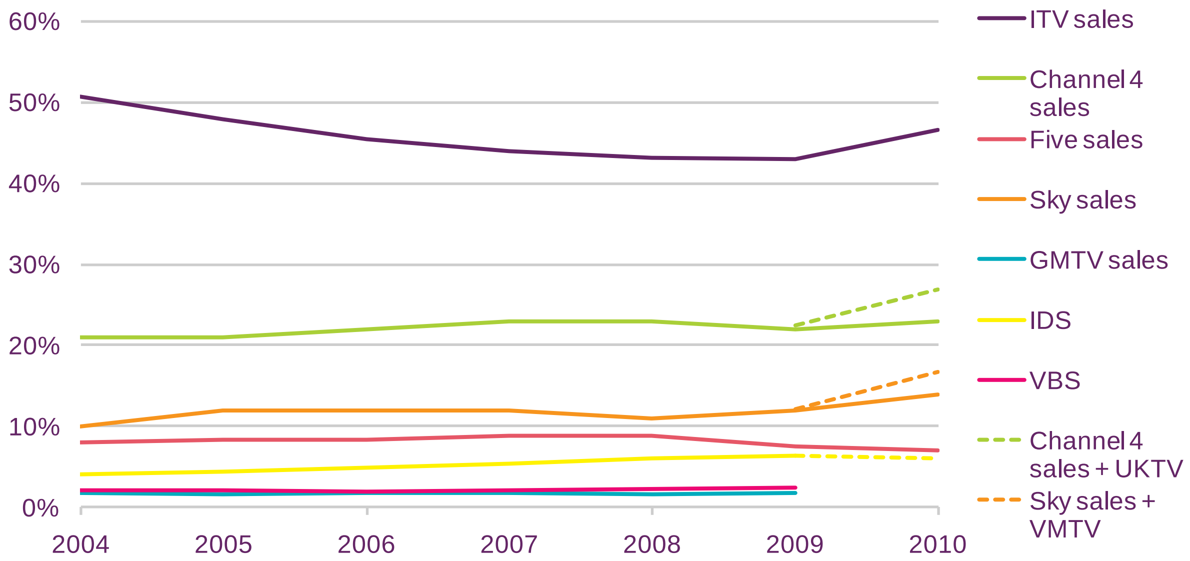
A1.60 However, while digital channels have increased their combined share of advertising revenues since 2004, the majority of the recent revenue gains to digital channels as a whole have actually gone to the commercial PSB portfolio channels, (shown in green in the diagram above) – these channels had negligible revenues in 2003 but by 2010 comprised over 14.5% of total sector NAR.

A1.61 This reflects the fact that PSBs launched additional channels after 2003[78] and these portfolios of channels have been successful in attracting an increasing share of viewing, commercial impacts and advertising revenues. This may indicate that PSBs have been able to broaden their overall offering to advertisers and possibly deliver a more targeted product to advertisers, even of this has contributed to a decline in revenues from their main channels. .

A1.62 For ITV, the growth of its family channels has only partially offset the decline in ITV1's share of TV advertising revenues; whilst for Channel 4, it has actually helped to deliver a slight increase in its sales house's share of revenue relative to its position six to seven years ago – this is illustrated in Chart A3.11 below.

[77] The CRR ratchet allows media buyers to withdraw revenue from ITV1 in proportion to the fall in ITV1's SOCI so part of ITV's decline in share of NAR can be attributed to the CRR remedy itself.
[78] For example, ITV3 was launched in 2004, ITV4 in 2005, More4 in 2005 and Five USA in 2006.

Chart A3.11: Share of NAR over 2004-2009 by sales house

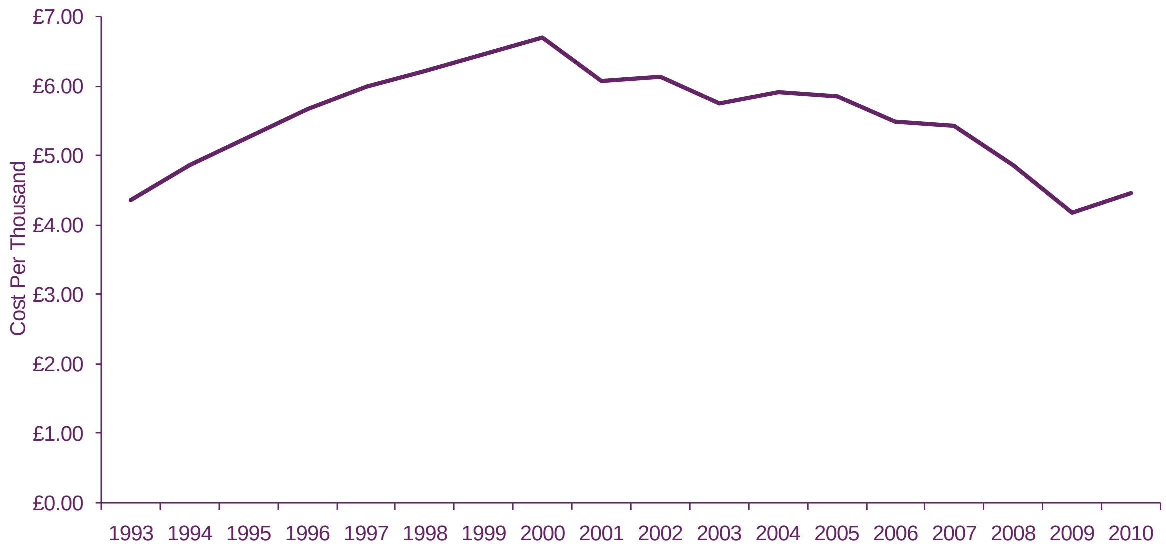


Source: Ofcom/broadcasters
Note: In June 2011, Sky bought Virgin Media Television (VMTV) and Channel 4 won a 10 year contract to sell the advertising airtime on the UKTV portfolio of channels. As a result, the IDS sales house was shutdown. Both the Sky and Channel 4 sales houses did not formally take over the selling of advertising airtime on VMTV and UKTV until January 2011.

Advertising prices have fallen

A1.63 In response to previous reviews, a number of stakeholders have told us that there has been a widespread fall in the price of commercial impacts in recent years. The large growth in the number of commercial impacts, as well as the stronger negotiating position of media buyers, may have contributed to this. Chart A3.12 below provides an indication of the changes in the average cost of commercial impacts over time (as measured by cost per thousand impacts or 'CPT').

Chart A3.12: Television advertising cost per thousand over time



Source: ITV plc 'Response TV' survey, slide 28. Research findings available at: http://www.itvmedia.co.uk/insights-and-effectiveness/insights/response-tv

Advertising revenue forecasts

A1.64 Historically, advertising spend has broadly reflected the general performance of the economy, although TV advertising has tended to outperform the broader advertising market. While TV advertising has recovered reasonably well from the fall in revenues in 2008, the sector is currently predicted to see relatively low levels of growth in real terms over the next few years. In September 2011, Enders Analysis forecast that TV advertising expenditure will experience 0% growth overall during 2011, predicted a weak start to 2012, with 1% growth for 2012 and beyond[79].. The Advertising Association/Warc also currently predicts that TV advertising will see negative real growth in 2011 of -2.8%, with growth of 2.1% in 2012. Nonetheless, concerns still remain about the wider economy and the likely impact any potential downturn in consumer spending might have on advertising revenues.

Future developments in TV viewing and advertising

A1.65 There are several technological developments which may have an impact on how viewers consume television and other audio-visual content in the future – Digital Video Recorders (DVRs[80]), Video on Demand (VOD) and VOD delivered over the internet.

A1.66 Non-linear viewing of audio-visual content is a small but growing component of all viewing. Ofcom research indicates that DVR viewing is driving consumption of on-demand content, and is the most popular way for consumers to view non-linear broadcast content. Ofcom's latest technology tracking data suggest that digital video recorder (DVR) take-up in Q1 2011 stood at 9.6 million homes (46% of the UK population), compared to 3.0 million in 2005. Furthermore, in Q1 2011, 35% of individuals claimed to have used the internet to watch catch-up television services. Within DVR homes, however, live viewing is still the preferred means of watching television. And despite the expansion of broadband (which is now available in 74% of homes), use of online catch-up TV still appears to be comparatively contained, though it is gradually increasing[81].

A1.67 There are concerns that if an increasing number of viewers begin to use DVRs to time-shift their television consumption, the impact of TV advertising may be reduced as viewers fast-forward through commercial breaks. However, thus far, the impact of DVRs in this regard has not been overly significant. The proportion of time shifted viewing time shifted via DVR usage within different types of DVR enabled homes has remained relatively stable over the last few years, with increases in overall DVR time shifting driven by increased rollout of DVRs, rather than growing usage within DVR homes. On this basis, total DVR time shifting across all TV homes and is predicted to grow to around 10-11% of all TV viewing by 2020[82]. According to the latest Skyview panel data (which accurately measures viewing patterns in Sky homes), 83% of viewing in a DVR household is to 'live' TV and viewing increases by 15% when homes acquire a DVR. In addition, of the 17% of viewing that is time-shifted, viewers with a DVR still watch 30% of advertising breaks at normal speed[83].

[79] UK advertising growth slows to a crawl, Enders Analysis, 8 September 2011.
[80] Also referred to as Personal Video Recorders (PVRs)
[81] Ofcom Communications Market Report 2011
[82] The UK Multichannel TV landscape, 3 Reasons Ltd, Spring 2011. This forecast is based on the assumption that as DVR penetration increases, the average proportion of time shifted viewing amongst DVR users will fall given that future DVR growth will be more focused on cable and DTT homes, where levels of DVR time shifting are lower than in Sky+ homes.
[83] http://www.thinkbox.tv/server/show/nav.898

Research also suggests that viewers still continue to engage with ads, even when they fast-forward through them[84] and some advertisers/broadcasters. Therefore, it appears that the effects of DVRs on TV advertising may not be as great as once feared.

A1.68 VOD content can be consumed in several ways (e.g. catch-up, movies, short clips) via a range of different platforms (e.g. over the internet on a computer, IPTV, on a TV set via a cable connection, on a mobile device). Ofcom research indicates that on demand viewing (on the TV or via the internet) accounts for an average of 33 minutes of viewing per week[85]. As the popularity of VOD increases there is the potential for viewing to move away from 'traditional' linear broadcasts, which may have a resulting effect on the number of commercial impacts available to TV advertisers. Similarly, advertising around, or in, VOD content may begin to attract advertising revenues away from TV and other advertising mediums. At present the VOD sector is still in its infancy and the degree to which it may impact on liner viewing, and thus TV advertising revenues, is not clear. In addition, the existing linear broadcasters are likely to be prominent suppliers of VOD in the future, benefiting from access to content and viewer loyalty.

A1.69 The role out of next generation broadband, in combination with connected TVs and other IPTV services also has the potential to further transform viewing habits and the way content is consumed and distributed. Similarly, stakeholders have observed that the prospect of entry by new players such as Apple and Google may also change the dynamics of the TV advertising. However, in both cases, the likely scale and speed of such changes taking place, and its impact, remains unclear.

A1.70 Widespread adoption of DVR and VOD will also allow for new forms of TV advertising such as targeted advertising (ad insertion), product placement and click through from content to product sale. For example, Sky AdSmart allows the advertising shown to be tailored the viewer and their interests, therefore, households with children may receive one type of advert, dual income/childless families can receive another and singles could get a third. In addition, Channel 4 has forecast that around two thirds of all TV audiovisual content viewing time (on TV, PC and mobile) will be tracked intelligently in some way by 2020[86].

A1.71 However, at present it is not clear that these alternative types of advertising are likely to overtake the current model. TV advertising during programme breaks continues to remain an important means of effectively targeting specific consumer groups. The presence of a relatively sophisticated and well establish measurement system (BARB) continues to provide advertisers with reassurance that their ads are being appropriately targeted. In addition, there does not appear to be a strong incentive for broadcasters to move away from the existing model given it may have the potential to undermine the existing trading system and associated revenues.

A1.72 The recent acquisition by Northern & Shell of Five could also signal the potential for advertising to be sold on a cross-media basis (e.g. bundling TV and print advertising). Negotiating across a wider portfolio of products has the potential to change the dynamics of the negotiating strength exercised by media owners and media buyers, and may ultimately influence how TV advertising is traded in the

[84] http://www.thinkbox.tv/server/show/nav.898
[85] Ofcom Communications Market Report 2010.
[86] David Abraham speech to the Royal Television Society, 23 May 2011. http://www.rts.org.uk/sites/default/files/David-Abraham-2011.pdf

future (e.g. may be a trend towards a common ‘currency’ for cross-media advertising bundles).