



Ofcom's Second Public Service Broadcasting Review

Phase 2: preparing for the digital future

Consultation

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Section 1

Executive summary

The Public Service Broadcasting review so far

- 1.1 Ofcom is required by Parliament to review public service broadcasting at least once every five years, and to make recommendations about how its quality can be maintained and strengthened. In doing so, our focus is on audiences' needs: both understanding them, and ensuring they continue to be met as sweeping changes take place in the media landscape.
- 1.2 Our comprehensive research in phase 1 showed the importance audiences place on the continued availability of high quality, original UK content that meets public service purposes, from a range of providers. For now, linear television remains the main way of watching this content, but audiences are enthusiastically taking up the opportunities of digital media, especially younger audiences.
- 1.3 We found that the broadcasters are broadly fulfilling the purposes of public service broadcasting, but that the existing model for commercial provision of public service content lacks the flexibility to adapt to audiences' evolving needs. The market is unlikely to deliver all that audiences consider important in the future, with gaps already emerging in valued genres.
- 1.4 We asked stakeholders for views on these findings and on four illustrative models for public service broadcasting delivery, alongside possible ways of funding those options. We also asked what action stakeholders considered appropriate in the short term. This phase 2 document addresses the many and varied responses we received, and elaborates on the choices lying ahead.

While the BBC is highly valued, stakeholders and audiences want alternatives to it, and do not agree on how to achieve this

- 1.5 The importance to viewers of public service broadcasting and UK originated content was widely accepted by respondents to our consultation. Audiences value the BBC very highly, but virtually nobody favoured it becoming the only provider of public service content.
- 1.6 Views about the need for new intervention to sustain provision beyond the BBC were more varied. Some respondents argued that the market would meet most future needs, while others suggested that existing indirect funding for the commercial public service broadcasters (PSBs) would support a greater level of ongoing provision than we forecast.
- 1.7 In contrast, some respondents felt that the growing pressures on commercial public service content demanded more urgent action, arguing for sharply reduced obligations, or for new funding to replace the declining indirect subsidy. Several respondents argued phase 1 neglected the role of local content, especially on digital terrestrial television.
- 1.8 There are compelling arguments and strong audience support for alternative public service provision to complement the BBC. However, some respondents argued we had overstated the importance of this. To investigate, we reviewed new viewing data showing that competition in public service provision enhances rather than reduces

impact, opening up genres to audiences who tend not to watch similar content on the BBC. We also carried out further research which suggests that audiences would be willing to pay to ensure provision of public service content outside the BBC.

Commercial public service broadcasting under the current system will not survive the transition to an all-digital world

- 1.9 Our analysis of the funding available to the commercial PSBs for public service content, reviewed for this phase, shows they will continue to deliver much UK public service content, often for commercial reasons. The regulatory assets identified in phase 1 used to fund provision of this content, such as access to reserved spectrum, will retain some value beyond the completion of digital switchover in 2012.
- 1.10 But this will not be enough to sustain the current level of provision by ITV1 and Channel 4 across a range of genres. The value of the ITV1 licences will fall below the cost of their current obligations before 2012, with the result that ITV plc may have incentives to surrender those licences. After 2012 the obligations linked to the licences will need to be very limited if no replacement funding is available. By 2012, we estimate that Channel 4 will need additional funding in the order of £60-100 million to sustain investment in public service content, excluding the cost of its ambitious *Next on 4* proposals.

The market will make a growing contribution, but is unlikely to meet all needs

- 1.11 Viewers have access to a wider range of content than ever before, on digital TV and online. Multichannel broadcasters now make a significant contribution to public service content, particularly in sport, entertainment, archive and acquired programming, and in one case, news. But they provide very little original programming in the genres under most pressure on commercial public service channels – current affairs, nations and regions programming, challenging UK drama, UK scripted comedy, and UK drama and factual programming for children. This is unlikely to change as provision on the commercial PSBs declines, because most multichannels do not reach the audiences required to justify large and risky investments in these areas and will themselves face increasing economic pressure.
- 1.12 In digital media, the potential exists for new commercial provision of content which meets public service purposes, especially online. However, our assessment shows online business models remain highly uncertain, especially for content already under pressure on commercial television. Moreover, it is unlikely that such content will have the reach and impact of television for some time to come. The BBC and Channel 4 may have roles to play in future in introducing audiences to a wider range of public service content from other providers.
- 1.13 Given the speed of ongoing change, the evolution of the market is particularly uncertain. It may come to meet more of audiences' needs in future. We therefore need a more flexible model of intervention that focuses public funding on areas in which the market cannot deliver and recognises these may change over time.

Existing institutions retain important roles, while competition for funding could create greater flexibility during an era of great change

- 1.14 The model for provision of public service content beyond the BBC now faces its greatest challenge – how to harness the opportunities opened up by digital media while responding to growing pressures on funding, and reconciling the divergent needs of different audiences.

- 1.15 Some respondents argued that the existing model is well placed to meet the challenges and opportunities that lie ahead, and that significant reform is not needed.
- 1.16 We agree that the existing public service institutions retain important roles, and that continued support for institutions with values aligned to delivery of public purposes should be an important element of any future model. However, our analysis is clear that a model in which institutions retain their current roles but with no new funding, and no flexibility to adapt to audiences' changing needs, will not deliver the vision based on audiences' priorities that we set out in our first consultation.
- 1.17 As we look forward to an all-digital world, new providers could play an important and growing role in meeting public service purposes. Competition for funding, which is widely used in other areas of public service, could enable an enhanced contribution from a range of alternative organisations. It could keep providers accountable and ensure the main public service institutions do not become complacent.
- 1.18 In phase 1, we set out four illustrative models for the future. The **BBC-only** model attracted scarcely any support, from either audiences or stakeholders. However, there was no consensus in relation to the three remaining models.
- 1.19 The evolution model was favoured by those who believed Channel 3 licensees retained an important role, especially in the devolved nations. The BBC/Channel 4 model was supported by many respondents and viewers, who welcomed Channel 4's ambition to play an enhanced role. Audiences and stakeholders valued the flexibility of the competitive funding model, but expressed concern about possible bureaucracy.

Three models for the post-switchover world

- 1.20 Driven by this assessment, this document sets out three refined models for further consideration. All of these models would require significant change to the existing legislative framework. Given that the current model will become unsustainable before 2012, we continue to believe that there is a pressing need for action with a clear direction established by government no later than 2010.

An enhanced Evolution model

- 1.21 If audiences' needs change relatively little over the next few years, and the existing broadcasters remain best placed to meet those needs, an enhanced **Evolution** model has advantages.
- 1.22 In this model the main commercial PSBs would retain obligations. ITV1 could become a network of nations-based licences, or a single UK licence, with obligations only for UK origination, UK and international news, and potentially news for the devolved nations and the English regions, for which replacement funding is likely to be required.
- 1.23 Channel 4 would have an extended remit to innovate and provide distinctive public service content across platforms, with additional funding.
- 1.24 Five's role would focus on UK origination, in particular UK children's programming, and news.
- 1.25 Even under this evolution model, there might be no need to retain a public teletext licence, nor a Channel 3 breakfast-time licence.

A refined BBC/Channel 4 model

- 1.26 If ITV1's and Five's incentives are no longer credibly aligned with public service purposes, and not for profit institutions are chosen as the primary way of securing those purposes, a **BBC/Channel 4** model offers benefits.
- 1.27 In this model the BBC and Channel 4 would be the main recipients of public funding and regulatory assets. Channel 3 and Channel 5's licences would be auctioned or the spectrum rights and other regulatory assets transferred directly to Channel 4 and the BBC to enhance their public service propositions.
- 1.28 Competition for new funding could be introduced for nations, regions and potentially local news. Channel 3 licensees would have no ongoing public service benefits or obligations, but could compete for funding to provide nations and regions news, alongside others. Five would also lose public service status but could similarly bid.

A refined competitive funding model

- 1.29 If audiences turn rapidly to new platforms and forms of content, and competition for funding is deemed the best way to ensure the accountable and efficient use of public resources, a **competitive funding** model offers advantages.
- 1.30 In this model, the BBC would remain as the cornerstone of provision, but additional funding would be opened up to a wider pool of providers. Channel 4 could retain its PSB status along with its existing regulatory assets, but be required to bid for any additional funds alongside other providers. Current Channel 3 licensees and Five could also bid for funding, alongside others, if they wished to continue to contribute.

Provision of news and information for the devolved nations is an essential requirement for any future model, and is likely to need replacement funding

- 1.31 Because the costs of provision for some Channel 3 licensees will soon outweigh the benefits of PSB status, it is likely that replacement funding will be needed for nations and regions services, particularly news. The options as we see them are:
 - Do nothing, and allow provision to decline over time, against clear audience preferences;
 - Provide new public funding for Channel 3 licensees in the nations and regions;
 - Introduce competitive funding for services in the nations and regions to enable other providers to bid, potentially enabling the creation of cross-media services in Scotland, Wales and Northern Ireland; or
 - Fund the creation of dedicated channels for the devolved nations, such as that proposed by the Scottish Broadcasting Commission.
- 1.32 In Scotland, our analysis shows that replacement funding is likely to be needed significantly earlier than 2012 in order to continue to meet audiences' needs, particularly in relation to news.
- 1.33 New opportunities are opening up for market and community provision of local video content, as a consequence of the growth of broadband and the framework put in place by Ofcom for access to spectrum. The evidence suggests audiences value this type of content, but are concerned it should be of high quality. Funding models for

local video content in the UK remain unproven; in addition to market provision, new competitive funding models could help to meet local needs if required.

Replacement direct or indirect funding of £145-235 million is likely to be necessary by 2012

- 1.34 If audiences continue to want to enjoy the same mix of public and private content they have today, we estimate that public funding of between £330-420 million is likely to be required by 2012 in addition to the core licence fee. Towards that total, we estimate existing regulatory assets will contribute around £185 million, leaving a likely gap of £145-235 million. After 2012, it is increasingly difficult to be precise about funding requirements given uncertainty about the wider media environment.
- 1.35 A wide range of possible funding sources exist, the ultimate decisions about which lie with government and Parliament.
- 1.36 **Regulatory assets** will continue to have value, particularly reserved spectrum, and many respondents saw these assets as an appropriate funding source. Beyond 2012, the value of these assets becomes increasingly uncertain.
- 1.37 Some respondents to our consultation supported **direct public funding**; many expressed concern about its impact on the independence of content providers, although there are already successful examples of direct funding with arm's length oversight to ensure independence is retained.
- 1.38 Many expressed concern about the impact on the BBC of the potential use of **the licence fee** to fund other providers. But the surplus in the current licence fee settlement that is ring-fenced to pay for costs of digital switchover, if retained, could be used for other purposes after 2012 without in any way curtailing the BBC's ability to deliver high quality public service content. This surplus is worth around £130 million per annum in the current settlement. Our research indicates that using such a funding source after 2012 would be supported by audiences, and that understanding of what the licence fee currently funds is fairly limited.
- 1.39 Other proposals, such as the BBC developing partnerships with commercial broadcasters, or the transfer of some or all of **BBC Worldwide to Channel 4's** ownership also have merit, although the practicalities require careful assessment.
- 1.40 **Industry levy** schemes could also offer attractive solutions. The argument for a broadly based industry levy would be significantly strengthened if there were further indication that digital business models were harming the prospects for investment in UK content. Our analysis suggests that this kind of impact has been fairly limited so far, but that this could change. The range of options for industry levies is broad - elsewhere in Europe schemes already exist to enable content rights holders to gain from reuse of broadcast content and the retransmission of channels over other platforms.
- 1.41 In any model, we must be confident that recipients of public funding use resources effectively and efficiently. Any new model of funding should be transparent and proportionate, should not impact unduly on market provision and should be subject to independent scrutiny. Appropriate governance arrangements would be essential.

Channel 4 needs clarity about its future role and model by 2010

- 1.42 Channel 4 has an important ongoing role to play in public service content, but is experiencing increasing financial pressure. It has already cut its programme budget for 2008 and 2009 in order to break even. Its reserves could be used to sustain its public service investment to around 2010, but certainty about its long term role and funding is now a pressing priority.
- 1.43 The principal choices to address its funding deficit are:
- increasing its regulatory assets, for example allocating to it regulatory assets currently held by ITV1 and Five (or by being allocated the value of these assets which would be delivered by auction);
 - building its scale by transferring some or all of BBC Worldwide to Channel 4; or
 - providing direct funding through the switchover surplus in the licence fee, an industry levy or direct taxation.
- 1.44 Alternatively, it could compete for additional funding, but not be allocated any further funding by right, as in our competitive funding model.
- 1.45 Any new public investment in Channel 4 is likely to require changes to its accountability arrangements, such as enhanced responsibilities for the Channel 4 Board or independent external oversight of its use of public resources and delivery of a revised remit.

Our proposals for the commercial PSBs' obligations from 2009 are designed to ensure audiences' priorities are secured

- 1.46 Ofcom is required to decide what obligations the commercially funded public service broadcasters should have. They retain important roles over the next few years, especially in providing high levels of original UK content, national and international news, and nations and regions news.
- 1.47 But their obligations must be sustainable and targeted at the areas most highly valued by audiences. In making these proposals, we are mindful of the need not to foreclose any long term options government and Parliament may wish to consider. However, even our proposed changes – most of which could take effect early in 2009 – may not be sufficient to achieve a sustainable settlement beyond 2012, and will need further assessment before this point.
- 1.48 ITV plc has proposed a series of areas where they wish to reduce or amend the obligations on ITV1. We have considered these carefully. In so doing, we have sought to align obligations with the continuing value of the ITV1 licences before the end of switchover.
- 1.49 Taken together, these proposals seek to ensure audiences' priorities of UK programmes, UK news and nations and regions news are served. To do that we are proposing to reduce the costs of obligations substantially in other areas, consistent with existing legislation.

- 1.50 We therefore seek views on the following proposals for ITV1:
- retained nations and regions news, but a modest reduction in the minimum requirement for news minutage, reflecting removal of some daytime bulletins;
 - reduced minimum requirements for nations and regions non-news programming, to 15 minutes in England and from 3 to 1.5 hours in Wales, Scotland and Northern Ireland;
 - reduced quotas for out-of-London production to 35%, in the context of new commitments to such production from the BBC and Channel 4 (see below);
 - reduced network current affairs minimum quota of 50 minutes per week, with the reduction largely outside peak time.
- 1.51 We propose to maintain ITV1's quotas for original UK productions, independent productions and national and international news.
- 1.52 In addition, ITV plc is also seeking to rationalise its regional news delivery in England and the Scottish Borders from 17 separate main programmes to 9. We regard its most recent proposals, developed after detailed discussion with us, as a credible means to sustain quality national and regional news services on ITV1, and propose to accept them.
- 1.53 We propose to raise Channel 4's out-of-London quota from 30% to 35% from 2010, and to introduce a new quota for Channel 4's productions from Scotland, Wales and Northern Ireland, also from 2010. These would need to be aligned to new long term funding arrangements for Channel 4.
- 1.54 We also propose to make a small adjustment to Five's current quota for original productions from 53% to 50%, with a reduction from 42% to 40% in peak time, from 2009. Alongside this, we welcome Five's commitment to enhanced delivery of children's programmes going forward.
- 1.55 In the absence of a statutory basis to set quotas for children's programming, there is limited scope to enforce provision by other PSBs. We want to ensure that the BBC continues to play a leading role, including in safeguarding programming for older children and teenagers. Alongside Five's commitment, we propose to support Channel 4's aim to play a role in serving 10-16 year olds.

Provisional conclusions and next steps

- 1.56 Based on responses to our previous consultation, and the research and analysis we have conducted for this review, our provisional conclusions are:
- the BBC should remain the cornerstone of public service content, and its core programme and services budget should be secure;
 - audiences should have a choice of providers in most areas of public service content, which the market alone will not provide. To achieve this, replacement funding of between £145-235 million per annum may be necessary by 2012, in addition to the regulatory assets held by the existing PSBs;
 - public service remits should be delivered across digital platforms in future, although linear TV remains essential;

- the provision of content for the devolved nations – in particular dedicated news – remains an essential requirement for any future model;
- institutional and competitive funding could both play important complementary roles in the future model for public service content;
- Channel 4 should have a significant public service role in the digital age, building on its current contribution. It needs an economic model and funding mechanism to support this;
- between now and 2014 ITV1 and Five should retain important roles focused on UK origination and news, and (for ITV1) the nations and regions and (for Five) children's content. After 2014, the arguments for retaining their public service benefits and obligations are more evenly balanced; and
- all the funding sources we set out in our first consultation are credible, and a mix of sources may be needed to meet audiences' needs.

1.57 This consultation will run until 4 December 2008. Following responses, we will publish a final statement in early 2009 setting out further details on the long term models we have described here. It will then be for government and Parliament to consider the issues and make final decisions on the long-term questions.

1.58 At the same time, we will confirm our final decisions on the short-term regulatory options set out in this document.

Consultation questions

Section 4: Models

- 1) Do you agree that public service provision and funding beyond the BBC is an important part of any future system?
- 2) Which of the three refined models do you think is most appropriate?
- 3) Do you agree that in any future model Channel 4 should have an extended remit to innovate and provide distinctive UK content across platforms? If so, should it receive additional funding directly, or should it have to compete for funding?
- 4) Do you think ITV1, Five and Teletext should continue to have public service obligations after 2014? Where ITV1 has an ongoing role, do you agree that the Channel 3 licensing structure should be simplified, if so what form of licensing would be most appropriate?
- 5) What role should competition for funding play in future? In which areas of content? What comments do you have on our description of how this might work in practice?

Section 5: Long-term: nations and regions

- 1) Do you agree with our findings that nations and regions news continues to have an important role and that additional funding should be provided to sustain it?
- 2) Which of the three refined models do you think is most appropriate in the devolved nations?
- 3) Do you agree with our analysis of the future potential for local content services?

Section 6: Funding

- 1) Do you agree with our assessment of each possible funding source, in terms of its scale, advantages and disadvantages?
- 2) What source or sources of funding do you think are most appropriate for the future provision of public service content beyond the BBC?
- 3) Which of the potential approaches to funding for Channel 4 do you favour?

Section 7 and annex 1: Matters for short-term regulatory decision

- 1) Do you agree that our proposals for 'tier 2' quotas affecting ITV plc, stv, UTV, Channel TV, Channel 4, Five and Teletext are appropriate, in the light of our analysis of the growing pressure on funding and audiences' priorities? If not, how should we amend them, and what evidence can you provide to support your alternative?

Section 2

Stakeholders' responses to our phase 1 consultation

Introduction

- 2.1 Ofcom's duty, as set out in the Communications Act, is to recommend ways to "maintain and strengthen" the quality of public service broadcasting. Phase 1 of this review (published 10 April 2008) revealed that viewers continue to attach importance to the purposes of public service broadcasting and that they value the BBC highly but do not want it to become the only provider in some areas. Based on what audiences told us, we set out a vision for public service broadcasting in the future. However, our analysis showed that the costs of several of the commercially funded public service broadcasters' licences will soon outweigh the benefits they receive. This means that, in the future, a new model will be needed to ensure that audiences' needs continue to be met.
- 2.2 Phase 2 of the review has three overarching objectives:
- to review and reflect on the consultation responses and the new evidence submitted to Ofcom;
 - to evaluate further the possible long-term models for public service broadcasting; and
 - to set out specific proposals on the short and medium-term regulatory framework, including quotas for the commercial PSBs.

Overview of phase 2 - moving the debate on

- 2.3 In phase 2 we have reviewed the evidence presented by respondents, gathered additional evidence and conducted further analysis to inform our and government's thinking on these questions.
- 2.4 In this section we reflect on the key issues raised in the consultation, flagging up areas of consensus as well as issues that are unresolved. We outline the new evidence we received from respondents.
- 2.5 In section 3 we consider the challenges facing the delivery of public service broadcasting and whether any intervention is required to exploit fully the potential of online provision of public service content. We also ask how critical competition for the BBC in provision of public service content is to audiences.
- 2.6 Section 4 investigates the potential future models for delivering public service broadcasting. It builds upon the four models set out in phase 1, drawing upon the stakeholder consultation responses, deliberative research¹ and additional analysis to see if, and how, the models would work in practice.

¹ See PSB review phase 2 annex 7: *The future of public service broadcasting- a deliberative research report by Opinion Leader*

- 2.7 Section 5 examines how the models would meet the needs of audiences in the nations, regions and localities, and considers other issues that were flagged up in the consultation responses, including local TV and the provision of indigenous language programming.
- 2.8 In section 6 we examine the potential scale and the advantages and disadvantages of a range of sources of funding that might support a future model of public service provision. This section draws on stakeholders' responses to the consultation and on the deliberative and quantitative consumer research that we conducted during the second phase of the review.
- 2.9 Decisions about long-term models and funding are ultimately issues for Parliament to decide. However, Ofcom must now decide, within the framework set out in the Communications Act, what level of obligations the commercially funded public service broadcasters should have. Therefore, section 7 looks at how Ofcom can ensure continued delivery of the purposes of public service broadcasting in the short term. We examine these issues in the light of audiences' priorities and the pressures on commercial funding models, and draw on new audience research that explores the general public's attitudes towards regional and national news and specific ITV1 regional news proposals, evidence presented to us by stakeholders and further analysis conducted by Ofcom. These issues are explained in greater detail in annex 1.
- 2.10 Finally, section 8 sets out our recommendations and the next steps of the review, detailing how the debate will be moved forward in the next and final phase.
- 2.11 This document is supported by a set of annexes that describe in detail the further research and analysis we have carried out in phase 2.
- 2.12 Annexes 1 – 5 follow the main report. They are:
- Annex 1: Matters for short-term regulatory decision.
 - Annex 2: Responding to this consultation.
 - Annex 3: Ofcom's consultation principles.
 - Annex 4: Consultation response cover sheet.
 - Annex 5: Glossary.
- 2.13 Alongside this document, we have published a further series of annexes online:
- Annex 6: Assessing the value of public service programming on ITV1, Channel 4 and Five. A quantitative research report by Holden Pearmain.
 - Annex 7: The future of public service broadcasting. A deliberative research report by Opinion Leader.
 - Annex 8: PSB Review phase 2 audience research slidepack.
 - Annex 9: Public service content and the internet. A quantitative research slidepack.

- Annex 10: Investigation of funding models for content in the online childrens and local and regional markets. Analysis by MTM London.
- Annex 11: Incentives in PSB delivery and implications for PSB models. A summary report by Oliver & Ohlbaum.
- Annex 12: Models for the nations and regions PSB television: a focus on Scotland. Analysis by Oliver & Ohlbaum.
- Annex 13: Growth of the internet and implications for UK TV content. Analysis by Oliver & Ohlbaum.
- Annex 14: Approaches to public service investment and competition in the cultural sector. Analysis by Tom Fleming Creative Consultancy.
- Annex 15: Impact assessment.
- Annex 16: Regional news. A quantitative report by Holden Pearmain.
- Annex 17: Regional news. A deliberative research report by Essential.

Key findings from phase 1

- 2.14 In phase 1 of our consultation on public service broadcasting we identified that access to public service content has expanded dramatically in the past few years, largely as a result of the internet and digital television. Consumers and citizens today have a huge digital opportunity: greater access than any previous generation to information from around the world and about the topics that interest them. Our research showed that audiences attach high value to programming that reflects the UK, and the public service broadcasters play a dominant role in delivering this. They account for over 90% of investment in new networked UK-originated television content.
- 2.15 Our phase 1 audience research showed that audiences across the demographic spectrum continue to believe that the purposes and characteristics of public service broadcasting (see Figure 1) are vitally important. Television – and the public service channels in particular – are seen to have an essential role to play in delivering the purposes of public service broadcasting. Our analysis in phase 1 suggests that content made in the UK is essential to the full delivery of public service purposes.

Figure 1: The purposes and characteristics of public service broadcasting

Public service broadcasting: purposes

Informing our understanding of the world - To inform ourselves and others and to increase our understanding of the world through news, information and analysis of current events and ideas

Stimulating knowledge and learning - To stimulate our interest in and knowledge of arts, science, history and other topics, through content that is accessible and can encourage informal learning

Reflecting UK cultural identity - To reflect and strengthen our cultural identity through original programming at UK, national and regional level, on occasion bringing audiences together for shared experiences

Representing diversity and alternative viewpoints - To make us aware of different cultures and alternative viewpoints, through programmes that reflect the lives of other people and other communities, both within the UK and elsewhere

Public service broadcasting: characteristics

High quality - well-funded and well-produced

Original - new UK content rather than repeats or acquisitions

Innovative - breaking new ideas or re-inventing exciting approaches, rather than copying old ones

Challenging - making viewers think

Engaging - remaining accessible and attractive to viewers

Widely available - if content is publicly funded, a large majority of citizens need to be given the chance to watch it

- 2.16 These purposes and characteristics encapsulate the reasons audiences believe public service content continues to be important. Our objective in assessing the current provision of and future prospects for public service content is to ensure that these purposes will continue to be met.
- 2.17 A wide range of different kinds of content contribute to these purposes, and different kinds of content have very different economic characteristics. For this reason, we tend to focus on genres in analysing the delivery of public service content, and in assessing whether the public service broadcasters are fulfilling the purposes. In doing so, we recognise that different genres are relevant to different purposes, and that some genres can relate to a number of different purposes.
- 2.18 Our research and analysis in phase 1 showed that the public service broadcasters are meeting the public purposes on the whole, although gaps in delivery are appearing in some areas, including programmes for the UK's nations and regions and UK children's content.
- 2.19 We conducted economic modelling to understand how the market may develop in the future; this modelling identified a range of possible scenarios. We concluded that the BBC is likely to continue to make a strong contribution to the purposes of PSB. But, there is less certainty about the future contribution of the commercial public service broadcasters, with potential impact on a wider range of areas of content including current affairs, specialist factual programmes, challenging UK drama and scripted comedy. We identified that all the commercial PSBs will need certainty about their long-term roles by 2011 at the very latest, when for some, the costs of their PSB

commitments may outweigh the benefits. For some of the commercial broadcasters this may be required even earlier.

- 2.20 The audience research that we conducted in phase 1 showed that viewers value alternatives to the BBC in provision of public service content. This plurality of provision delivers a number of perceived benefits and, although the market will provide competition for provision of PSB in some areas, our analysis suggests that this contribution is unlikely to increase significantly. In particular, we said that the market is unlikely to fill gaps in those PSB genres that are unsustainable on commercially funded public service channels.

The vision for public service content is driven by what audiences tell us they want

- 2.21 In phase 1 we set out a vision for public service content in a digital age, based on audiences' priorities. This vision is for a system which:
- delivers high levels of new UK content meeting the purposes of public service broadcasting;
 - provides public service content which is innovative, original, challenging, engaging and of consistently high quality;
 - is available in a form, and on a range of platforms, to achieve maximum reach and impact;
 - ensures competition for the BBC in each public purpose, with sufficient scale to achieve reach and impact;
 - exploits the distinctive benefits of different delivery platforms; and
 - supplies diverse content which meets the needs of all communities within the UK.
- 2.22 The analysis we conducted for phase 1 suggested that the current model would struggle to deliver this vision. Taking into account the economic modelling and the audiences' priorities, and in the light of our statutory duty to recommend ways to maintain and strengthen the quality of public service broadcasting, we said that new funds should be found to supplement the declining implicit subsidy for commercial public service broadcasting and to maintain plurality. Consequently we identified a range of potential funding sources, ranging from direct public funding and the licence fee, to regulatory assets and industry funding.

The existing model is not flexible enough to meet audiences' needs

- 2.23 In phase 1 we argued that the existing model for public service broadcasting faces three major challenges. It is not flexible enough to respond to changing audience requirements, its funding model is unsustainable and the commercial broadcasters lack incentives to maximise the reach and impact of their public service content.
- 2.24 As a result we reasoned that the existing model is not well placed to take advantage of the opportunities offered by new technologies or to tackle the challenges facing public service broadcasting in the digital age. We developed four stylised models for future PSB delivery:
- model 1: **Evolution** of the existing model;

- model 2: **BBC-only**;
- model 3: **BBC and Channel 4 plus limited competitive funding**; and
- model 4: **Broad competitive funding**.

2.25 Delivering a new model will require new legislation and is a decision for government and Parliament. But we did recommend that any new legislation should be in place by 2011, which represents the point at which our analysis suggested that some current licences may fall into deficit and Channel 4 will face increasing financial pressure that is likely to affect its ability to deliver its public service remit.

2.26 Finally, we identified that any new approach will need to meet the needs of the UK's nations, regions and localities. ITV's proposals to restructure its provision of regional news in England and the Scottish Borders form part of this consideration. Additionally, we suggested that the BBC, Channel 4, Five and S4C could play a role in enhancing public service provision for children.

Phase 1 consultation responses

2.27 In total, we received around 270 formal responses to the consultation, approximately 13,000 individually signed postcards supporting the campaign for Border TV's *Lookaround* news programme, and around 2,000 postcards and 700 emails. We also welcome the responses and the numerous online debates and comments made by individuals via the interactive executive summary of the consultation, and on our blog. We are grateful to all those who took the time and effort to convey their views to us and also to those respondents – including public service broadcasters, the Satellite and Cable Broadcasters Group (SCBG) and Discovery – who provided us with evidence from research they had conducted.

2.28 Those responses, campaigns and comments have given us a large amount of information, evidence and alternative options to consider. Non-confidential versions of all the responses can be viewed at:
www.ofcom.org.uk/consult/condocs/psb2_1/responses/

2.29 We posed 20 consultation questions in phase 1 of the review. We have grouped these into four areas:

- Audience priorities - including the purposes of public service broadcasting and their delivery, competition for the BBC, the role of UK-originated content and the prospects for children's programming.
- Delivery on new platforms – the contribution of digital channels and interactive media towards the public purposes.
- Long-term options for the delivery of public service content, including long-term models for delivery of public service content, funding sources for public service content in the future, and the provision of content in the nations, regions and localities.
- Short-term regulatory decisions and options for Channel 4, ITV1, Five and Teletext.

2.30 The consultation revealed that there are some areas of clear consensus. Respondents agreed that audiences continued to value public service content and

broadly accepted the vision we had set out. Most concurred that UK-originated content was important to the delivery of public purposes. Nearly all respondents agreed that television plays an essential role in delivering the purposes of public service broadcasting but that digital media – especially the internet - also played an increasingly important role.

- 2.31 But in other areas views were more mixed, and respondents submitted new and valuable evidence. Respondents differed as to whether there is a need for new intervention to deliver this vision. Some argued that further intervention was not required. Conversely, others felt that the pressures on commercial public service broadcasting were already urgent and immediate action was required.
- 2.32 Some respondents, including the BBC, maintained that although plural provision of public service content was attractive it was not as critical as we had argued in phase 1. They argued that the costs of plurality could outweigh the benefits, and that while audiences value competition they were not willing to pay for it. Some respondents suggested that there was a trade-off between plurality and the impact of public service content, and that impact would be maximised by concentrating resources in a single provider.
- 2.33 In response to our assessment of the criteria to judge the models of public service broadcasting, respondents broadly supported the effectiveness tests we had set out. Five suggested four additional tests: cost-effectiveness, efficiency of delivery, trustworthiness and lack of disruption. The BBC suggested adding two additional tests: value for money and audience acceptability.
- 2.34 There was a range of opinion regarding the four illustrative models:
- **model 2: BBC-only** was supported by only two respondents (both private individuals);
 - many stakeholders, including most large broadcasters, favoured **model 1: evolution**;
 - some stakeholders, including Channel 4 supported **model 3: BBC/Channel 4 plus limited competitive funding**; and
 - **model 4: competitive funding** was favoured by several respondents including SCBG, Discovery and the Broadcasting Policy Group, but many said they would like more details about how it would work in practice.
- 2.35 Some stakeholders argued that phase 1 of the review failed to address some of the pressing issues in the provision of public service content, in particular, audience demand for local content on digital terrestrial television and the importance of universally available content.
- 2.36 The rest of this section sets out the consultation responses in each of these areas, in more depth.

Audience priorities

- 2.37 Our research for phase 1 showed that there was broad consensus among people as to the importance of the purposes and characteristics of public service broadcasting, irrespective of age, ethnicity and socio-economic group. But there were some differences in the level of importance placed on different types of programming.

Younger people, aged 16-24, were less likely than older people to rate some elements of public service programming as important, for example: "showing interesting programmes about history, science and arts". The majority of people from ethnic minority groups thought that each of the purposes and characteristics statements was important. They were more likely to think that "programmes showing different kinds of cultures and opinions from within the UK" was important, as well as those "reflecting the interest and concerns of people like me".

- 2.38 The PSB purposes and the vision set out in phase 1 were overwhelmingly endorsed by the majority of respondents. The BBC supported the vision, and suggested that trust should be added as a key objective. While we agree with the BBC that trust should be a key aim of the public service broadcasters, we believe that this is an issue that is relevant to all broadcasters not just PSBs. As such, it is more appropriate that issues of trust are dealt with in the context of Ofcom's Broadcasting Code.
- 2.39 Overall, nearly all respondents agreed that television continues to have an essential role in delivering the purposes of public service broadcasting. The general consensus was that the public service broadcasters largely deliver the public purposes but other providers, including digital channels, radio, interactive media and the internet, also play a significant role. Some respondents suggested that the definition of public service content should be extended to include content such as online public service content, films produced in and representing the UK, and commercial local television programming.
- 2.40 Although there was broad endorsement of the vision of public service broadcasting, there was some disagreement on whether new intervention would be required to achieve it.
- 2.41 The majority of respondents agreed that the future of public service broadcasting, if left to the market alone, is problematic, but some respondents, including BSkyB, and the Satellite and Cable Broadcasters Group (SCBG), were more optimistic and argued that further intervention was not required. These stakeholders suggested that the challenges to the existing model were not as great as we had suggested in phase 1, and they provided evidence that the market would meet most audience needs in future, particularly on digital platforms. In its response BSkyB argued:
- "On the Sky platform alone, there are 14 dedicated news channels, over 50 channels catering to foreign language or ethnic audiences, 15 channels dedicated to religion and faith, and 29 channels for children. Devotees of wildlife documentaries, gardening, history programmes, the arts and many other interest areas are similarly well-catered for."
- 2.42 On the other hand, some of the responses we received maintained that the pressures on the commercial public service broadcasters were more urgent than we had identified, and that the costs to the commercially funded public service broadcasters of providing public service content could soon outweigh the benefits. ITV plc and Channel 4 argued that the existing model could be sustained but only with significantly reduced obligations (for ITV1) or with new funding (for Channel 4).
- 2.43 In the next section we examine in further detail the scale of the problem facing public service broadcasting, reflecting on the evidence submitted in consultation and on the new research and analysis that we conducted during this phase of the review.

The role of UK-originated content

- 2.44 Almost all respondents agreed that UK-originated content is fundamental to the delivery of public service broadcasting purposes. Only three respondents disagreed.
- 2.45 Stakeholders argued that UK-originated programming should reflect the diverse nature of the population, and its various age groups and differing cultural sensitivities at a national and regional level. A few respondents suggested that these types of programmes should be produced by people who live and work within the region portrayed in any particular programme.
- 2.46 Other respondents pointed out that the independent production sector has a role to play in securing diverse and high quality UK originations.
- 2.47 Stakeholders also suggested that UK originations increase international awareness of British cultures and places, and provide the basis for collaboration with international broadcasters. It was therefore argued that a diminution of UK-produced public service content would jeopardise the UK's position as a global leader in the creative economy.

Competition for the BBC in provision of public service content

- 2.48 The declining contribution to PSB by the commercial public service broadcasters and the limited contribution of the market, raise the question of whether any further intervention, beyond the BBC, will be required in future.
- 2.49 Our phase 1 research demonstrated that audiences continue to value having access to alternatives to the BBC in provision of public service content – that is, plurality. Our evidence suggests that it delivers benefits to audiences in three respects: it guarantees access to a range of voices and perspectives; it enhances the reach and impact of public service content; and it acts as a competitive spur, helping to ensure that public service content remains relevant and focused on meeting audience needs. In this sense, plurality is key to the continued success of the BBC as well as the commercially funded public service broadcasters.
- 2.50 The vast majority of respondents to our phase 1 consultation agreed that plurality would continue to be important, both to encourage competition and to ensure choice and diversity.
- 2.51 However, several respondents to our consultation questioned whether competition to the BBC was as important as we had suggested. There were five main varieties of argument.
- First, some respondents argued that the benefits of competition are not as great as we, or the audiences we surveyed, had suggested. The BBC suggested Radio 3, Radio 4 and its natural history programming were examples of services which have no direct competitors but which nevertheless maintain high standards and are highly valued by audiences. The BBC also argued that plurality does not necessarily result in diversity, pointing to our own analysis² which suggests that the different news providers, who operate within impartiality requirements, have tended to develop a fairly similar tone of voice and editorial agenda.

² *New News, Future News*. <http://www.ofcom.org.uk/research/tv/reports/newnews/>

- Secondly, some respondents – the BBC, BSkyB, the Satellite and Cable Broadcasters' Group – argued that plurality is important, but that due to the explosion of choice on digital TV and online, it would increasingly be provided by the market. They argued that we had underestimated the contribution of the market to UK public service content, by, for example, excluding spending on sports rights from our analysis of commercial investment. These respondents argued that the case for intervention beyond the BBC could be restricted to specific areas in which the market will not deliver e.g. nations and regions news.
- Thirdly, the BBC argued that competition in broadcasting is now global rather than national. The need to compete in an increasingly international marketplace requires it to maintain a strong focus on audience needs, regardless of the nature of competition within the UK.
- Fourthly, the BBC disputed that audiences were willing to pay the costs associated with further intervention, and published research which suggested that public support for plurality declines sharply when confronted with the cost of intervening to achieve it.
- Finally, some respondents argued that the plural provision of PSB was not an efficient use of public funds, and would tend to reduce the impact of public service content by distributing limited resources for public service content to a wider set of organisations. This was contrary to our assessment in phase 1, which suggested that plurality tended to increase the reach and impact of content as different providers target different audiences in different ways.

2.52 The issue of how important plurality is in delivering the vision of public service content is crucial. In the next section we draw on these consultation responses and on new audience research to investigate just how important plurality really is in meeting audience needs.

Prospects for children's programming

- 2.53 Most respondents noted that plurality in children's programming is important and agreed that action is needed urgently in this area.
- 2.54 The BBC thought that Ofcom had overstated concerns about the amount, range and quality of existing children's provision and had underplayed the important role which digital media and Five could play in the provision of children's programming. Nevertheless, subject to approvals from the Trust, the BBC noted its commitment to extending and improving its own services and supported the commitment that Channel 4 has made to provide content for older children.
- 2.55 Channel 4 agreed with Ofcom's assessment but thought that only two of the options – extending Channel 4's provision and exploring a greater role for S4C - would achieve the object of ensuring plurality. It believed that in the future, new platforms would be vital to the provision of content for children. Five stressed its contribution to younger children's programming and indicated that it would favour tax breaks for producers of original children's programming. Five also welcomed Channel 4's commitment to providing programmes for 10-15 year olds but then noted that "unlike Five's commitment, [Channel 4's commitment] is dependent in the medium to long term on external funding". The introduction of tax breaks to boost UK-originated production in children's programming was also favoured by various industry bodies.

- 2.56 However, some stakeholders such as the National Union of Journalists (NUJ) were not convinced that tax exemptions are the best way of producing an increase in children's programming. Finally, a few respondents believed that S4C's investment in children's programming meant that the broadcaster had the potential to become a major provider for the UK.
- 2.57 The future provision of children's programming is discussed in greater detail in section 7.

Delivery on new platforms

- 2.58 Respondents were divided in relation to the contribution that digital channels and interactive media make to the purposes of public service broadcasting. Some stakeholders argued that we had underestimated the contribution of a wide range of content providers, from the public, private and voluntary sectors which are already producing a range of content that meets aspects of the purposes and characteristics of PSB. Others felt that digital channels and online services are not a substitute for the main PSB channels as, despite changes to people's viewing habits, mainstream public service broadcasting will remain the primary route for delivering the purposes of PSB to the audience: television maintains its unique ability to reach and engage with mass audiences.
- 2.59 The SCBG argued that Ofcom had downplayed the role played by multichannels in meeting the needs of those consumer groups that public service broadcasters find it difficult to reach and BSkyB submitted evidence of market-produced material that meets public purposes.
- 2.60 Several respondents pointed out the contribution to public service content made by online providers while others claimed that such content does not fulfil the public service purposes as defined in the Communications Act because these content providers are not universally available at no additional cost.
- 2.61 In the consultation some stakeholders emphasised the potential for new media to reach subject-specific audiences and to meet some public service needs. There was some concern that this content was not available to all and that it should be both available and discoverable and also capable of attracting and engaging audiences. BSkyB argued that increasing the scope of intervention in this area would risk crowding out market provision of PSB-type content and new media. Instead, we should seek to strengthen the incentives for private investment in public service content.
- 2.62 In the next section we examine these issues considering what, if any, intervention is required to fully exploit the online provision of public service content.

Long-term models for the delivery of public service content

- 2.63 In phase 1 we set out four illustrative models for the long-term delivery of public service content and we listed several 'effectiveness tests' against which we thought any long-term model should be assessed.
- 2.64 Most respondents broadly agreed with the proposed tests and some respondents suggested additional tests. Both the BBC and Five recommended adding tests associated with delivering 'value for money' and the BBC also suggested adding 'audience acceptability'.

- 2.65 In its response the BBC pointed out that these models essentially represented a choice between the institutional and competitive models of funding and delivering public service content. It argued that institutional methods of intervention are more effective. Despite their differences, a significant number of responses to our consultation shared a common assumption that something close to the existing model will remain the most effective way of delivering public service broadcasting. There were differing views as to how much intervention and funding was required beyond the BBC.
- 2.66 **Model 2: BBC-only** was the least popular of the models in the consultation, supported by only two respondents. The vast majority of stakeholders felt that intervention would continue to be needed to secure plurality, competition and diversity of voice and content in at least in some areas such as nations and regions news, UK children's programmes, current affairs and specialist factual programming.
- 2.67 Many respondents, including most of the public service broadcasters, favoured, **model 1: evolution** or a variation of this model. They cited its ability to offer plurality of public service broadcasting institutions. However, most proponents of this model assumed that new funding would be found to secure the long-term sustainability of the commercial public service broadcasters and, specifically, that ITV1 would continue to provide regional news and non-news programming.
- 2.68 Opponents of this model argued that it was unlikely to be financially sustainable without additional funds, and that it fails to respond flexibly to the challenges and opportunities of the digital world.
- 2.69 **Model 3: BBC/Channel 4 plus limited competitive funding** was supported by a wide range of respondents, including the Arts Council England and Channel 4, which also saw a role for ITV1 and Five. Supporters of the model did acknowledge that, without ITV1, this model would struggle to provide national and regional programming with the level of reach and impact that it has today.
- 2.70 Channel 4 argued that it should remain a publicly owned statutory corporation noting that its core values remain relevant today. Channel 4, which submitted its vision document, *Next on 4*, highlighted a number of priorities, including developing into a public service cross-media network, providing more new UK programmes in peak time and expanding into new areas, e.g. content for older children. We received relatively little direct response to this vision in our consultation, nor to our analysis of the future funding pressures faced by Channel 4.
- 2.71 **Model 4: broad competitive funding:** a range of respondents including SCBG, Discovery and the Broadcasting Policy Group supported the introduction of an element of competitive funding. They argued that it would encourage a mix of quality public service content from a wider range of providers. However, some were cautious, expressing a desire to see more information about how the model would work in practice. Several respondents expressed concern about the potential bureaucracy and lack of certainty for providers.

Meeting audiences' needs in the nations and regions

- 2.72 Our phase 1 research showed that viewers in Scotland, Wales and Northern Ireland value programmes made in and for their nations. They value plurality beyond the BBC, and place a high priority on plural provision of both news and other content – although they value non-news less highly than news.

- 2.73 But our evidence pointed to an ever-widening gap between these audience needs, and what the current system can deliver. Without replacement funding, the Channel 3 licensees in the nations will need to seek ever more relief from their obligations as declining revenues push them towards deficit.
- 2.74 A few felt that Ofcom had over-stated the importance of maintaining TV plurality of nations and regions output, arguing that the internet and other media, together with the BBC's plans for new local services online, would be sufficient. But most agreed that this area remains a priority, with some arguing that provision for the devolved nations in particular should be enhanced beyond current levels.
- 2.75 A common theme in many responses from around the UK was one of high ambition and aspiration for provision for the nations in future, and an agreement that different solutions may be needed for different parts of the UK.
- 2.76 A number of stakeholders in the local TV sector felt that phase 1 of this review did not take audiences' demand for local content on digital terrestrial television into account. United for Local Television said public service status and free spectrum should be conferred on local services to ensure their universal availability on digital terrestrial television (DTT) and other platforms. The group supports the idea of a nationwide network on DTT ('Channel 6') into which local operators would insert their particular channel offerings (dubbed 'add-drop').

Funding sources for public service content in the future

- 2.77 Public service broadcasters and other stakeholders recognised the importance of additional funding sources to support the delivery of public service content in the future. But, BSkyB, SCBG and a few other respondents however believed that no additional funding should be provided and that any funding shortfalls should be addressed by re-prioritisation of resources by the existing public service broadcasters.
- 2.78 There was a mixed reaction to the discussion of specific funding sources in phase 1. A few respondents supported direct funding, while many felt that maximising the value of existing regulatory assets was the most appropriate solution in return for public service content obligations.
- 2.79 There was some support for the introduction of industry levies. Some respondents warned that levies could have a negative effect on market development but others including BECTU, the Institution of Practitioners in Advertising (IPA), the TUC and the Musicians Union thought that there might be a case for commercial broadcasters licensed in the UK to contribute a small percentage of their sales to subsidising public service content.
- 2.80 The bulk of the public discussion since the publication of phase 1 of this review has been on the potential use of the licence fee.
- 2.81 The use of the licence fee, currently used primarily for BBC services, to fund non-BBC services was opposed by a number of stakeholders including the BBC and Five. Debate was also sparked by the posited use of the switchover surplus in the current licence fee settlement. This refers to the proportion of the licence fee ring-fenced for Digital UK and the switchover help scheme for the elderly and vulnerable, which if retained in the next settlement from 2012/13 could be used for other purposes. The BBC does not recognise this amount as an excess and argues that whilst it is ring-fenced, it is fully allocated to the BBC's sixth purpose of building digital Britain.

- 2.82 However, a number of respondents, including the Welsh Assembly Broadcasting Committee, the IPA, Institute for Local TV, PACT and several individuals, thought the idea of redistributing this switchover surplus to fund other providers of PSB was worthy of further consideration.
- 2.83 The BBC suggested a number of partnerships that might strengthen public service broadcasting including sharing its own expertise in digital production with producers and other broadcasters, working with creative and cultural partners to enhance the ease of finding public service content online, and exploring ways of making the BBC's regional and local news available to other outlets. The BBC will provide the BBC Trust with more details in the autumn.
- 2.84 Section 6 of this document evaluates and assesses the potential funding sources in more detail.

Short-term regulatory decisions

- 2.85 In the short-term, the majority of respondents would like to see ITV1 and Five maintain their public service broadcasting obligations and a few suggested that ITV1 and Five's licences, EPG prominence and brands are more valuable than Ofcom's estimates suggest, though they did not provide supporting analysis.
- 2.86 Five argued that it requires only modest regulatory adjustments in the levels and definition of original productions and its terms of trade and exemption from spectrum charges from 2014, in order to maintain its public service commitments. Five also offered to strengthen its commitment to children's programming.
- 2.87 ITV plc's response to the PSB review was confidential. However ITV plc has consistently argued that it will require relief from its regulatory obligations in the near term. Michael Grade, ITV plc's executive chairman, has stated that "significant regulatory relaxation is overdue in commercial public service broadcasting", and the broadcaster has argued that its current obligations are outdated and have serious cost implication. In 2007 ITV plc put forward proposals to restructure its regional news service.
- 2.88 Most respondents questioned the need for continued public service obligations on Teletext given the strengths of online platforms in delivering information and search results. But Ofcom's Advisory Committee on Older and Disabled People (ACOD) pointed out the value of TV text-based information, particularly news and regional information, to deaf and hard-of-hearing people, and the value of the obligation to make the public teletext service accessible to visually impaired people. ACOD considered that, without intervention via a licence, it would not be possible to regulate for a widely accessible TV-based text service as an alternative to the BBC.

Conclusion

- 2.89 The responses to the phase 1 consultation represent a range of differing, and sometimes conflicting views. They raise a series of fundamental questions that require further investigation and are dealt with in this consultation document:
- To what extent will the market provide public service content?
 - How significant are the challenges facing provision of public service content by the commercially-funded public service broadcasters?

- How important is plural provision of different types of public service content for different audiences?
- Is any further intervention required to exploit emerging opportunities to achieve public purposes on different platforms?
- How important will the existing public service broadcasters be in meeting audiences' needs for public service content, and to what extent should there be opportunities for new providers to be funded to help meet public purposes in future?
- What are the needs of audiences in the nations, regions and localities and how can these be met?
- What sources of funding are available?
- How do we ensure that the purposes of public service broadcasting are met in the short term, in the light of audiences' priorities and the pressures on commercial funding models?

2.90 The first four of these questions are addressed in section 3. The remainder are covered in subsequent sections.

Section 3

New evidence from audiences and economic analysis

Introduction

- 3.1 This section looks at the four issues on which responses to our consultation varied most:
- To what extent will the market provide public service content?
 - How significant are the challenges facing provision of public service content by the commercially-funded public service broadcasters?
 - How important is plural provision of different types of public service content for different audiences?
 - Is any further intervention required to exploit emerging opportunities to achieve public purposes in digital media?
- 3.2 To investigate these questions this section draws on new evidence provided by stakeholders during the consultation and further analysis which we have conducted on these issues.
- 3.3 Firstly, this section examines the scale of the challenge facing the commercial provision of public service content. There are three key factors that drive this: the prospects for the provision of public service content by the market, the level of financial pressure facing the commercial PSBs and the prospects for original UK programming.
- 3.4 Secondly, we ask how important provision of public service content beyond the BBC is to delivering the vision we set out in phase 1. This analysis draws on stakeholder responses, new evidence and analysis, and further audience research, including:
- a quantitative assessment of the value that audiences place on public service programming on ITV1, C4 and Five and their attitudes towards different funding mechanisms;³
 - deliberative research into future models and funding mechanisms for PSB;⁴ and
 - a face-to-face omnibus survey exploring attitudes towards the licence fee and the BBC.⁵
- 3.5 Finally, we ask whether further intervention is required to exploit emerging opportunities to achieve public purposes in digital media. We draw on a range of

³ See PSB review phase 2 annex 6: *Assessing the value of public service programming on ITV1, Channel 4 and Five*. A quantitative research report by Holden Pearmain

⁴ See PSB review phase 2 annex 7: *The future of public service broadcasting*. A deliberative research report by Opinion Leader

⁵ See PSB Review phase 2 annex 8: *Audience research slidepack*

new analysis and evidence including audience research on their use of public service content online and the ease with which people can find that content.⁶

How significant are the challenges facing commercial provision of public service content?

- 3.6 To investigate this question, we examined further three issues that phase 1 argued were central to the future delivery of public service content:
- the prospects for provision by the market;
 - the commercial pressures facing the public service broadcasters; and
 - the prospects for the future delivery of UK originated programming.
- 3.7 The evidence we published in phase 1 suggested that the market would not deliver the vision without continued intervention, and that the existing model for public service content beyond the BBC was coming under increasing pressure and would not survive the transition to a digital-only world.
- 3.8 Despite the broad support for the vision set out in phase 1, many respondents to our consultation disagreed with our view that new intervention would be required to achieve it. As outlined in the previous section, some assessments were more optimistic, arguing that the market would deliver more of this vision than we expected and that the pressures on commercial public service broadcasting were not as great as we identified. Other responses were more pessimistic, maintaining that the pressures on commercial public service broadcasting were more urgent than we had identified, and that the costs to the commercially-funded public service broadcasters of providing public service content would soon outweigh the benefits.
- 3.9 We have carefully reviewed the evidence presented by stakeholders. These two positions are clearly not compatible with each other. Our assessment suggests that neither is fully supported by the available data.

Provision by the market

- 3.10 In our first consultation we stated that the market increasingly delivers in some areas, and that broadcasters such as BSkyB and Discovery already play an important role in meeting the needs of some viewers. Furthermore, online providers deliver large volumes of content that meet some of the purposes of public service broadcasting. However, the terrestrial broadcasters still have a unique ability to reach mass audiences. Take up of digital television has increased significantly in last few years and 87%⁷ of main sets are now connected to multichannel television. But public service content on satellite or cable platforms does not currently reach the same breadth of audiences as does programming on the terrestrial channels.
- 3.11 Our analysis shows that multichannel broadcasters make a significant contribution in certain areas – sport, entertainment, film, acquired and archive programming. We agree that these contribute to public service purposes and that there is little evidence of a need for substantial public investment to maintain provision. The Satellite and Cable Broadcasters Group commissioned an independent study by Deloitte which

⁶ See PSB review phase 2 annex 9: *Public service content and the internet*: quantitative research slidepack, Gfk NOP face-to-face omnibus, June 2008

⁷ Ofcom Communications Market Report Q 1 2008. <http://www.ofcom.org.uk/research/cm/cmr08/>

found that cable and satellite broadcasters provide content across a range of public service genres, including news, factual programming, arts and music, drama and comedy.

- 3.12 However, in some types of content – current affairs, nations and regions programming, UK drama and UK scripted comedy – there is very little original provision by multichannel broadcasters, because their relatively small audiences cannot support investment in such expensive, high-risk genres. We received no new evidence to suggest that the market's contribution in those areas was likely to grow.
- 3.13 In news, the picture is unclear. The market does support some news provision – evidence from the US suggests that most major networks have commercial incentives to carry news in or near peak time. But the closure of ITV's news channel reveals the challenges faced by commercial news providers in the UK.
- 3.14 Online, the picture is very different. We commissioned MTM London to investigate the nature of online business models in two of the areas most at risk on broadcast television – regional and local content, and UK children's content – on the basis that while online content and services are not directly substitutable for traditional broadcasting, our research shows they can make a valued contribution to public service purposes. MTM London's full report is included as annex 10.
- 3.15 MTM London's analysis suggests that there is a large and ongoing expansion in the range of locally-focused content online, driven by growth in the online local advertising market and reduced barriers to entry. Much of this provision comprises listings, directories, user-generated content and aggregated third party content, rather than 'original' professionally produced content. This reflects, among other things, the relative size of the classified and search advertising market relative to display advertising.
- 3.16 Those organisations which are investing online in local news services – predominantly the regional newspaper groups, but also broadcasters, commercial radio companies, and a range of local online micro-businesses – face some challenging market conditions:
 - 3.16.1 Online local news content is by definition location-specific and much of it has a limited lifespan and archive value, limiting the size of the target audiences and therefore the commercial returns that can be generated.
 - 3.16.2 The market is highly fragmented, with a broad range of providers, offerings and propositions competing for the time and attention of local audiences.
 - 3.16.3 There is significant competition for advertising revenues from a range of powerful, often international, online specialists, many of whom are investing heavily in potentially disruptive technologies.
- 3.17 Given these characteristics, MTM London found that some analysts argued that growing online revenues are unlikely to compensate for falling traditional revenues, leading potentially to lower investment in local news-gathering and journalism.
- 3.18 MTM London's analysis suggests that the local online market remains at a critical stage in its development, characterised by high levels of innovation and continuing evolution in the business models of traditional and new market entrants. The range of content provided by online communities and users will continue to grow, complementing increasingly sophisticated local information services. Taken together,

this provision represents a rich and valuable addition to the media mix. It is likely that traditional media players will continue to invest heavily in their local online offers as they migrate towards cross-platform business models, incorporating a substantial body of professionally-produced original content. However, it is too early in the market's development to say at what level (in terms of the nature and extent of their content offer) these local services will become commercially sustainable.

- 3.19 UK content for children aged 5-12 was also identified as under-supplied in phase 1. MTM London's analysis suggests that online provision is dominated by a small number of large-scale international cross-platform media companies and the BBC, and to a lesser degree by a range of online gaming specialists. In addition, children are heavy users of the same large-scale services used by older groups, such as Google, eBay and Bebo. Commercial providers in the children's market tend to operate a mix of advertising, subscription and transaction funding models, with advertising being the main source of revenue.
- 3.20 The economics of the children's market favours the international (and predominantly US-based) cross-platform media companies which are pursuing a strategy based on using content across multiple territories and channels. The UK children's market online is currently relatively small and highly competitive, which makes significant investment in content that cannot be leveraged across multiple territories difficult to fund. Consequently, the BBC is the leading provider of original, UK-focused content for pre-school and younger children.
- 3.21 This analysis suggests that whilst much of the children's content produced by commercial providers will contribute to public service purposes in certain areas, notably entertainment, it is unlikely to contribute significantly in two respects:
- 3.21.1 The largest properties are unlikely to be UK-originated or UK-focused, as providers will be driven by commercial pressures to produce content that is culturally neutral in order to maximise returns in what is, increasingly, an international marketplace.
- 3.21.2 Providers are likely to cluster around a narrow range of genres focused on entertainment and gaming, with only limited factual, informational and educational content.
- 3.22 This analysis concentrates necessarily on the relatively near term – the next three to four years. Beyond that, it becomes increasingly difficult to predict how audience behaviours, business models and technology may develop. Our scenario analysis for phase 1 suggested that a very wide range of outcomes was possible, with very significant implications for the ability of commercial providers to meet public purposes.
- 3.23 Consequently, it is possible that the market will meet a much wider range of needs in future than it does today, particularly online. Our position is not that the market is incapable of delivering public service content – it already does in a number of areas highly valued by audiences. It is that in the short term there is no evidence to suggest that the market contribution will grow sufficiently to fill the gap left as pressures on the commercial PSBs intensify.
- 3.24 In the long term, these issues may turn out to be transitory. Audiences' needs for public service content could be very different in future, as they move to take up the interactive and participatory opportunities offered by digital media. New business models may emerge that allow the market to respond more effectively to those

needs. Technologies could evolve in a way that changes our understanding of 'public service broadcasting', just as the internet has done over the last ten years or so.

- 3.25 The next public service settlement may need to last to 2016 or beyond, a period which is likely to see continued dramatic change in media use. We will therefore need a more flexible model of intervention for the future, one which allows markets to thrive where they can and focuses public resources on areas where the market will not deliver. No responses to our consultation disputed this point.

The commercial pressures facing the public service broadcasters

- 3.26 Our analysis shows that the value of the regulatory assets held by the public service broadcasters will undoubtedly decline as switchover completes. While some of the responses we received said we were too pessimistic about the continued ability of the commercial public service broadcasters to contribute to the purposes of public service broadcasting, ITV plc in its response argued that the contributions made by the smaller licensees in the nations are well below the share of revenue that they derive from the network schedule and that this represents a 'subsidy' from the larger licensees (notably ITV plc) to the nations.
- 3.27 We have reviewed our analysis from phase 1 in detail to take account of these responses. Given the current high digital TV penetration rate (87%) and the current deteriorating outlook, we believe that our view of the benefits of public service status to commercial broadcasters (specifically regarding incremental advertising revenues from remaining analogue homes) has not been too pessimistic. If anything the short-term pressures have intensified since our April report.
- 3.28 With respect to Channel 3, our analysis now shows that, based on current contributions to the network programme budget, the benefits of PSB status for ITV plc licensees will outweigh the costs for around two more years. The value of stv's licence turns negative in 2009/10, while the PSB benefits and costs for Five, UTV and GMTV stay aligned beyond switchover. However these timings would be altered if there were to be a significant change in the way in which the costs of the network schedule are shared between the ITV regional licensees. The costs of Teletext's obligations will outweigh the limited benefits available to it from around 2010.

Figure 2: Estimated date when costs of PSB licences outweigh benefits of PSB status

PSB licence holder	Estimated date when licence costs exceed benefits
ITV plc	Before 2012
ITV1 Wales	2009
stv	2009/2010
UTV	Continuing benefits beyond switchover
Channel TV	Reliant on providing compliance services to the ITV network
GMTV	Continuing benefits beyond switchover
Five	Modest continuing benefits beyond switchover
Teletext	2010

Source: Ofcom analysis

- 3.29 After 2012, the remaining regulatory assets available to the PSBs – in particular, reserved access to digital broadcasting spectrum - will have significant value that could be used to fund public service programming. So, some public service provision could be maintained beyond switchover, if those assets continued to be allocated to the broadcasters, although it would be much less than today. Furthermore ITV1, Five and Teletext would continue to provide much of the same content as they do today for purely commercial reasons.
- 3.30 However, our refined analysis continues to show that the current level of public service obligations for ITV plc and for some of the non-ITV plc licensees will become unsustainable before 2012 as many of these licences will fall into deficit (i.e. PSB costs will outweigh benefits). We will therefore need to accept a reduced contribution from ITV1 and consider alternative ways of funding the non ITV plc licensees if we wish to maintain ITV1 as a PSB provider up to and beyond switchover. Options in this respect are discussed in section 7 and annex 1.
- 3.31 We said in phase 1 that Channel 4 would face increasing financial pressure, which would be likely to impact on its ability to deliver its public service remit by 2010-11. We argued that if it were to retain its existing remit, it would need to draw on new sources of funding; and if a wider set of public service responsibilities were entrusted to Channel 4, the pressures would be greater and arrive faster.
- 3.32 In its vision document *Next on 4*, published in March 2008 and submitted to us as part of its response to our consultation, Channel 4 outlined its strategy for delivering an enhanced new public service remit. This set out its ambition to fulfil its public service role in a digital world, and proposed a set of public purposes, applicable to its activities across all platforms. Specific initiatives included a greater commitment to new talent and ideas, a guarantee to provide more new programmes in peak time than any other public service broadcaster, more public service content for younger viewers including older children, and an initiative – 4iP – for high quality content across digital platforms.
- 3.33 This vision responds to several of the emerging challenges that we identified for public service provision, including provision of UK content for older children and continued delivery of innovative, risk-taking UK content. We received relatively little comment in responses to our consultation about Channel 4's future vision, or its potential need for new funding. However a number of stakeholders argued generally that we had underestimated the value of the regulatory assets available to the commercially funded PSBs.
- 3.34 Channel 4's modelling suggests that it would need additional funding to a value of just over £150m per annum by 2012 to deliver this vision. This divides into just over £100m⁸ to sustain delivery of its existing remit, plus up to £50m per annum to deliver *Next on 4*. It excludes any potential new investment in HD services on digital terrestrial television (DTT) if it secures capacity as a result of the current reorganisation of the DTT platform.
- 3.35 Since the publication of phase 1, we have carried out our own assessment of the further funding, if any, that Channel 4 is likely to need in future to deliver its remit. This has drawn on the work carried out by LEK for our financial review of Channel 4

⁸ This figure is an estimated operating loss in 2012, calculated before interest and taxation. We note that Channel 4 may incur substantial net interest payments under a scenario where it maintained its programming budget without receiving additional funding. In such a scenario Channel 4's financial position would deteriorate rapidly and it would incur interest payments on its net debt.

in 2006-07, on independent forecasts of television advertising and on Channel 4's own modelling. Since our phase 1 publication, the short-term prospects for TV advertising have deteriorated significantly, with most independent analysts now forecasting declines in both 2008 and 2009, and we note that Channel 4 has already made cuts to its 2008 and 2009 programme budgets in order to achieve a break-even financial position⁹.

- 3.36 Our analysis suggests that there continues to be a wide range of uncertainty about Channel 4's future prospects, and the uncertainty is increased by current volatility in the advertising market. However, Channel 4's estimates for advertising market growth are towards the bottom end of analysts' expectations. We note that Channel 4 has already implemented a number of cost-saving initiatives since the LEK report, and it continues to target further cost savings in the coming years. We believe that these savings will help to reduce the funding requirement, but are unable to fully mitigate the need for additional funding.
- 3.37 Our latest forecast suggests that by 2012 Channel 4 could require additional funding of between £60-100m¹⁰ a year in order to continue to deliver its existing remit¹¹. This is before any additional costs of implementing *Next on 4* are taken into account. If the government decided that it wished Channel 4 to take on this enhanced role, this could increase the funding requirement to £110-150m per annum by 2012. There would be further incremental costs should Channel 4 be successful in its bid for a potential new high definition service on DTT.
- 3.38 Particular genres are at greater risk than others. Oliver & Ohlbaum's analysis of the profitability of different genres for phase 1 suggested that innovative or challenging UK drama, UK comedy, current affairs and documentaries would be the most likely to face challenges if additional funding were not available¹².

Investment in UK origination is likely to continue to decline

- 3.39 Phase 1 showed that audiences think UK originations are critical to delivering the purposes of public service broadcasting: this viewpoint was reinforced by the majority of respondents to our consultation.
- 3.40 Our deliberative research from phase 1 showed that participants value UK-originated content highly. It is perceived to be more relevant and in tune with the lives of people in the UK than overseas content and can play an important cohesive role in a society which is perceived to be fragmenting. The majority think that UK-originated content is fundamental to the delivery of public service broadcasting purposes. In the phase 1 quantitative study¹³ 83% of respondents felt that it was very important or quite important that programmes made in the UK and reflecting life in the UK are shown on the main TV channels.

⁹ In terms of operating profit, Channel 4 made a loss in 2007 and expects to do the same in 2008, although these losses are offset by interest income earned on its cash reserves, hence enabling it to achieve break-even profit before tax (PBT).

¹⁰ The analysis builds upon the work conducted by LEK for the Channel 4 financial review and is based on commercially confidential data.

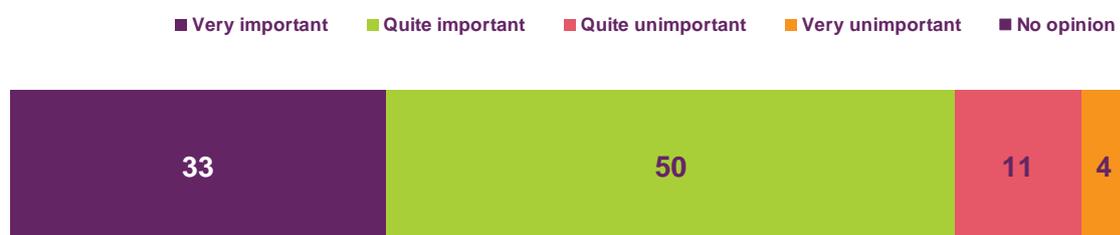
¹¹ This represents the estimated operating loss for Channel 4 in 2012. See Footnote 8 above for more explanation of operating loss.

¹² See PSB Review phase 1 annex 7: *Future scenarios for public service broadcasting and content*,

¹³ See PSB review phase 1 annex 5: *The audience's view on the future of public service broadcasting*

Figure 3: Audiences value programmes made in the UK

How important is it that 'programmes that are made in the UK and reflect life in the UK are shown on the main TV channels as a whole?'



Source PSB Review Phase 1 quantitative survey among 2260 people aged 16+ in the UK

- 3.41 Oliver & Ohlbaum's analysis for this review suggested that levels of investment in UK-originated content are likely to decline in all plausible future scenarios. We have carried out further analysis in phase 2 to understand the reasons for this decline.
- 3.42 The principal driver of reduced investment in UK content in recent years has been the fragmentation of audiences as viewing shifts from the PSBs, which invest a high proportion of revenues in original UK content, to non-PSBs. Overall, non-PSBs invest a greater proportion of their revenues in acquired or archive programming, and in particular genres including sports, film and entertainment. As a result, the business case for the PSBs to invest in more expensive and riskier genres, such as current affairs, and innovative or challenging UK drama or comedy, has been weakened. Consequently both the overall level of investment in UK content is declining, and the range of that output is narrowing.
- 3.43 Our concern in this area is not to seek to maintain high levels of investment in UK content for industrial policy reasons. UK-made content is a means, not an end; although acquired programming has a role to play, it is impossible to meet the purposes of public service broadcasting largely with programming made for other markets. Ensuring the continued delivery of UK-made content by the commercial public service broadcasters will become increasingly difficult to maintain as the costs of PSB status begin to outweigh the benefits.
- 3.44 The importance of UK origination to audiences varies from genre to genre. Additional investment is most likely to be required in areas in which profitability is relatively low, and where audiences attach high value to the availability of UK content from more than one provider. Analysis of audience priorities and prospects for future investment is outlined in the chart below, which shows that more investment is most likely to be required in specialist factual and UK children's programming. Entertainment and sport, which are provided profitably by the market, are excluded from this analysis.
- 3.45 It is worth noting that UK drama includes three different categories of programming: soaps, long running serials and innovative single or short series dramas. The third category is more likely to be at risk in the future than the others.

Figure 4: The case for future intervention in areas of public service content under pressure on commercially funded channels

	Audience views					Profitability		Assessment of future investment required	
	Importance of genre to PSB purposes	Importance to be on main PSB channels	Desire for more on main PSB chs than currently provided	Need for more than 1 PSB TV provider	Main PSB chs could be substituted by online/digital chs	Importance of UK origination	Current investment and output		Current profitability
UK News	Crucial	Crucial	Low	Crucial	Low	Crucial	High	Medium	Same
Nations/Regions News	High	High	Medium	High	Low	High	High	Low	Same
Nations/Regions Non-news	Medium – Low	Medium – Low	Low	Medium	Unknown	High	Medium	Low	Same (Nations) Less (Regional)
Current Affairs	High	High	Low	High	Low	High*	Medium	Low - medium	Same
Specialist Factual	High	High	High	High	Low	High*	High	Medium	More
UK Drama	High - Medium	High	Medium	High	Low	High*	High	Medium	Same
UK Comedy	Medium	High	Medium	High	Unknown	Medium*	Medium	Low	Same or more
UK Children's (<i>among parents</i>)	High	Mixed	High	High	Mixed	High	Medium	Low	More
Schools/Formal Education	High	Medium - Low	Unknown	Unknown	High	Unknown	Low	Low	Same
Religious programmes	Low	Low	Low	Low	High	Low	Low	Low	Less
Arts and Classical Music	Low	Low	Unknown	Low	High	Low	Low	Medium	Less
Progs including EMGs	Unknown	High	Low	Medium	Unknown	Medium	Unknown	Mixed	Mixed
Portrayal of UK/ nations/ regions/ parts of UK	Medium - High	High	Medium	High	Unknown	Crucial	Mixed	Mixed	Mixed

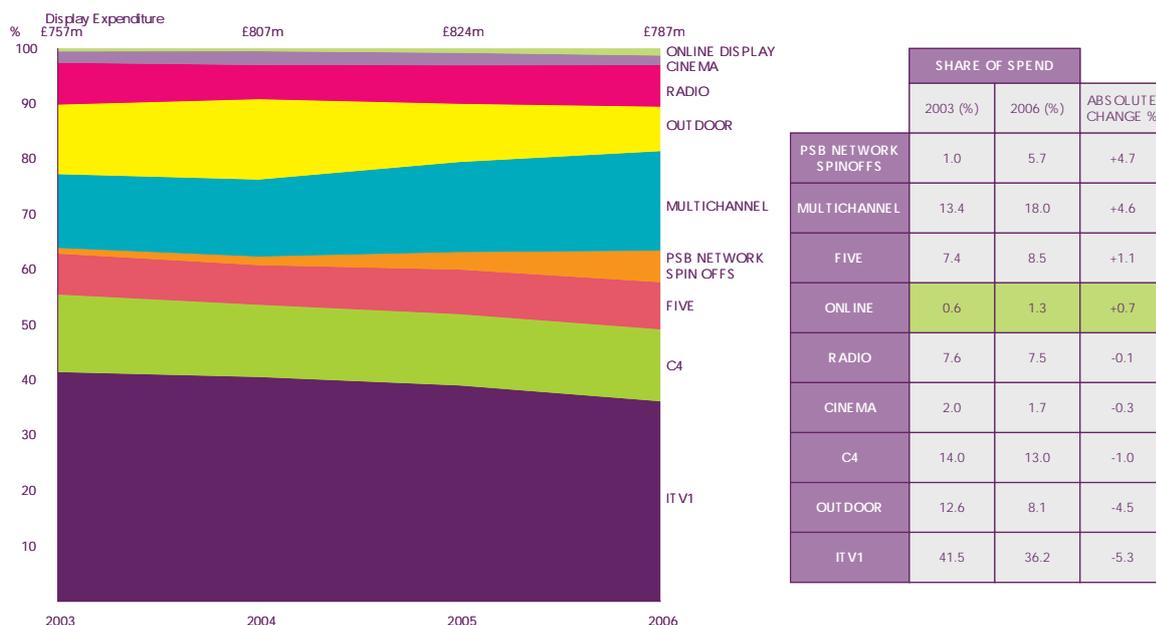
Note: Within each column 'crucial', 'high', 'medium', 'mixed' and 'low' summaries are *relative* rather than absolute measures. These are based on available data, including quantitative, qualitative and financial information.

* Audiences are also happy with a mix of UK and imported programming.

Source: PSB phase 1 audience research, PSB output and spend data, PSB phase 1 Oliver & Ohlbaum

- 3.46 If emerging business models, on digital TV or online, could undermine the business case for providing content from a UK perspective, we should consider the costs and benefits of potential regulatory and policy solutions.
- 3.47 So far the evidence suggests the greatest shift in advertising revenues has been from the commercially funded PSBs to multichannel broadcasters. There is relatively little evidence of a shift in advertising revenues from TV to other media, particularly online (see Figure 5).

Figure 5: Share of top ten TV advertisers “display advertising” spend by medium, 2003 – 2006



Note: press and direct mail spend not included
 Source: Nielsen MMS, Oliver & Ohlbaum analysis

3.48 But this picture could change rapidly. If take-up of online video increases, is more widely substituted for TV and becomes more prone to unauthorised and illegal use, this could have a threefold impact on content investment: revenues may be shared in ways that result in content originators taking a smaller share than on TV; fragmentation could undermine investment in high-cost, high-risk content; and unauthorised reuse of video content could prevent content providers from securing the full value of their investment. In these scenarios the impact on content originators may be significant; the experience of the music industry represents one possible outcome.

3.49 Arguably, UK content providers have not fully exploited the commercial potential of online video to date. This may also change. However, current forecasts suggest that response-based advertising will take a greater share of growth in advertising spend than all forms of display advertising, including TV, over the next few years. It is therefore possible that online advertising will generate relatively little additional funding for original content investment over the short and medium term.

3.50 Longer term, the market may adjust to these scenarios by finding new ways for audiences to pay for the UK content that they value most highly. But the availability of relatively cheap English language content from the US, and the continued provision of high quality UK content free-to-view by the BBC, represent potential obstacles to commercial providers' ability to build a business case for investment in UK content.

How important is competition for the BBC in provision of public service content in different areas and for different audiences?

3.51 The preceding analysis suggests that provision of public service content by the commercial PSBs is likely to continue to decline, and the market is unlikely to fill the gap in a number of areas important to audiences. The BBC is likely to become the sole provider in those areas. The extent to which this matters to audiences is one of

the key issues underlying our recommendations to government. We have therefore undertaken more research and analysis to test this issue, drawing on three main sources:

- responses and evidence submitted in response to phase 1;
- new audience research investigating the value people place on public service programming from ITV1, Channel 4 and Five; and
- analysis of the reach and impact of different broadcasters and their ability to reach different audiences.

3.52 Our audience research, including further research conducted for this phase of the review, has consistently shown that audiences do not want the BBC to be the only provider across most areas of public service content. The vast majority of respondents to our consultation agreed that it was essential to have alternatives to the BBC in provision of most kinds of public service content, but not all did, and there was dispute about the need for continued intervention to achieve it. This section therefore seeks to resolve three questions:

- Why do audiences care about maintaining competition to the BBC?
- Will the market deliver sufficient competition without further intervention?
- Are audiences willing to pay to maintain alternatives to the BBC?

Why do audiences care about maintaining competition for the BBC?

3.53 Competition for the BBC in the provision of public service content – that is, plurality – is a means, not an end in itself. Audiences tell us they value having alternatives to the BBC because they believe that plurality ensures they are exposed to different perspectives and voices, multiple providers can meet public purposes more effectively than a single institution, and competition drives up standards and encourages innovation. We have carried out further research and analysis to assess whether these benefits, in fact, exist.

3.54 First, audiences tell us they value having **access to alternative perspectives and different voices**. This particularly applies to news, at UK and nations/regions level, and current affairs. Some respondents to our consultation questioned whether provision by multiple organisations does in fact deliver this diversity. But our research¹⁴ shows that audiences are aware of, and attach great significance to, the differences between different providers, with Channel 4 particularly appreciated for its distinctive and innovative approach. Even in news, where there is some evidence to suggest that mainstream broadcasters tend to deliver similar agendas, our analysis shows there are differences, with Channel 4 News providing a significantly higher proportion of international stories than other bulletins¹⁵. For nations/regions news,

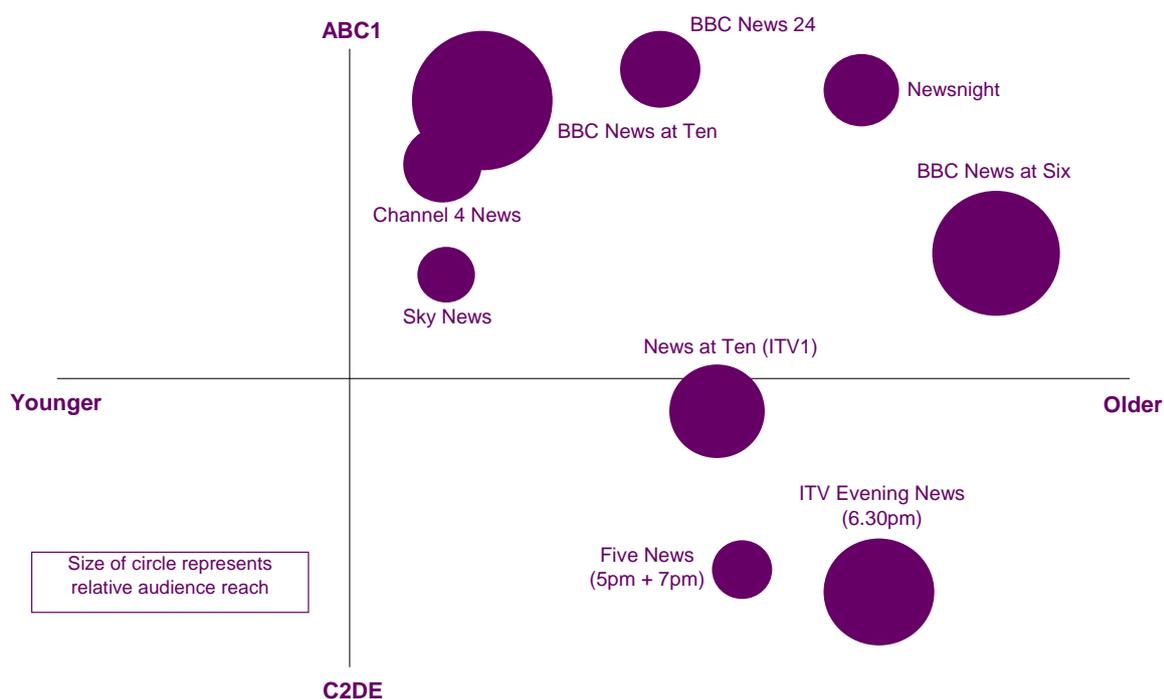
¹⁴ See PSB review phase 2 annex 7: *The future of public service broadcasting. A deliberative research report*, and phase 1 annex 5: *The audience's view on the future of public service broadcasting*.

¹⁵ See *New News, Future News* <http://www.ofcom.org.uk/research/tv/reports/newnews>

over four in five adults believe it is important to have more than one provider, rising to 90% in the devolved nations¹⁶.

- 3.55 Viewing of news illustrates the way different broadcasters reach different audiences with varying styles and formats. The BBC's 6pm bulletin reaches an older audience than any other service; the demographic for ITV1's news is more C2DE than others, as is Five's; younger audiences are more likely to watch Channel 4 News or Sky News than other services. Five's 5pm and 7pm bulletins have been aggregated to show their combined reach, but its 7pm bulletin reaches a significantly younger audience than the earlier version.

Figure 6: Demographic profile and reach of TV news services, January-June 2008

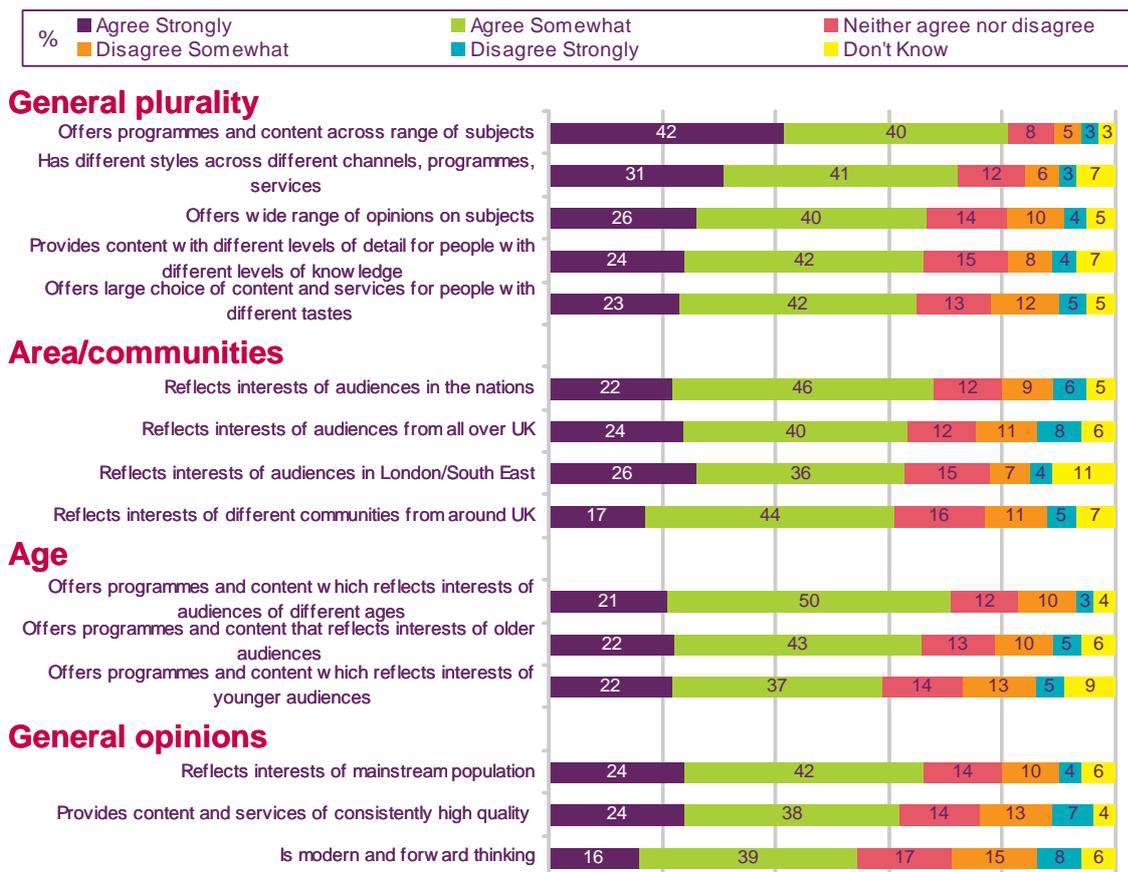


Source: BARB, Jan-Jun 2008. All homes, all individuals, 15 min reach

- 3.56 Secondly, audiences believe that **no single institution can be equally good at meeting all audiences' needs** – a range of providers offers different kinds of content to meet different audiences' needs. Our audience research found that the BBC is highly regarded for providing a range of different subjects and different styles, 82% of respondents agreed that it offers “programmes and content across a range of subjects” and 66% of people felt that it offers a wide range of opinions on subjects. It is however, less well rated for providing content meeting different tastes, reflecting different communities and offering content for younger audiences.

¹⁶ See PSB review phase 1 annex 5: *The audience's view on the future of public service broadcasting*: Quantitative research among 2,260 adults 16+ in the UK, 2007

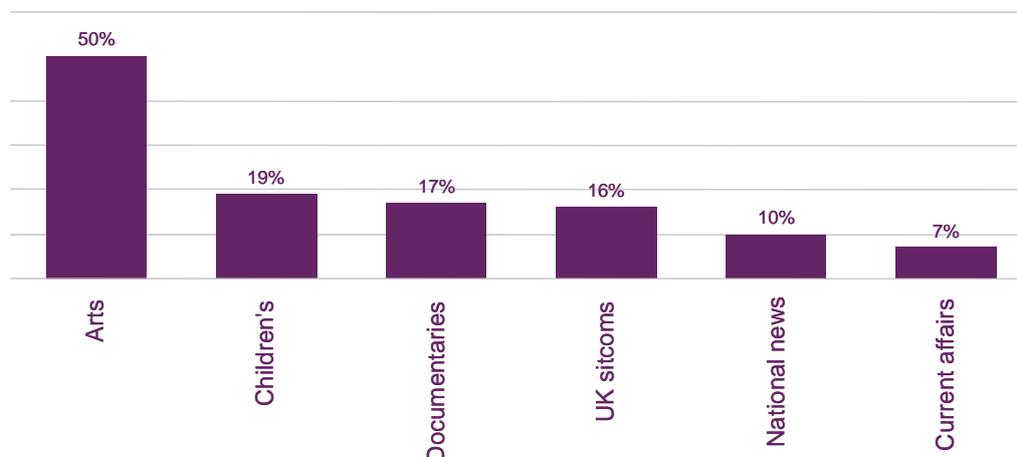
Figure 7: Attitudes towards the BBC and plurality



Source: PSB review phase 2 quantitative omnibus Q: "Can you tell me how much you agree or disagree with the following statements about the BBC?" Base: All adults 16+ (949)

- 3.57 New viewing analysis shows that the BBC does not reach all audiences equally. For example, BARB data show that in the first six months of 2008, 85% of viewers in multichannel homes watched 15 minutes of at least one BBC TV service in an average day. But only 75% of black and minority ethnic viewers did the same, and only 67% of 16-24 year old viewers.
- 3.58 By genre, the picture is similar. In many genres (including news and current affairs) most viewers do watch that type of programming on the BBC. However, in other genres, a significant minority of viewers of that genre never watch it on the BBC. Consequently, other providers may be better placed to reach that portion of the audience with public service content than the BBC. Contrary to the arguments made by some respondents, plurality does not trade off with impact – it can enhance impact by enabling different providers to reach particular audiences in the ways that are most relevant to them.

Figure 8: Proportion of viewers of each genre who do not watch BBC programmes in that genre, April 2008



Source: BARB, April - June 2008. All homes, all individuals
Children's includes non UK children's programming

- 3.59 Finally, audiences believe that **competition between providers drives up quality** and encourages new approaches. The BBC disputed whether plurality was necessary to achieve this end, arguing that several of its services do not have any competition yet retain high standards.
- 3.60 Our research does show some areas in which plurality is deemed less important, particularly religious programmes and programmes for schools. But we have no evidence to suggest that audiences believe this applies to the areas mentioned by the BBC – natural history, classical music radio and speech radio. Indeed in some of those areas the BBC does have competition – Radio 3 faces competition from Classic FM and other specialist music radio stations; the BBC's natural history output faces competition from Discovery and National Geographic, as well as (to a lesser extent) from the commercial public service broadcasters. And the BBC's strength in natural history stems originally in part from an historic rivalry with the Anglia nature strand *Survival*.
- 3.61 We agree that Radio 4 maintains high standards in the field of speech radio, despite the lack of direct competition. But this is an area in which plurality might enhance the reach of speech radio by enabling other providers to take different approaches. On average, Radio 4 reached 19% of adults each week between April-June 2008, compared to 66% of adults for BBC radio as a whole; it reached 28% of radio listeners aged 55 or over but only 7% of 15-34 year olds.
- 3.62 The BBC also argued that the competitive function is now delivered internationally, as the need to compete in an increasingly global marketplace requires it to maintain a strong focus on audience needs, regardless of the nature of competition within the UK.
- 3.63 But this is only true for certain genres. We pointed out in our phase 1 report that in some areas – notably drama, comedy, and some factual genres – overseas programming does provide competition that has helped to drive high standards within the UK. But in other areas – such as current affairs, certain areas of specialist factual

programming, including for children, nations and regions services – there is no international competition to the BBC.

Will the market deliver sufficient competition in provision of public service content without further intervention?

- 3.64 Most respondents agreed that plurality delivered the benefits identified by audiences. But some questioned whether intervention was necessary to secure them, claiming that the market now delivered sufficient plurality to meet most people's needs.
- 3.65 There is undoubtedly more choice available to audiences now than there has been in the past, due to the growth of digital TV and the internet. This choice is highly valued by audiences. But our analysis shows that this provision is focused on certain kinds of content – sport, entertainment, film, acquired programming and archive content. In a range of areas, the market currently does not make much contribution – current affairs, nations and regions programmes, challenging UK drama, UK scripted comedy, and UK drama and factual programmes for children. Additionally, the non-PSB channels offer much less originated UK content than the public service broadcasters. In phase 1 we estimated that the public service channels continue to represent over 90% of the spend on original UK programming.
- 3.66 Therefore the increase in choice can only eradicate the need for intervention for plurality if audiences see what the market provides as a suitable alternative to those kinds of public service content. Our evidence shows that this is not the case. Audiences think continued provision of those kinds of content is highly important, and many of the areas most under pressure on commercial channels are those in which audiences deem plurality most important. The undoubted expansion of choice, valued as it is by audiences, does not substitute for continued provision of public service content across a wide range of areas.
- 3.67 Moreover, even where alternatives to provision by the public service broadcasters are available – for example in news and factual programmes – they typically reach much smaller audiences than the public service broadcasters. No matter how high the quality of Sky News, it does not yet represent an alternative to ITV1 or BBC news in terms of the number of viewers it reaches.
- 3.68 This does not mean that the existing public service broadcasters are or should be the only sources of plurality in future. In some areas, the market is already providing some level of plurality; in future, it may provide much more, and the gap in reach and impact between the main five channels and other channels may diminish. In other areas, new providers and different approaches may be more effective than continuing to invest public resources in linear broadcasters.
- 3.69 But this does not alter the core conclusion that there remains a need to ensure alternatives to the BBC in a range of areas of public service content. The gap in market provision is unlikely to be filled entirely, or optimally, by the BBC alone. It is more likely to be filled effectively if different providers are able to take different approaches to reaching their target audiences, if they compete for audiences through innovation and a continual drive for greater quality.

Are audiences willing to pay to have alternatives to the BBC?

- 3.70 Our analysis suggests plurality is essential to meeting public purposes. But it has associated costs. The BBC suggested that, despite valuing plurality, audiences were not willing to pay these costs. It published quantitative research concluding that

public support for PSB on ITV1, Channel 4 and Five declines sharply when confronted with the cost of intervening to achieve it.

- 3.71 It is perhaps the case for almost everything that people's enthusiasm is reduced when they are asked to pay for it. But even in the BBC's own research, on balance participants preferred to pay more to retain plural provision than to accept a diminished contribution by commercial providers. This was consistent with our own deliberative research.
- 3.72 We carried out further quantitative research on this issue for this phase of the review. This found that there was significant readiness amongst the public to pay for public service broadcasting beyond the BBC. The results showed that approximately three-quarters of adults were prepared to pay for public service programming on ITV1, Channel 4 and Five up to an average value of £3.50 per month - in addition to the current licence fee (see Figure 9). This equates to £42 per household per annum; or over £800 million per annum aggregated across all households willing to pay for plural provision. This research is described in detail in Figure 10.

Figure 9: Value audiences place on public service programming on ITV1, Channel 4 and Five



Source: PSB Review phase 2 *Assessing the value of public service programming on ITV1, Channel 4 and Five*, quantitative survey among 2,474 people aged 18+ in the UK.

Figure 10: The value audiences place on public service programming on ITV1, Channel 4 and Five

Summary of quantitative research into the value audiences place on public service programming

1. Aim of research

Ofcom undertook a quantitative survey to assess whether the general public place a value on public service broadcasting on ITV1, Channel 4 and Five in addition to the BBC. The detailed results of the study are published in annex 6.

2. Methodology

Ofcom commissioned independent research agency Holden Pearmain to undertake a quantitative face-to-face survey among 2,400 people aged 18+ across the UK. Questionnaires were allocated at random: half the sample were asked to consider the value of PSB when thinking about themselves and their household, whereas the other half were asked to think about its value from the perspective of the good of UK society as a whole.

The study assessed the value placed on public service programming on ITV1, Channel 4 and Five by evaluating participants' willingness to pay for public service content in addition to

paying the current licence fee for BBC services. The study also incorporated willingness to pay for the BBC alone, to provide a benchmark comparison for the value placed on non-BBC public service content.

The study adds to the current body of work on willingness to pay for public service broadcasting,¹⁷ which includes studies by the BBC and the DCMS. Most recently the BBC conducted a BBC valuation survey¹⁸ as part of its response to phase 1 of this review.

In developing our survey methodology, consideration was given to the techniques used in previous published studies. This study used a Gabor Granger methodology, the same approach used by both the BBC and the DCMS to assess the value of the BBC. We have used it in order to measure the value people place on PSB on ITV1, Channel 4 and Five, in addition to the BBC. Consideration was also given to the respondent propositions used in previous studies. The question framing used was similar to that used in the BBC's studies (2004, 2008). To assess views from a personal perspective, Ofcom's study adopted a voluntary subscription framing for the Gabor Granger exercise. Respondents were asked to think about themselves and their family and their willingness to pay a voluntary monthly subscription which meant if they did not pay, they would no longer receive the services presented. In the citizen questionnaire respondents were asked to imagine that there was a national vote on the future of the services in question. They were given a choice of paying at the price presented or not paying in which case the services would close and become unavailable to everyone in the UK.

In the personal questionnaire respondents also carried out a conjoint exercise to evaluate people's willingness to pay for various combinations of services. Conjoint exercises have been used in previous published studies, such as the Radiocommunications Agency's work in 2000 to assess willingness to pay for television. In the Ofcom study respondents were asked to choose from three different options for PSB. One option was to receive only the BBC at the current licence fee, while the other two offered different combinations of PSB from the BBC at the current licence fee, together with different public service genres from ITV1, Channel 4 and Five.

Ofcom recognises the challenges inherent in this survey; firstly of asking people to consider the value of non-BBC services which they may currently perceive to be freely provided by commercial organisations. And secondly the challenge of scope and scale inherent in evaluating two services with significantly different obligations and current costs; namely specific PSB services on ITV1, Channel 4 and Five which currently cost the equivalent of £1.20 per household per month, and all BBC services currently costing £11.62 per household per month. It was therefore important for respondents to be given clear explanations of PSB, as well as current broadcasters' obligations, funding mechanisms and the future challenges to the current system. To help ensure clear explanations were provided in the survey we undertook a number of focus groups to explore consumer propositions, as well as two quantitative pilots to test the questionnaires.

3. Questionnaire areas

What is public service broadcasting?

Respondents were given a definition of PSB, based on a summary of purposes and

¹⁷ *Willingness to pay for the BBC during the next charter period: A report prepared for the Department for Culture, Media and Sport* (The Work Foundation, 2006); Barwise, Professor Patrick, *The BBC licence fee bid: what does the public think?* London: BBC Government Unit (2006); *Measuring the value of the BBC: a report by the BBC and Human Capital* (2004); Ehrenberg-Mills, *The value of the BBC* (London Business School, 1990); *Willingness to pay for viewing television* (Radio-communications Agency/ DTI 2000)

¹⁸ *Public Service Broadcasting now and in the future – audience attitudes* (BBC/Human Capital, 2008)

characteristics. The nature of each broadcaster's obligations was then explained. All of the BBC's services were described as being public service, whereas ITV1, Channel 4 and Five provide some public service programming described principally by genre:

- ITV1, Channel 4 and Five all provide new high quality UK programmes: UK news, factual programmes and documentaries, and current affairs;
- ITV1 and Five provide children's programming;
- ITV1 provides nations/regions news and other programmes;
- Channel 4 provides UK drama and comedy and experimental programming.

Respondents were also informed that Channel 4 is required to make and show new, distinctive, innovative and educational programming that is different from the other TV channels.

Assessing the value of PSB

Respondents were informed, as in the DCMS Study, that the BBC is funded by the licence fee and that this currently costs each household £11.62 per month (£139.50 a year). They were then told that the way in which BBC services are provided may need to change in the future and were asked how willing they would be to pay for the BBC in the future. Nine price points were presented individually ranging from more than £32.50 to less than £7.50.

In each willingness to pay question a 4-point scale was used ('very willing', 'fairly willing', 'fairly unwilling', 'very unwilling') and 'don't know'; price points were presented individually in a random order.

Respondents were then informed that ITV1, Channel 4 and Five receive the right to broadcast at a discounted rate in return for showing PSB and that the current cost would be equivalent to spending £1.20 per household per month (£14.40 a year). It was explained that the way in which these programmes and services are provided may also need to change in the future as the current arrangement may no longer work. Respondents were then asked how willing they would be to pay for public service programming on ITV1, Channel 4 and Five PSB in addition to the current licence fee for the BBC. Seven price points were presented, ranging from more than £5.00 per month to less than £1.20.

Respondents were finally asked to consider how much they would be willing to pay in the future for all PSB, defined as all BBC services, plus PSB on ITV1, Channel and Five. They were presented with 12 price points, ranging from more than £38 to less than £9 per month.

Calculation of Gabor Granger results

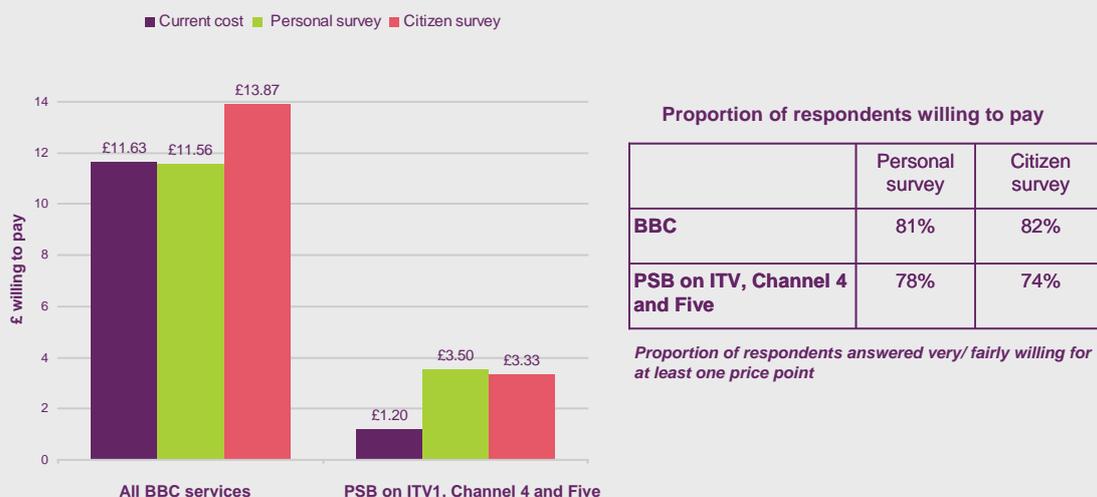
The average values from the Gabor Granger exercises were based on those willing to pay at any price point presented. The very willing/fairly willing responses were combined and the price calculated using a midpoint valuation between the highest price agreed to and the next price point.

4. Key findings

Results showed that the public value PSB on ITV1, Channel 4 and Five sufficiently to be prepared to pay for it from both a personal and from a citizen perspective. This supports our audience research findings from phase 1: that people value plurality of PSB provision.

Figure 11 shows that approximately three-quarters of respondents said that they value PSB on ITV1, Channel 4 and Five sufficiently to be prepared to pay for it in addition to the current licence fee for the BBC. The average amount they were prepared to pay was between £3.30 and £3.50 per month, with no significant difference between responses from a citizen perspective and from a personal perspective. In comparison, just over four in five respondents were prepared to pay for the BBC in both the personal and citizen questionnaires. The average value was £13.87 per month from a citizen perspective, and £11.56 per month from a personal perspective (the latter being in line with the current licence fee).

Figure 11: Proportion of respondents willing to pay for PSB programming on ITV1, Channel 4 and Five



Source: PSB Review phase 2 quantitative survey among people aged 18+ in the UK

The results for the BBC were lower than those found in the BBC's own studies¹⁹ from both a personal and citizen perspective (around £20 per month). These differences may in part be due to variation in respondent propositions: although both the Ofcom and BBC studies employed similar propositions, Ofcom's study was set in the context of future possible changes to provision, whereas both BBC studies were clearly set in a hypothecated world. In addition, the Ofcom study informed respondents of the current cost of the licence fee per household, (as did the DCMS study, 2005), which may have meant that people were 'anchored' to the current amount when responding. Ofcom's personal survey results were roughly in line with the DCMS study for current BBC services.

The results from this study's conjoint exercise confirms that respondents value PSB on ITV1, Channel 4 and Five. When presented with three choices for PSB in the future, only 12% of respondents²⁰ consistently chose the BBC-only option at the current licence fee. Respondents showed a high readiness to pay for PSB delivered by ITV1, Channel 4 and Five, with 47% choosing it at the £5 level. The average value people were willing to pay was £3.29 per month on top of the current licence fee.

If audiences are willing to pay for public service programming, for personal as well as social reasons, this might suggest that commercial broadcasters should be able to fund this programming either by selling subscriptions or through advertising. However, there are several reasons why existing commercial broadcasting models might not support content that people say they are willing to pay for. Other kinds of content are more profitable than some kinds of public service programming. There is currently no model that allows viewers to subscribe to particular programmes within a linear schedule, such as regional news or children's programmes within the ITV1 schedule. And if this kind of content were monetised through subscription, its reach would likely be more limited than if it were available free to view, which would conflict with the wider goal of maximising the impact of public service programming.

¹⁹ BBC/Human Capital 2004 and BBC/Human Capital 2008

²⁰ The conjoint results are based on 82% of the sample. 18% were excluded as they did not either complete the task, or consistently chose one option throughout - the exception being those who chose the BBC-only option who are included in the sample base.

Is any further intervention required to exploit emerging opportunities to achieve public purposes in digital media?

- 3.73 Phase 1 identified a number of opportunities for delivering public service content in new ways and many of the responses to the consultation recognised the contribution that public service content on other platforms could have either in meeting the public service purposes in their own right, or in complementing the provision by the public service broadcasters.
- 3.74 To examine further whether any intervention is needed to exploit emerging opportunities of delivering public service purposes in digital media we need to address three main questions:
- What contribution could digital platforms make to delivery of the purposes of public service broadcasting?
 - Is public service content on digital platforms as widely available as possible?
 - Are there any obstacles to audiences using this content?

What contribution could digital platforms make to the purposes of public service broadcasting?

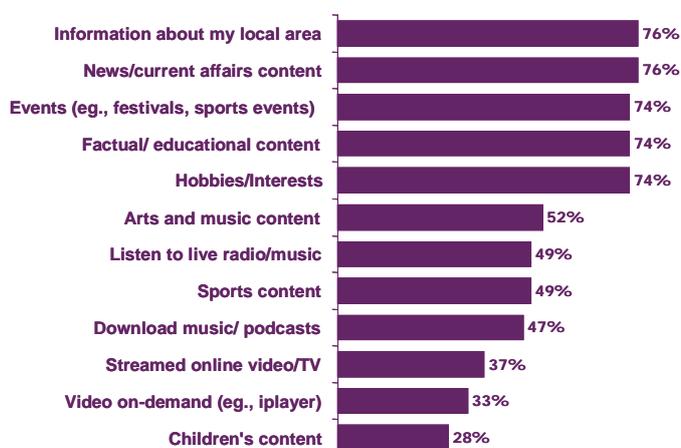
- 3.75 Our research from phase 1 shows that audiences continue to attach great value to the main five channels and recognise their distinctive contributions to public service programming. However, the ongoing transformation of the media environment means that much more profound questions about the existing model need to be addressed.
- 3.76 As we stated in phase 1, the pace of change in the media landscape will continue to be rapid, with:
- continuing innovation by broadcasters, pay-TV platform operators, online content providers and network operators;
 - the internet enabling rich interactive and social experiences and unparalleled access to niche content;
 - enhanced viewer choice and control through DVRs, on-demand services, video on the internet and mobile TV;
 - the award of the spectrum freed up by switchover – the so-called “digital dividend” – creating opportunities for new uses including more DTT (in standard and/or high definition), local TV, high-speed mobile broadband and mobile television;
 - new services launching on digital terrestrial television as a result of the reorganisation of the existing multiplexes;
 - open internet access via living room TVs likely to become increasingly widely available and taken up;
 - new models for digital rights management, pay-per-view and advertising offering new means of generating revenues for content producers; and

- very high speed broadband enabling high definition video on demand and other innovative content services.
- 3.77 Many of these developments create exciting opportunities for new business models to emerge, innovative ways for audiences to engage with an increasingly diverse range of content and new ways of meeting public purposes. IP and digital TV offer much greater ability to meet audiences' needs than a constrained, analogue world.
- 3.78 Transformation of the media and communications environment could result in transformation in the way public service purposes are achieved. The BBC has already recognised this, dedicating an increasing proportion of its overall budget to digital media. It argued in its consultation response that the purposes of public service broadcasting should now apply across all media platforms.
- 3.79 Channel 4 is also keen to fulfil its public service role across platforms and is confident that a multiplatform strategy and the interactivity of online services would allow it to maximise the reach and impact of programming through providing many opportunities and new ways for audiences to view content. In its response to our phase 1 consultation Channel 4 notes that Ofcom's research for phase 1 aligns closely with its own research conducted for *Next on 4*; that while there is high quality public service content online, it is not always easy to find this content and the level of UK origination is low.
- 3.80 In phase 1 we identified that new platforms, particularly the internet, are already playing an important role in achieving public service purposes. Online providers are already making a strong contribution in a variety of areas and this contribution is likely to continue in the future. However, our audience research in phase 1 shows that this is not yet seen as a substitute for high quality TV content – with the exception of schools programming which the audience thought could be effectively provided online.
- 3.81 We undertook new research in phase 2 to evaluate people's use of the internet for public service content and found that among internet users 62% claimed they had used the internet to access content matching a definition provided of 'public service content'²¹.
- 3.82 Figure 12 shows the range of activities undertaken by internet users based on responses to a prompted list. In addition to this prompted list respondents mentioned that they used the internet for other public service activities including finding information about health/health services (23%) and government or local councils (23%).

²¹ See annex 9: *Public service content and the internet*. Quantitative omnibus questions among 1002 people aged 16+ in the UK. Public service content was defined as "Content and websites that does one or more of the following: Informs our understanding of the UK or the world, encourages our interests in and knowledge about subjects, brings us together and strengthens our UK culture makes us aware of different opinions or different cultures. This can cover a wide range of areas like news, current affairs, arts, sports, religion, local information, hobbies and interests among other things."

Figure 12: Use of internet for public service content by activity

Which PSC related activities carried out online (prompted), amongst those using internet for PSC



Q: "Still thinking about this type of PSC, which of the following, if any, do you currently use websites for? (Respondents were given a description of PSC and prompted with the list of types of PSC)
Base: all adults 16+ who use the internet for PSC (452)

- 3.83 Some examples illustrate how public service content could be more effectively delivered in future. For example, **educational** content has historically been provided through factual programming on television, including some dedicated programmes for schools. But our analysis in phase 1 showed that serious factual programmes on commercial channels have tended to give way to lighter, more popular, factual formats, as commercial pressure grows and broadcasters have sought to increase audiences. Meanwhile there is a vast wealth of educational material available online which schools, as well as individuals, are increasingly turning to in order to exploit its flexibility and interactivity and its capacity to serve niche interests with rich, detailed content.
- 3.84 So in future, the schools part of the public service broadcasting remit may be much more effectively fulfilled by filling specific gaps in provision of public service content online, particularly with content relevant to a UK perspective, or to supporting individuals and educational institutions to navigate their way round the vast store of information available. Channel 4 has taken encouraging steps in this direction, investing a growing proportion of its budget for schools programming in online delivery and ventures such as *schoolofeverything.com*, which enables teachers and students to communicate and collaborate.
- 3.85 Secondly, there are new opportunities to serve communities **of ethnicity, interest and way of life** that did not exist in an analogue model focused on addressing geographical communities defined by transmitter location. Commercial services already exist on digital TV and online serving black and minority ethnic audiences. Religious communities too are increasingly served by multichannel TV, as are a range of other communities. Many of these services deliver content meeting public purposes, but do not necessarily fully achieve those purposes; for example, digital channels serving south Asian audiences commission relatively little UK content. Our phase 1 evidence suggests that black and minority ethnic audiences believe it is

important that they are represented on the main terrestrial channels but it is likely that there are some specific needs (for example, in languages other than English) that could be best met through dedicated services. At present, the BBC's Asian Network – which seeks to meet the specialist needs of the whole Asian diaspora in a single radio network – is the only example of a dedicated public service for minority ethnic audiences.

- 3.86 Finally, the potential for **local** digital services to deliver public service purposes, on TV and over broadband, has long been recognised. The sector has remained less developed in the UK compared to most other European countries. But, through our Digital Dividend Review (DDR), we are now creating the potential for more local terrestrial channels to operate by awarding some interleaved spectrum – the 'white spaces' between the transmitters used to broadcast DTT – in geographic packages suitable (albeit not reserved) for local TV. The development of next generation broadband, including seamless delivery of content to TVs, will help boost the prospects for commercial local broadband services. And the BBC has proposed to enhance its online local services to include video, subject to a public value test currently being conducted by the BBC Trust. These opportunities are discussed in more detail in section 5.
- 3.87 However, the development of new platforms as means of distributing public service content raises some new issues. Many future applications making use of higher bandwidth connections are likely to be rich video services, including public service content delivered by the existing PSBs and other organisations. There are costs associated with distributing this content, and these can be recovered in a number of ways – for example by additional charges on consumers and content providers, advertising around online content and so on.
- 3.88 Some models for cost allocation between consumers, content providers, aggregators and service providers could increase content providers' costs, including costs of public service content providers. The move to next generation access networks may make this increasingly likely, given the potential it creates to deliver high bandwidth services and more rich content, and the significant costs network operators will incur in rolling out these networks. But providers of public service content may not have the same opportunities to generate revenue to meet these costs as commercial content providers, for example by passing costs through to consumers.
- 3.89 It is primarily for content providers and network operators to negotiate the terms under which the revenues and costs generated by provision of content over new platforms are shared between them; it is not Ofcom's role to intervene in commercial relationships between different players unless one of those players has significant market power that results in significant consumer detriment. However, future funding for public service content may need to take into account any additional costs of distribution if public service providers cannot meet these costs through growing revenues commensurately.

Is public service content on digital platforms as widely available as it can be?

- 3.90 Availability of basic broadband is now nearly universal. According to BT, 99.6% of its network can support broadband at 512kbps²² - higher than the coverage of digital terrestrial television, even after switchover. Access to the internet at home is increasing, with 67% now able to access the internet at home in the first quarter of

²² Communications Market Review, Ofcom, 2007

2008²³. This wide availability, and the development of higher speed networks, offer a new and exciting opportunity for delivering public service content which broadcasters and a range of other institutions are already taking up.

- 3.91 Some respondents to our consultation argued that online provision could not contribute to the purposes of public service broadcasting as defined in the Communications Act because online services are not universally available at no additional cost. We do not agree with this analysis, for three reasons:
- 3.91.1 Our analysis shows that broadband at entry level speeds is now nearly universally available (although we recognise that some homes may have specific difficulties with gaining access).
 - 3.91.2 Historically a number of public services have launched that were not, at the time, universally available, including colour television, Five and the BBC's digital channels and websites.
 - 3.91.3 Provision of public service content over new platforms can help to extend the reach of that content amongst certain groups – particularly younger audiences – and encourage take-up of those platforms, helping new audiences benefit from new technologies.
- 3.92 The Communications Act does not set out any explicit requirements about the universal availability of public service content, other than through licence requirements placed on commercial PSBs to broadcast in licensed areas and to refrain from imposing charges. Nonetheless, the public service purposes established in our first review of public service broadcasting stipulate that public service content should be widely available. That is, the presumption is that if content is publicly funded a large majority of citizens need to be given the chance to watch it. We described some general principles of availability for public service content in phase 1, which are set out in Figure 13.

Figure 13: Principles of availability for public service content

In phase 1 of this review we set out three general principles of availability and access to public service content:

- core public service content should remain widely available, free-to-view, through provision on a range of platforms – at minimum, terrestrial and satellite. This should include all current designated public service linear channels;
- the value of public service content will be maximised if it is provided without additional payment. If content is paid for with public funding, audiences should have at least one opportunity to access it without any such payment. However, if the cost of subsequent distribution exceeds the public value, it may be appropriate to charge consumers some or all of that cost; and
- use of paid-for platforms and services to deliver some public service content is appropriate if those platforms can deliver greater reach or impact among a particular target audience than free-to-view platforms do.

²³ Communications Market Review, Ofcom, 2008

- 3.93 In future, services may emerge that require new very high speed broadband networks, which may not be as widely available initially as broadband at 512kbps. If so, it is possible that some consumers could be excluded from accessing some forms of public service content that require higher speeds.
- 3.94 However, our analysis suggests that this issue is some way off. Standard definition video does not require very high speed broadband, and it may be possible to deliver even high definition content at speeds that are already widely available. For example, our technical measurements suggest that BT's Vision service requires a 1.6Mbps connection, iPlayer works at 800Kbps²⁴ and Youtube videos are typically encoded at less than 500Kbps.

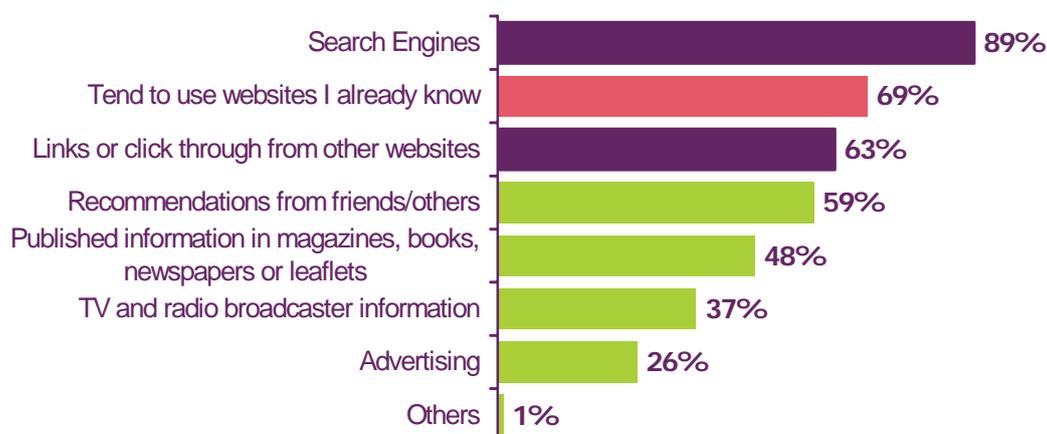
How could discoverability of public service content be enhanced?

- 3.95 In phase 1, we identified a potentially more significant issue for delivery of public service purposes online. In order to achieve reach and impact, public service content must not only be available but it has to be able to be found or 'discovered' by users. We have assessed the potential barriers to the 'discoverability' of online content in more detail in this phase. They break down into two categories:
- **Findability** – How easy is it for people to find public service content they know to be online?
 - **Awareness and serendipity** – Do people know about the full range of content opportunities available to them online, and how often do they stumble across content which they like but which they did not know existed?
- 3.96 In order to explore both these issues we conducted further quantitative research into audiences' experiences of discovering online public service content²⁵.
- 3.97 For the majority of those who currently use the internet for public service content 'findability' was generally not seen as an issue; four-fifths said it was seen to be 'easy' or 'very easy'. Only 6% found it quite difficult or very difficult.
- 3.98 The most popular method for finding public service content was through search engines followed by websites respondents already knew and trusted, via links or click throughs from other sites or from recommendations from friends.

²⁴ See for example http://www.bbc.co.uk/blogs/bbcinternet/2008/08/bbc_iplayer_goes_h264.html

²⁵ See PSB review phase 2 annex 9: *Public Service Content and the Internet*. Quantitative research slidepack, Gfk NOP face-to-face omnibus, June 2008

Figure 14: How public service content is found online, amongst those using internet for public service purposes



Source: PSB Review phase 2: *Public Service Content and the internet*. Q: How do you tend to find new, interesting or high quality PSC on the web?" (prompted)
 Base – all adults 16+ who use the internet for PSC (452), June 2008

3.99 Overall, our evidence suggests that barriers with respect to **awareness** and **serendipity** may be more significant. Our research on media literacy found that, in a typical week, 35% of home internet users use only familiar websites while 45% use one or two new sites. Although this research indicated that 47% of internet users said their main reason for using the internet was to find out things or learn, research with an online panel of internet users in phase 1²⁶ found that when asked to choose which activity they tended to use the internet for, respondents saw it mostly as a medium to extend existing interests and knowledge as opposed to discovering new things and interests. The 16-24 age group were more likely than older age groups to claim to use the internet for discovering new things and interests.

3.100 In its response to phase 1 Yahoo! pointed out that search is only useful as a way to achieve reach and impact of online public service content if the user knows what they are looking for. Yahoo! argued that search cannot be considered a substitute for the role linear schedules play in traditional broadcasting in introducing viewers to content they would not otherwise look for.

3.101 Research conducted for phase 1²⁷ highlighted that this 'serendipity' was a valued feature of television. Viewers do not believe the same applies to the internet. Respondents in our research stated that in order to find content, they need to look actively and use precise search terms. They felt that when using the internet the likelihood of having their views challenged or their knowledge expanded 'by chance' was minimal.

3.102 Our research suggests that links and clickthroughs may be effective ways of introducing people to new public service content. However, it is not often in the interests of commercial content providers to link heavily to other, potentially competitive, sites even though these links could help meet some public purposes.

²⁶ See PSB review phase 1 annex 6: Research findings slidepack April 2008

²⁷ See PSB Review phase 1: annex 5: *The audience's view on the future of Public Service Broadcasting*

- 3.103 There may therefore be a role for publicly funded institutions to seek opportunities to introduce users to a wider range of public service content offered by other sites. In its recent review of the bbc.co.uk service licence the BBC Trust highlighted the need for the BBC to link much more widely and effectively to third party sites.
- 3.104 This might include new online tools that help people 'bump into' new websites which otherwise they might not have found, along the lines of stumbleupon.com or last.fm, with a public service perspective.
- 3.105 In addition, it may be possible for other public institutions – outside broadcasting – to do more to promote their public service content online. Public institutions produce a wide and growing range of such content, and funders may be able to enhance the reach and impact of this content by encouraging funded bodies to do more to promote their online content as well as offline activities.

Conclusions

- 3.106 This chapter has set out the evidence detailing the challenges facing the commercial provision of public service content and assessed arguments about the need for continued intervention to deliver public service content beyond the BBC. Based on this evidence, we continue to believe that:
- 3.106.1 the BBC should remain the cornerstone of public service content, and its core programme and services budget should be secure;
 - 3.106.2 the existing commercial model for public service provision is breaking down;
 - 3.106.3 the market will not provide sufficient competition for the BBC in a number of areas highly valued by audiences;
 - 3.106.4 competition for the BBC has measurable benefits and strong audience support, including audiences' willingness to pay to maintain alternative provision;
 - 3.106.5 new digital opportunities are opening up on new platforms, and in future public service purposes should be delivered across platforms as well as on linear TV; and
 - 3.106.6 there may be a new role for public service broadcasters to introduce audiences to a wider range of digital public service content through initiatives to enhance its discovery.
- 3.107 In light of these findings, and because of our duties to maintain and strengthen public service broadcasting, we continue to believe options for new intervention will need to be considered to ensure audiences' needs for public service content are met in an all-digital, broadband environment.
- 3.108 Consequently, in the next chapter we review and build on the four models for delivering public service content we set out in phase 1.

Section 4

Refined models for public service content in the future

Introduction

- 4.1 In phase 1, we described four stylised models for the future delivery and funding of public service content. In this section we review feedback from stakeholders and the findings of our audience research into the models. We assess if and how the models might work in practice, set out their key strengths and weaknesses and ascertain how it might be possible to mitigate their drawbacks.
- 4.2 We start by setting out a short reminder of what we said in phase 1 about the four models – that is, 'evolution', 'BBC-only', 'BBC/Channel 4 plus limited competitive funding' and 'broad competitive funding'. We then summarise the feedback we had on the models through the stakeholder responses to our phase 1 consultation.
- 4.3 In addition to reviewing stakeholders' reactions, we also commissioned further audience research, consisting of six day long deliberative workshops undertaken around the UK in May and June 2008 to test audience's reactions to the models we had described. The aim of the research was to explore participants' views on Ofcom's four models for the provision of PSB in the future and also to assess attitudes towards different funding mechanisms.
- 4.4 This section also draws on further work undertaken by Oliver & Ohlbaum during phase 2 of the review, on the relative advantages and disadvantages of institutional and competitive funding models, drawing on international examples and analysis of the incentives for providers in each of the models. We also commissioned a study from Tom Fleming Creative Consultancy on methods of allocating funding in the creative sector.

In phase 1 we set out four possible models

- 4.5 The four models we set out in phase 1 are described in Figure 15 below.
- 4.6 In the **evolution model** existing public service broadcasters would maintain their institutional roles but either their public service responsibilities would be reduced in line with the declining value of their gifted spectrum, or additional support would be provided. The broadcasters would focus on key areas of content that are important to audiences with reduced, or no, provision likely in other areas.
- 4.7 Under the **BBC-only** model, the BBC would become the sole UK-wide intervention in public service content. ITV1 and Five would no longer retain PSB obligations or status and Channel 4 would be privatised. The licence fee would remain the principal source of funding for public service content, with a probable need for the BBC to focus more exclusively on areas undelivered by the market.

Figure 15: Long-term models for public service broadcasting

<p style="text-align: center;">Model 1: Evolution</p> <p>BBC remains cornerstone of PSB</p> <p>Commercial PSBs retain special roles</p> <p>Obligations reduced over time or more funding for PSB responsibilities</p>	<p style="text-align: center;">Model 2: BBC only</p> <p>BBC is the sole UK-wide intervention</p> <p>Extended role for BBC to fill market gaps</p> <p>Competition to BBC relies on the market</p>
<p style="text-align: center;">Model 3: BBC/C4 + limited competitive funding</p> <p>BBC/Channel 4 are core institutions</p> <p>Channel 4 remit extended + new funding</p> <p>Some long-term but transferable funding for further plurality</p>	<p style="text-align: center;">Model 4: Broad competitive funding</p> <p>BBC is the core institution</p> <p>Long-term transferable funding supports all competition to the BBC</p>

- 4.8 In the **BBC/Channel 4 plus limited competitive funding** model, we said that the BBC would remain the cornerstone of public service broadcasting while ITV1 and Five would lose their PSB obligations and status. Channel 4 would provide competition for the BBC and its remit would be extended into new areas and across different platforms. Additional funding and possibly new governance and accountability arrangements would be required to allow Channel 4 to deliver its existing remit and potentially the strategy it laid out in *Next on 4*.
- 4.9 In the **broad competitive funding** model a large proportion of public service content would be delivered through long-term but transferable supply agreements awarded by competitive tender. A funding body would be given responsibility for creating and overseeing these agreements with an overall financial settlement and framework of purposes established by government. The commercial PSBs would not retain their special institutional roles.
- 4.10 We asked stakeholders for their feedback on these models, and whether they thought any other models or combinations of models would be more appropriate.

Responses to our consultation showed support for a range of models

- 4.11 In responses to our consultation, there was virtually no support for a **BBC-only** model – only two individuals favoured this approach. The majority of respondents believed that there was a need for funding to secure provision beyond the BBC in several areas: nations and regions news, UK children's programmes, current affairs and specialist factual programming were the areas most often mentioned.
- 4.12 Views were more mixed about the other models. Many stakeholders including the BBC, ITV1, S4C and Five, favoured variants of the **evolution** model, and most argued that additional funding would be required to secure some aspects of the current obligations of the commercially funded broadcasters, particularly nations and regions news. BSkyB, although it did not express a specific preference for this model, argued that the indirect funding available to the existing public service broadcasters could be used to sustain greater obligations than we had suggested.

- 4.13 However, some opponents of model 1 argued that this model is likely to be unsustainable without additional funding; that it fails to respond to the challenges and opportunities of the digital world, and it does not allow organisations other than the existing public service broadcasters to gain access to terrestrial spectrum.
- 4.14 The **BBC/Channel 4 plus limited competitive funding** model was preferred by Channel 4 (who also saw a role for ITV1, Five and the wider market) and by a wide range of other stakeholders, who believed that it combined the merits of competition between two public service institutions with mass reach with a greater flexibility to direct funding to new providers. A major concern was how plural provision of nations and regions content would be secured in this model.
- 4.15 A range of stakeholders, including the Satellite and Cable Broadcasters Group, Discovery, Yahoo! and the Institute of Local TV, supported greater use of **competitive funding** in principle. However, many felt that they would like to see more details on how model 4 would work in practice before expressing a preference for it. Several respondents argued that competitive funding would go hand-in-hand with close monitoring of providers and measurement against key performance indicators, which could chill creativity. Concerns were also raised about the cost and bureaucracy of a new body to allocate funds.
- 4.16 Various organisations and individuals proposed a 'hybrid' of models 1 and 3. They envisaged a licence-fee funded BBC, with competition provided by a strong, financially secure Channel 4 as well as by public service provision from ITV and Five in defined areas (such as UK originations and regional and international news) in return for their prominent positions on the EPG and access to reduced cost spectrum. There were also arguments for and against having a competitive fund alongside this model to support digital media services.

Audiences value the roles of the existing institutions, but also see the attractions in opening up opportunities to new providers

- 4.17 In phase 2 we conducted deliberative research to investigate audiences' views of the models and possible funding sources for future delivery of public service broadcasting (see Figure 16 below). This research included an explicit assumption that all new models would involve additional funding, to create a level playing field between them. We also asked audiences for their views on making *no change*, and allowing indirect funding for public service content to decline as the value of the commercial broadcasters' licences falls.

Figure 16: Audience research into long-term models for public service content

Methodology

Ofcom commissioned Opinion Leader Research to conduct a programme of deliberative workshops with the general public to assess their views on Ofcom's models for delivering public service content in the future, as well as opinions on how to fund PSB. annex 7 provides full details of the research.

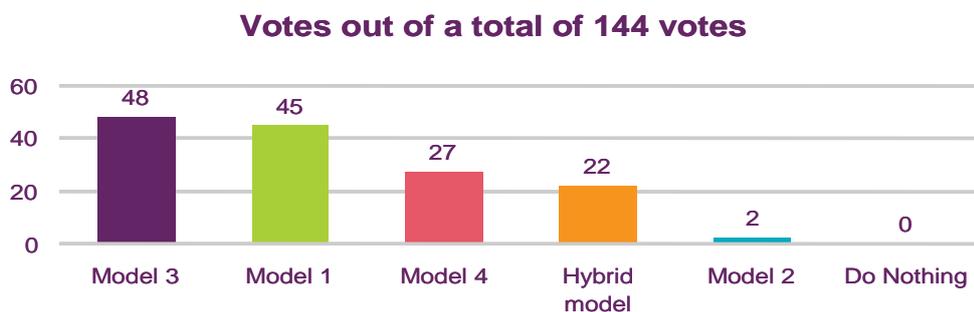
Six day-long deliberative workshops with adults aged 16+ in May-June 2008 were conducted in Croydon, Nottingham, Aberdeen, Beverley, Londonderry/Derry and Swansea. A pilot was conducted in London in order to fine-tune the design of the day. Each workshop had 24+ people participating, with a spread across age, gender and socio-economic group. All had digital television and the majority were regular internet users.

Given the complexity of the issues, a deliberative approach was deemed most suitable:

participants were provided with a wide range of evidence about the rapidly changing media environment, the current PSB system, the pressures on commercial PSB providers and the likely future challenges and opportunities. They were given time for in-depth informed discussion from a 'citizen' as well as consumer point of view. Discussions were framed from the perspective of '2012'. For the sake of clarity the models presented were simplified versions of those published in Ofcom's consultation document, including omitting the competitive funding element from model 3.

- 4.18 After considering all the options, all the participants in the deliberative research supported the idea of a new model for public service content even though it entailed additional funding. 'Doing nothing', despite being the only cost-neutral option, was not seen as a viable future option as this would mean a reduction in PSB programming overall and a decrease in choice and range.
- 4.19 However, none of Ofcom's suggested models matched all audiences' preferences for a future model for public service content. When considering all the options, including hybrids, **evolution** and **BBC/Channel 4** were the preferred options; viewers in England tended to prefer **BBC/Channel 4**, attaching greater value to the distinctive contribution they perceived Channel 4 to provide. Audiences in the devolved nations tended to prefer **evolution**, because they valued the role of their respective national Channel 3 company, and attached high priority to plurality in nations news. Figure 17 below shows how participants voted for these options.

Figure 17: BBC/Channel 4 and evolution are most popular with audiences



Source: PSB Review phase 2: Deliberative research

- 4.20 At each workshop some participants called for an alternative offering, combining competitive funding with guaranteed roles for existing providers in addition to the BBC to create a stable, yet flexible, new model. These participants suggested a hybrid model, combining competitive funding with models 1 or 3. Participants felt that this hybrid combined the benefits of PSB provision by known and trusted providers with an element of flexibility.
- 4.21 The BBC only model received by far the fewest votes. It was rejected by all but two research participants, because most did not believe it provided enough choice and alternative perspectives to the BBC; they felt certain audiences would be less likely to access PSB (e.g. younger audiences); and that the model would not be flexible enough to respond to future audience and market changes. Viewers in the devolved nations worried particularly about the lack of plurality in nations news.

Stakeholder and audience feedback suggests that no single model is the clearly preferred solution

4.22 In summary, no single model emerged as the clearly preferred solution in our consultation or audience research. In fact the views on the four models raised by participants during our deliberative workshops were very similar to those expressed in the consultation responses we received. These views are broadly summarised in Figure 18 below:

Figure 18: Audiences and stakeholders' views on the four models

Model 1	Model 2	Model 3	Model 4
Strengths			
<ul style="list-style-type: none"> Builds on capabilities of existing PSB institutions Known quantity and low risk Retains choice of providers, especially for nations and regions news Retains diversity of tone and style, especially news and current affairs Achieves impact through institutions with scale and mass market reach 	<ul style="list-style-type: none"> Concentrates resources in one institution with near universal reach BBC more trusted by audiences than commercial providers to use resources in public interest BBC could become more innovative Gives 'freedom' to the commercial PSB providers Potential to leverage BBC's scale and experience in partnership with commercial providers 	<ul style="list-style-type: none"> Builds on competition between BBC and Channel 4 Channel 4 has a different perspective to the BBC Public ownership helps ensure incentives aligned to delivery of public purposes Could facilitate delivery of PSC by new providers if competitive funding available 	<ul style="list-style-type: none"> Flexible and potentially well placed to deal with challenges of digital media and an increasingly competitive and fragmented market Encourages efficiency and transparency Encourages mix of quality public service content from a range of providers Familiar in other countries
Weaknesses			
<ul style="list-style-type: none"> Tackles the challenges but does not maximise opportunities, especially in digital media Seen as short term fix rather than long term solution Limited scope for innovation so may provide poor value for money Commercial and regulatory objectives will not be aligned Will not meet audiences' needs without new funding 	<ul style="list-style-type: none"> Lack of competition to the BBC could lead to a decline in BBC quality Does not provide enough choice Only one perspective on nations and regions news Certain audiences less likely to access public service content Not flexible enough to respond to changing audience needs Too much expect BBC to meet all public service needs 	<ul style="list-style-type: none"> Model seen as a duopoly which could limit choice and competition Potential lack of plurality in nations and regions programming May lack flexibility and scope to open up public service content to new providers 	<ul style="list-style-type: none"> Sounds too risky and too different to the current system Lack of clarity about objectives and working methods of funding body Potentially bureaucratic Requires potentially intrusive scrutiny of content providers Concerns around who would bid for funding and the reach and impact of funded content

Although some benefits of plurality could be achieved within a BBC-only model, it is not a favoured model

4.23 In both our audience research and stakeholder feedback, there was virtually no support for a BBC-only model. Our analysis suggests that, without additional funding, this model would be highly unlikely to meet audiences' needs in future as the model would rely on delivery from the BBC and market, resulting in shortfalls in key areas of public service programming as identified in section 3 above. In addition to resulting in shortfalls in delivery of the public service purposes, the model would also fail to achieve plurality in key areas including nations and regions news. We have considered ways of mitigating some of the disadvantages of the BBC-only model, by seeking to replicate some of the benefits of plurality in a single institution, as set out in Figure 19 below.

Figure 19: Achieving the benefits of plurality within a single institution

Mechanisms to secure greater plurality within the BBC could include:

- Increasing the amount of independent productions to allow a greater range of suppliers and voices. This could be delivered by one channel, such as BBC Two. Spinning off BBC Production could achieve a similar effect.
- Delegating airtime and budgets across the nations and English regions and to channel controllers along the lines of the BBC's recent announcement to recruit five new commissioning executives across the devolved nations, thereby spreading commissioning power across a number of points.
- Evolving one of the existing BBC channels into a 'nations, regions and localities' service to provide in-house and independent producers outside London greater access to a UK-wide network. This could also involve transferring the management of that channel to the nations, as proposed by the Scottish Broadcasting Commission.
- Altering the structure of the BBC, so that BBC centres in the devolved nations report directly to the BBC Trust, thereby making them more independent from the BBC executive.
- Giving the devolved nations more freedom to provide a different pattern of news and other kinds of nations programmes.

A number of these mechanisms were suggested by Samir Shah, one of the BBC's non executive directors, in his essay *The Price of Plurality*, published earlier this year, although many of the associated constraints were noted.

Similar mechanisms to ensure a greater plurality of programming supply in a single institution, and from the nations and regions, have been employed in other EU countries such as the Netherlands and Germany.

- in the Netherlands, the national public broadcasting union (NPO) consists of 21 broadcasting organisations representing different social, political and cultural interests which compete to provide programming broadcast on three national PSB channels;
- in Germany, the main licence-funded public service broadcaster, ARD, is an umbrella organisation of nine regional broadcasters, which compete for share of public funding and to supply their programming to the main Das Erste channel.

- 4.24 Many of the suggestions for achieving plurality within the BBC have disadvantages. For example, devolved systems create significant organisational costs. They could damage the impact of the BBC as a whole and in key public service genres – such as news, current affairs and children's – they may still only result in only one supplier.
- 4.25 While these mechanisms could be considered if no further funding were available for other providers, this model is clearly not favoured by stakeholders and audiences. Further, as obligations under the Communications Act require us to have a view to maintaining and strengthening the quality of public service television broadcasting, the BBC only option does not to us appear to be a favoured option.

There was broad support for the tests of effectiveness that we set out for any future model

- 4.26 In phase 1 we set out seven tests that any future statutory model for public service provision would need to meet to ensure its effectiveness: reach and impact, plurality, flexibility, governance, complementarity to the market, openness to new means of distribution and sustainability.
- 4.27 We asked stakeholders whether they felt these tests were the right ones. Most respondents who offered a view were broadly supportive. The BBC suggested that two more should be considered: 'value for money' and 'audience acceptability' a proposal which we support. Five also suggested cost-effectiveness and efficiency of delivery (which we believe can be accommodated within a general 'value for money' test), trustworthiness (which as Five described it may be associated with audience support for the model) and lack of disruption as additional considerations. We also asked audiences for their views, who prioritised choice, appeal and availability of content, and value for money.
- 4.28 We propose to add value for money and audience acceptability to the tests of effectiveness. However, we do not believe that avoiding disruption should in itself be a criterion. While the costs of change should be taken into account in considering options for the future, it is precisely because audiences' needs and market provision are changing that we should consider the potential for different approaches to meeting audience needs in future.
- 4.29 Our final set of tests is set out in Figure 20.

Figure 20: Tests for a future model for public service broadcasting

Objective	Test
Reach and impact	Are providers incentivised to deliver public service content that achieves reach and impact?
Plurality	Does competition between providers deliver the benefits of plurality?
Flexibility	Is the model sufficiently flexible to respond to audience and market changes?
Value for money	Does the model make efficient and effective use of public resources?
Governance	Do providers have clear remits, independence, transparent accountability arrangements and incentives aligned to public purposes?

Complementarity	Does it complement, not discourage, market provision?
Openness to new platforms	Does it embrace the platforms, content forms and services that most effectively meet audience needs?
Sustainability	Are providers' funding models sustainable?
Audience support	Is the model broadly supported by audiences?

Public service institutions have important roles to play, but there are good arguments for creating opportunities for new providers to contribute

- 4.30 In its response to phase 1 the BBC made an overarching observation about the models, arguing that the choice of model really reflected a debate about the relative merits of institutional and competitive interventions. Three of the four models set out in phase 1 (**Evolution**, **BBC-only** and **BBC/Channel 4 plus limited competitive funding**) are primarily institutional models.
- 4.31 The BBC argued that institutional models have a number of benefits: they can support innovation, offer scale to ensure that public service content achieves reach and impact, be flexible, help ensure providers' independence from political interference, attract people whose own values are aligned to meeting public purposes, and encourage the transfer of creative intangible skills. These are strong arguments that echo much of our own thinking in this area. In phase 2 of the first PSB review (2004-05) we noted some of the advantages of institutions, including that these organisations were imbued with an ethos to promote PSB purposes and characteristics and that they had a well of audience loyalty. However, the arguments surrounding institutional and competitive methods of delivery require full assessment.
- 4.32 During a period in which the media environment changed relatively slowly, and the public service broadcasters dominated audiences' viewing, the historic institutional model served UK audiences very effectively. Combining popular, entertaining programming with public service programming proved an effective way of achieving reach and impact and ensuring that a range of tastes were served.
- 4.33 Even today, the existing public service broadcasters continue to represent the majority of all TV viewing in the UK, and have unparalleled reach and impact among many audiences.
- 4.34 However, the media landscape is changing rapidly and audiences are increasingly fragmenting. New platforms are developing and consumer behaviours are changing rapidly. The future is highly uncertain, both with respect to how audiences' needs will evolve and the capacity of the market to meet those needs.
- 4.35 In light of this rapid change and the proliferation of media providers, several stakeholders have made a case for opening up public service provision to new organisations. For example, the Culture Media and Sport Select Committee has proposed to establish a contestable fund, available to all broadcasters, to provide genres such as regional programming, children's programmes and current affairs. The Scottish Broadcasting Commission has called for a new not-for-profit Scottish digital TV network to make more original Scottish content available to viewers and create new opportunities for talent and innovative ideas.

- 4.36 Introducing some competition for funding of public service content could help secure a greater contribution from a range of new providers, some of whom may be able to achieve some purposes and reach certain audiences better than existing institutions. Competitive funding could also keep providers more clearly accountable, and help ensure that public resources are used as efficiently as possible. And, it could encourage the existing institutions to continue to focus on meeting audiences' needs, by making their funding dependent on their ability to make a case for funding in competition with other providers. Figure 21 describes how competitive funding could work in practice.

Figure 21: How could competitive funding work in practice?

International analysis shows that competitive funding models have to date usually been used to support limited content objectives in small markets. Competitive funding schemes have typically had one or both of these two objectives:

- to support programme genres that the market alone would not provide e.g. heritage, culture, serious factual and occasionally children's content (as is the case in the Republic of Ireland and New Zealand) and to ensure their broadcast on mainstream channels; or
- as part of a policy to support and nurture the indigenous TV production market (as in the schemes in France, Canada and Singapore). This includes (globally) commercial genres such as children's and drama as well as to support programmes for local audiences.

In the UK, Ofcom's analysis suggests that a competitive funding model would be likely to work best if it consisted of a small number of large ongoing contracts for delivering public service content rather than a large number of small contracts for individual programmes or services. Figure 29 in section 5 illustrates how such an approach could be used to deliver nations and regions news.

This approach would have several key benefits: it would offer certainty of funding for providers over a sufficiently long period to allow for effective planning and building an audience. It would also reduce bureaucracy and administrative overheads. And it allows editorial and creative control to remain in the hands of the provider, not the funding body, thereby avoiding second guessing or twin layers of commissioning.

If there is to be competition for funding, there needs to be a body to allocate funds, with a budget and objectives set by Parliament. The funding body's duty would be to award funding through competitive tenders to meet identified deficits in provision of public service content, informed by consultation with audiences about their priorities. It could be a reconstituted institution, such as the BBC Trust, or a new organisation.

We might envisage that tenders would be awarded on the basis of providers' ability to deliver the purposes of public service broadcasting and to achieve reach and impact with target audiences. Tenders might not pre-specify particular forms of content or methods of distribution. Opportunities could exist for creative organisations to identify public service needs and submit service proposals to the funding body; as well as the funding body itself identifying audiences' needs.

- 4.37 To explore these arguments, we commissioned Oliver & Ohlbaum to review the relative attractions and limitations of institutional and competitive models. Their findings are summarised in Figure 22.

Figure 22: Institutional and competitive approaches to allocating funding for public service content

Competition for funding is now used to deliver aspects of public service in a wide range of areas, including health, education, local environmental services, social services and so on. In principle, competition for public resources – whether direct funding or assets, such as gifted spectrum – offers maximum potential for efficiency, since the winning bidder is the one who can either deliver a specified level of service with minimum subsidy, or achieve the highest quality service for a given level of subsidy. The process of competition among rival bidders reveals information about the true costs of delivery, which helps those allocating the money to ensure they pay no more than necessary to achieve public service objectives.

However, in the case of broadcasting there are a number of reasons why competition for resources might not operate effectively in some instances:

- there may be only one bidder for an obligation (or, possibly more likely, only one bidder with sufficient scale and reach to achieve the minimum impact required);
- several bidders might apply, but might not face a level playing field due to differences in their business models and their opportunity costs provision;
- if a certain type of content attracts a significant amount of commercial funding and requires only a small top-up, it will be difficult to tell whether that content might have been provided anyway in which case public funds would have been wasted, or commercial provision crowded out;
- the outputs – delivery of the purposes of public service provision – are complex to define and to hold providers to;
- if significant economies of scope exist between different services, and they are constructed separately, the competition process might become too contingent (that is, the bids for one obligation depend on the outcome of another auction). This could lead to bidders over-estimating the level of funding they need, or a dominant bidder becoming the only viable provider although these issues could be resolvable through the design of the auction; or
- bidders need to have time to make a return on their bid - either financial or in terms of reach and impact – which could create a trade-off between the need to give certainty to bidders and the desire to retain flexibility in the system.

This suggests two conclusions:

- it may be more efficient to deliver some obligations by allocating funding directly to public service institutions; and
- obligations should be assessed on a case-by-case basis to assess whether competitive funding would be likely to deliver the most efficient outcome, or would fall foul of the limitations, as described above.

A competitive process may be best suited to obligations that need substantial funding and where there are likely to be a number of bidders with similar business models, opportunity costs and audience reach. This might apply to children's content, for example.

Alternatively, an institutional approach may be best when only top-up funding is needed, where the outputs are difficult to define and measure and where only one organisation is likely to be interested in the obligation. This might apply to alternative comedy on Channel 4, for example.

In some areas there may be arguments on both sides: for example nations and regions news may require significant funding in future, but arguably in the short term only ITV1 could deliver it with significant reach and the cross-promotional benefit of a mass audience schedule.

Arguments for an institutional approach to public service provision often amalgamate several different issues which need to be separated. An institutional approach can mean:

- a large organisation with significant reach and impact among viewers;
- a not for profit commercially funded organisation; or
- a public institution, in which managers and employees are (in theory) motivated by public objectives.

For the purposes, an institutional approach is one in which particular organisations – whether commercial, publicly owned but commercially funded or publicly funded – are entrusted resources in return for obligations to deliver particular kinds of content.

There are advantages to this approach, in avoiding the potential pitfalls of competitive models. But it is not clear that two of the benefits identified by the BBC are an inherent feature of institutional models, defined in this way:

- they can be inflexible, in that resources are allocated for a long period and cannot necessarily be easily moved around; and
- they only achieve reach and impact because the institutions in the model themselves achieve reach and impact. But competitive models could also deliver this benefit, if the ability to achieve reach and impact with a particular target audience – which is not exclusively delivered by the PSBs – is a key criterion for awarding funding.

Where an institutional approach is better suited to delivering public service purposes, there may be advantages to those institutions being not-for-profit or even publicly owned such as the BBC, Channel 4 or S4C. Institutions of this kind may have fewer or less significant conflicts of interest than purely commercial organisations, and their culture and values may be better aligned with delivering public service purposes, although this is clearly contingent upon the institution in question.

4.38 This assessment suggests that while institutions are important some element of competition for funding could also create greater flexibility during an era of great change.

4.39 This approach, involving a blend of competitive and institutional dynamics, is more akin to the model operating in other areas of the cultural sector. We commissioned Tom Fleming Creative Consultancy to assess the application of competitive and institutional models in the arts. Their analysis suggests that ongoing funding for not for profit institutions has been an essential feature of the pursuit of public value in the arts. However, more sophisticated approaches to measuring the outputs and outcomes of arts institutions have been introduced to improve understanding of where and how public value is created. This is leading to more sophisticated and nuanced specifications of what arts institutions aim to deliver. Direct competition for funding is relatively rare in the arts, but indirect competition is more common as arts institutions compete to demonstrate that they can meet the aims of their funding bodies and justify their funding.

Three refined models merit further consideration

4.40 Based on our audience research and the arguments made by responses to our consultation, our provisional conclusions about the ongoing roles of the current public service broadcasters are:

- 4.40.1 the BBC should remain the cornerstone of public service content, and its core provision of high quality public service output should not be reduced;

- 4.40.2 Channel 4 should have an ambitious public service role for a digital age, with a new funding mechanism to support this;
 - 4.40.3 ITV1 and Five retain important roles between now and 2014, particularly for ITV1 in the nations and regions, but their current obligations will need to be reduced. After 2014, the arguments for retaining their public service benefits and obligations are more evenly balance; and
 - 4.40.4 scope for competitive funding should be considered, as it offers real advantages in a more fluid, changing media environment.
- 4.41 The choice of model is for government and Parliament to make. Based on our analysis and stakeholder and audience feedback, we have developed three refined models that we believe represent practical options for the future. Any of these models would require significant change to the legislative and regulatory framework, and to the roles of the existing public service institutions.
- 4.42 The choice of model will depend on judgements about the relative importance of different elements of public service provision, particularly:
- 4.42.1 the extent to which the existing institutions represent the most effective ways of reaching audiences;
 - 4.42.2 the value of opening up funding to new providers through competition;
 - 4.42.3 the extent to which audiences are likely to turn to new platforms in future, relative to the ongoing importance of linear TV.
- 4.43 Our analysis shows that in any of these models, ITV1 and Five would continue to do much that they currently do for purely commercial reasons. This may include high levels of investment in UK programming (albeit not as high as today), news, drama, factual programmes and entertainment. Teletext would also be likely to continue to provide an interactive text service on digital platforms.
- 4.44 The question therefore is not whether these broadcasters would provide any public service content but whether they should continue to have access to indirect public subsidy in return for meeting certain public service obligations; and if so, what those obligations should be.
- 4.45 All of the refined models envisage a role – and in some cases an extended role - for Channel 4. In each of the three refined models we envisage that Channel 4 should deliver its remit across a range of platforms to achieve reach and impact. This is consistent with Channel 4's own ambition as set out in its vision document *Next on 4*. Channel 4 is already delivering some public service content on new platforms in response to changing audience needs, for example its programming for schools.
- 4.46 The provision of dedicated news and other content for the devolved nations remains an essential requirement for any future model. Future options for this provision are described in detail in section 5.

An enhanced Evolution model

- 4.47 If we believed that changes in technology will have relatively little impact on audiences' behaviours and what they want from public service broadcasting; that the existing institutions remained best placed to meet audiences' needs; and that

maintaining these institutions is more important than opening up funding to new providers, an **enhanced Evolution** model might be most appropriate, in which most of the existing commercial public service broadcasters would retain public service obligations and benefits.

- 4.48 In this model, the Channel 3 network's role would be focused on high levels of UK origination and UK and international news. The only other requirement may be to provide space in the network schedule for news for the devolved nations, and possibly for the English regions. Channel 4 would have a wider remit to innovate and provide distinctive content across platforms. Five's role would focus on UK origination and in particular UK children's programming, including for older children, and news. Teletext would move to a purely commercial model, as it would in all these models.
- 4.49 To ensure delivery of nations and regions services, especially news, it is likely that additional funding would be required, unless Channel 3 licences are worth significantly more after switchover than our analysis currently suggests. Additional funding would also be required for Channel 4, to ensure sustainable high levels of UK origination and continued innovation and plurality in areas such as current affairs, specialist factual programming and challenging drama and original comedy.
- 4.50 Channel 3 would have a simplified licensing structure of either a single UK-wide licence or five licences for England, Scotland, Wales, Northern Ireland and the Channel Islands. If the latter, the terms of the networking arrangements between the licensees would need to be reviewed and might look very different from today. The contribution to the network programme budget paid by each licensee would need to reflect the revenue-earning potential of the licence, the regulatory benefits and obligations attached to the licence and the benefit that each licensee derives from membership of a UK-wide network. Licences would be for 24-hour services with no separate breakfast licence. News below nations level could be provided either by regional Channel 3 services, as at present, or possibly at a more local level with additional public funding.
- 4.51 This model would require significant change to the existing regulatory framework, including nations-based licences for Channel 3, a new statutory remit and enhanced funding for Channel 4, and greater powers for the regulator to ensure effective delivery of public service objectives where these are not in the commercial interest of the provider. One additional option would be to create greater flexibility for the public service institutions to deliver their remits across platforms, subject to regulatory approval.
- 4.52 As with other models where spectrum is used as a funding mechanism, further consideration should be given to means of ensuring that this asset is used efficiently. For example, it might be appropriate to open up competition for Channel 3 and Five licences to a wider set of potential bidders in 2014.

A refined BBC/Channel 4 model, with limited competitive funding

- 4.53 If we believed that ITV1's and Five's incentives can no longer be effectively aligned with public service purposes; that they would provide most of what they currently provide even without public service obligations; that the residual value of their regulatory assets was too small to add significantly to the delivery of public purposes; and that Channel 4 has the flexibility to adapt to audiences' changing needs, a refined **BBC/Channel 4** model with limited competitive funding would be the most appropriate. The BBC and Channel 4 would be the main recipients of public funding

and regulatory assets, with competition for funding for services that the BBC and Channel 4 were unable to provide sufficiently.

- 4.54 To ensure plural provision of nations and regions news services in this model, competition for delivery and funding by other providers could be introduced. Alternatively, Channel 4 could play a greater role in the nations and regions, although this may not be the most effective use of its public funding.
- 4.55 Channel 3 licensees and Five would lose public service benefits and obligations, but could potentially compete for funding or be allocated public funding directly to provide particular services such as nations and regions news (along with others); this could provide an opportunity for stv and UTV to continue to contribute. However if ITV plc chose to launch a UK wide service rather than continuing to operate in partnership with the national licensees, our analysis suggests their business models could face significant challenges without access to additional public funding.
- 4.56 In this model, Channel 4 would have a remit to innovate and provide distinctive UK content across platforms. Sources of secure funding for Channel 4 could include the switchover surplus, if retained in the licence fee settlement, direct government funding or a share of proceeds from an industry levy. Some or all of BBC Worldwide could be transferred to Channel 4's ownership, or Channel 4 could receive a share of its dividend. A further alternative, in this model in which ITV1 and Five are no longer public service broadcasters, is for Channel 4 to acquire their regulatory assets, including the 48.5% of the Digital 3&4 multiplex that is currently allocated to ITV1, and EPG prominence for second and third channels.
- 4.57 These and other possible approaches to funding for Channel 4 are discussed in more detail in section 6.

A refined competitive funding model

- 4.58 Finally, if we believed that audiences are likely to turn rapidly to new platforms and content providers; that Channel 4 should continue to play an institutional role but that new providers should also have an opportunity to contribute; and that competition for funding would help ensure its efficient use, a refined **competitive funding** model would be most appropriate.
- 4.59 In this model, additional funding would be opened up to a wide range of new providers through competition. Channel 4 would retain its existing regulatory assets but would receive no additional funding by right. It would be required to bid for funds to provide public service programming which exceeded the value of its existing regulatory assets. This would enable the existing Channel 3 licensees and Five to continue to contribute if they wished to bid for funding in place of their existing regulatory assets. Opportunities would also exist for new providers to compete for funds. We have described in more detail in Figure 21 above how we see a competitive funding model work. And in the next section we have set out an illustration of how a tender might be set out. (See Figure 29.)

Consultation questions

- 1) Do you agree that public service provision and funding beyond the BBC is an important part of any future system?
- 2) Which of the three refined models do you think is most appropriate?

- 3) Do you agree that in any future model Channel 4 should have an extended remit to innovate and provide distinctive UK content across platforms? If so, should it receive additional funding directly, or should it have to compete for funding?
- 4) Do you think ITV1, Five and Teletext should continue to have public service obligations after 2014? Where ITV1 has an ongoing role, do you agree that the Channel 3 licensing structure should be simplified, if so what form of licensing would be most appropriate?
- 5) What role should competition for funding play in future? In which areas of content? What comments do you have on our description of how this might work in practice?

Section 5

The models in the nations, regions and localities

Introduction

- 5.1 Audiences see the provision of news and information about where they live as among the most important of all areas of public service content. But evidence suggests it is highly unlikely that the current model will be able to deliver the desired level of plurality in programming for the nations, regions and localities in future.
- 5.2 This section describes the opportunities and challenges ahead for provision of content at nations, regions and local level. It explains how the three refined models set out in section 4 could deliver distinctive content for different areas of the UK. It explains the implications of this analysis for each of the devolved nations, including for provision of content in indigenous languages. And it describes how content could be provided at a much more local level in future, exploiting the potential of digital platforms.

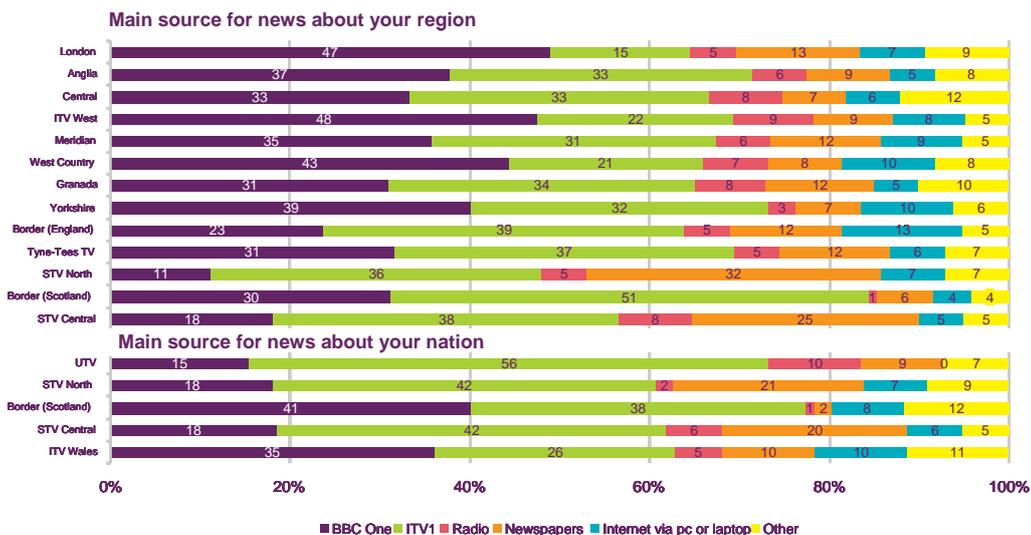
Meeting audience needs will require new funding

- 5.3 Research carried out for phase 1 of this review²⁸ showed that television is an important provider of news in the UK nations and regions. More than four fifths of people agreed with the statement that "TV is an important source of news about my nation/region", and this rises to more than 90% in each of the devolved nations.
- 5.4 The same survey showed that almost nine in ten people (88 per cent) thought it important that the main TV channels provide nations and regions news. When people were asked specifically whether it was important for ITV1 as well as the BBC to provide nations and regions news programmes, there were high levels of agreement with audiences in the devolved nations again more definitive than those in England.
- 5.5 Research undertaken for phase 2²⁹ supports the findings that television is an important source of nations and regions news and that plural supply is highly valued. When asked to choose their main source for nations and regions news, respondents named BBC One and Channel 3 most frequently. (See Figure 23.)

²⁸ See PSB Review phase 1 annex 5: *The audience's view on the future of PSB*. Quantitative survey among 2,260 people aged 16+ in the UK undertaken by Ipsos Mori, Oct – Dec 2007.

²⁹ See PSB Review phase 2 annex 16: *Regional news*. A quantitative report by Holden Pearmain. Among 3706 people aged 16+.

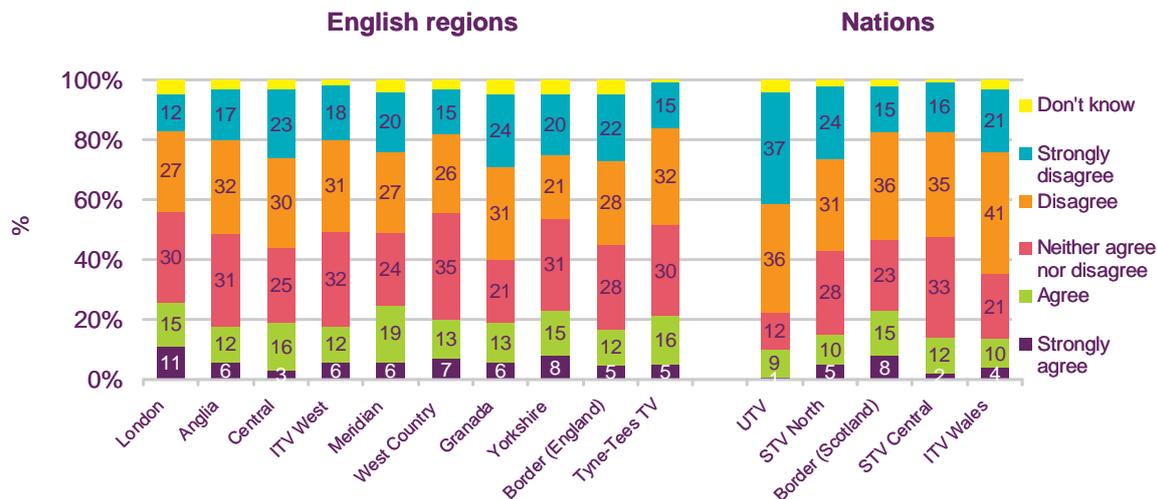
Figure 23: Main source for nations and regions news



Source: PSB Review phase 2 research into nations/regions news among 3706 people aged 16+ in the UK. Note: respondents are grouped based on ITV geographical regions, which differ from BBC regions. Minimum sample in any region = 200

5.6 Results from the same research shows that respondents in each English region and devolved nation believe that nations and regions news provision cannot be left solely to the BBC. (See Figure 24)

Figure 24: Agreement with statement 'I think it is enough for the BBC to provide nations/regions news, I don't need it on any other channel'



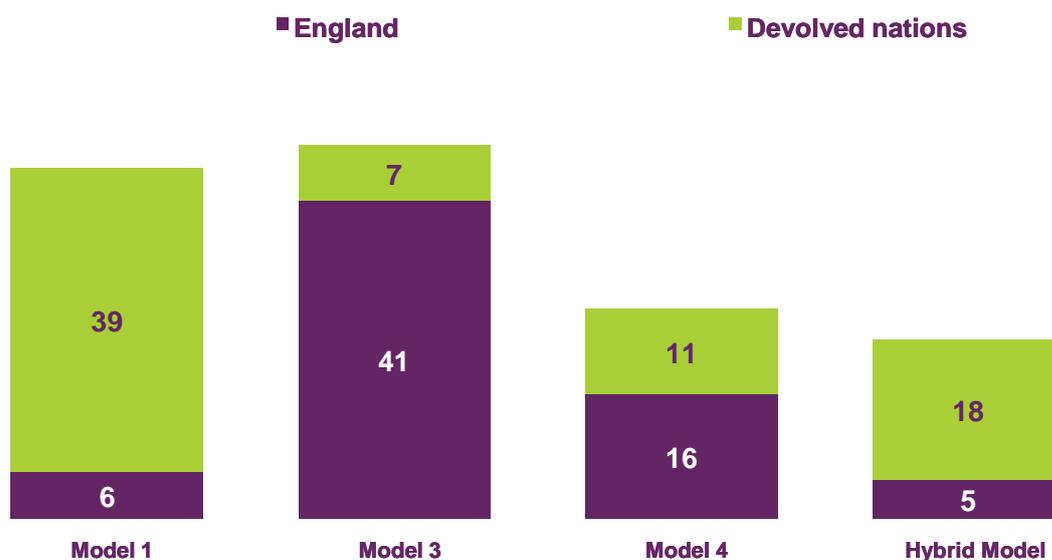
Source: PSB Review phase 2 research into nations/regions news among 3706 people aged 16+ in the UK. Note: respondents are grouped based on ITV geographical regions, which differ from BBC regions. Minimum sample in any region = 200

5.7 The phase 1 survey also identified that over three-quarters of people (78%) would like the main channels to show programmes that provide local news. New phase 2

quantitative research³⁰ supports the finding that people value local television news. When asked to prioritise different elements of nations and regions television news in terms of importance, “focus on my local area” consistently ranked highly in almost all the nations and English regions.

- 5.8 In broad terms, representation on UK networks is seen as consistently more important by those in the devolved nations, and somewhat less so comparatively by those in England. When the phase 1 survey asked specifically about whether it is important for ITV1 to show programmes that “are made in a variety of different parts of the UK”, 70% agreed, with responses higher in the devolved nations than in England.
- 5.9 New deliberative research undertaken for phase 2 on audiences’ reactions to the four future PSB models shows that participants in the devolved nations have different to people in the English regions - and favour a PSB model that retains a clear role for their Channel 3 licensee. Guaranteeing the continuation of stv, UTV and ITV Wales in their current forms was important for most participants in Scotland, Northern Ireland and Wales, and shaped reactions to each model. Channel 3 has a symbolic value in the devolved nations, beyond its PSB provision and is seen to represent national identity in ways which other TV channels do not. As a result, model 1: **evolution** was the preferred option in the devolved nations, as illustrated in the final votes for participants’ preferred model illustrated in Figure 25.

Figure 25: Final votes for preferred model, by nation



Source: PSB review phase 2: *The future of public service broadcasting – a deliberative research report*. Results are indicative only. Hybrid model covers participants own combinations of existing models.

- 5.10 Against this background, we assessed the prospects for achieving the vision for the future of PSB in the nations, regions and localities under possible future models proposed. Audience research suggests three specific requirements for the nations, regions and localities in addition to the general considerations set out in section 4. They are:

³⁰ See PSB review phase 2 annex 17: *Regional news*. A quantitative research report by Holden Pearmain. Among 3706 people aged 16+.

- sufficient content in the devolved nations to address their distinct political and cultural needs (including sufficient plurality); and similarly at regional and local levels;
 - portrayal of the different areas and communities of the UK in UK-wide programming; and
 - an appropriate level of output in indigenous languages.
- 5.11 Until now, and for the past 50 years, the federally structured Channel 3 network – based on separate regional licences - has been able to compete effectively with the BBC in both nations and regions news and in other programming for the nations and regions, including current affairs.
- 5.12 In the 1990s take-overs and mergers transformed this fully federal structure of 15 separate companies into the current much more centralised operation. The network now comprises ITV plc (11 licences) plus the three remaining non-ITV plc owned companies (two licences held by stv, and one each by UTV and Channel). The non-ITV plc companies receive the core network schedule through the ITV networking arrangements.
- 5.13 This system is sustainable so long as the benefits to ITV plc of PSB status significantly outweigh the obligations imposed. This will cease to be the case, at the current level of obligations, before the end of switchover. Multichannel growth has reduced the benefits of Channel 3 licences to the extent that ITV plc might have incentives to surrender its licences before the end of the current licence period (2014). In that eventuality, the non-ITV plc companies' access to the sustaining network schedule could be challenged, although that would not necessarily be the case.
- 5.14 Even without licence surrender, the current model may be unsustainable in commercial terms: ITV plc has signalled its wish to end what it regards as its subsidy of the network schedule in the devolved nations. Economic analysis suggests the non-ITV plc licensees could already be in deficit if ITV plc sought and obtained a higher contribution from them to network schedule costs. However, the other licensees argue that any subsidy does in fact run in the other direction. (See also section 7 and annex 1.)
- 5.15 It is against this background that future models for PSB need to be considered for the UK nations and regions. Along with children's programming, the pressures on commercial public service provision in the devolved nations may be the most immediate and most significant of any area of public service broadcasting.
- 5.16 In their responses to the phase 1 consultation, some stakeholders (e.g. stv, UTV) said that delivery of programming for the devolved nations must remain one of the core elements for any system of public service broadcasting. Stv said direct funding to preserve plurality in nations and regions programming had to be considered. It also proposed ring-fenced money for other Scottish programmes within a contestable fund; and support for a second stv channel on Freeview.
- 5.17 In its own consultation response, the BBC said intervention was justified to secure plurality in nations and regions news programmes (the only other area where the BBC saw such justification was in programmes for older children). Many other respondents to the consultation expressed the view that it would be regrettable if regions/nations news on TV became solely the preserve of the BBC. The Ofcom

Advisory Committee for Wales favoured the creation of a dedicated funding agency for Wales to support non-BBC PSB on TV, radio and online.

- 5.18 The issues thrown up by the models of public service delivery outlined in the phase 1 document are set out in Figure 26 below. The potential absence of ITV1/ Channel 3 as a PSB channel under three of those models exposes the lack of any obvious alternative provider of plurality. It is a key weakness in the BBC-only model (Model 2). In considering the other models - Evolution (model 1); BBC + Channel 4 plus limited competitive funding (model 3); and the competitive funding model (model 4) - we have sought to explore alternative ways to deliver programming for the devolved nations. But in the short-term these alternative options are unlikely to deliver content with the same reach and impact achieved today.

Figure 26: Issues for long-term models in nations/regions

Issues common to all nations/regions	Issues particular to one nation/regions
<ul style="list-style-type: none"> • Historical dependence on old ITV structure to deliver nations/regions plurality alongside the BBC • ITV plc offering no guarantee of any nations/regions programming from 2012 • ITV plc has suggested that non-ITV plc licensees pay a discounted rate for the network schedule that amounts to a subsidy from ITV plc; the other licensees argue that they in fact pay more than a fair price • Unclear where new funding for nations news might come from 	<ul style="list-style-type: none"> • Scotland: new funding likely to be required from 2010 to ensure continued plurality in Scottish news • Northern Ireland: range of possibilities for alliances with PSB/commercial channels in Republic of Ireland in addition to UK options • Wales: S4C already a large-scale market intervention, supporting Welsh production sector • England: biggest nation structurally, culturally, politically – no imperative for 'national' solution. Longer-term focus may be local

Source: Ofcom analysis

There are three refined models possible for the devolved nations

- 5.19 In the previous section, we argued that plurality of provision was sufficiently valued by audiences that a BBC-only model was unlikely to be sufficient. This argument holds particularly in the devolved nations, with their separate political, cultural, legal and educational arrangements. Research for phase 1 suggests this plurality should include news and, ideally, an appropriate amount of current affairs and other programming. It should also include representation of nations/regions at a UK level and output in indigenous languages.
- 5.20 The three refined models described in the previous section could meet these needs in different ways, detailed in the following sections. However, all of them would require new funding. It is currently unclear what the appropriate mix of funding from UK and devolved administrations should be; this has been highlighted by the Scottish Broadcasting Commission, which has argued that as public service broadcasting has historically been overseen and funded at the UK level, the UK should continue to fund provision for audiences in the devolved nations.
- 5.21 The three refined models represent a choice for the future provision of nations services, between:

- 5.21.1 continuing to use Channel 3 as the 'carrier' service for nations news and, potentially, other nations programming, in which case new funding is likely to be required; and
- 5.21.2 making funding available on a competitive basis for new services, possibly including new dedicated channels for Wales, Scotland and Northern Ireland, or possibly in conjunction with a role for Channel 4 or another broadcaster.

The refined Evolution model assumes a continuing relationship between ITV plc and the nations broadcasters, and requires new funding

- 5.22 The Evolution model was the preferred option amongst audiences in Scotland, Wales and Northern Ireland. Stv in Scotland, UTV in Northern Ireland and ITV Wales were seen as 'national channels' and a strong alternative to the BBC.
- 5.23 However, the much reduced benefits of PSB status after switchover cannot ensure delivery of existing levels of content. There will be continuing pressure from ITV plc to cut its public service obligations on out-of-London production, English regions news (its most expensive obligations), and Welsh content. Similar pressures will apply to UTV and stv in spite of the fact that news and non-news programmes for Northern Ireland and Scotland, respectively, are core to their offer. The Scottish Broadcasting Commission (SBC) final report goes further, to conclude that "the Scottish licences within the ITV system will not be a secure and sustainable source of public service competition to the BBC."³¹
- 5.24 Therefore, further reforms would be needed to ensure that the needs of audiences in the devolved nations were met. Possible options within an evolutionary model are:
 - restructuring the existing Channel 3 licences into five nations-based licences (England, Scotland, Wales, Northern Ireland, Channel Islands) alongside a requirement to review the level of contribution which each licensee makes to the network schedule as a function of its revenue earning potential, its regulatory benefits and obligations and the value it derives from membership of the network;
 - creating an affiliate system whereby nations providers partner with ITV or (potentially) other network broadcasters (e.g. Channel 4, Five); or
 - Channel 3 could be offered as a single UK-wide licence with appropriate obligations in the nations attached.
- 5.25 The existing model is entirely dependent on the ITV network schedule, and any of these options would require continued provision of a network schedule into which nations services could be incorporated. The alternative is to create a separate network, entirely independent of the existing broadcasters, as proposed by the Scottish Broadcasting Commission for Scotland. This is discussed in the context of the role of competitive funding below.

Restructuring the Channel 3 licences

- 5.26 Under this option, the Channel 3 licences could be simplified by moving to five nations licences to operate a 24-hour service in each case, with no breakfast time

³¹ *Platform For Success*: Final report of the Scottish Broadcasting Commission, September 2008

licence; or to a single UK licence, with an obligation to continue to provide dedicated services for each of the devolved nations.

- 5.27 In a scenario of nations based licences, the Scottish part of the Border region would be incorporated within an all-Scotland service. This is an approach supported by the Ofcom Advisory Committee for Scotland in its consultation response. Ideally, it might result in a three-region split (North, Central and Borders) within the Scottish licence. This might be more affordable if production facilities were concentrated in part in a national 'hub', while retaining news-gathering within the individual regions. However, the economics would be likely to militate against this.
- 5.28 It might be that the Welsh licence could be separated from the licence for the West of England. Such an approach was supported by the Advisory Committee for Wales in its consultation response, alongside its proposals for a dedicated Welsh funding agency.
- 5.29 Our analysis suggests further funding is likely to be required in order to ensure continued provision of nations and regions content, including news. In the refined Evolution model, providers in the devolved nations would be directly funded in order to maintain an ongoing role in nations news, as discussed in section 4.

Can an affiliate model work for Channel 3?

- 5.30 In phase 1, we proposed to explore the possibilities for new models of delivery post 2014, particularly affiliate models similar to those in the US. In an affiliate system, the network broadcaster would provide its network schedule at no cost to other nations, and sell advertising time throughout the UK within it. The nations licensees would sell airtime around their own output. Such an approach is supported by the Institute of Welsh Affairs.
- 5.31 To explore the potential of this model, we commissioned Oliver & Ohlbaum to analyse the feasibility of this form of commercial public service delivery. The analysis takes into account people's demand for national content and the market that currently delivers this. It makes comparative assessment of the suitability of the UK nations and regions advertising markets for the local affiliate model which is successful in the US. It then considers a range of affiliate models that could deliver public service programming. A full summary of the analysis is included in annex 12.
- 5.32 We asked Oliver & Ohlbaum to focus on Scottish services - particularly Scottish national news - as our analysis for phase 1 suggested that challenges to funding would likely emerge in Scotland ahead of other parts of the UK. Since Scotland is also the largest of the devolved nations we considered that new models might have the greatest chance of success in this market. While the analysis is focused on the Scottish market, the models for commercial public service delivery may also be applicable to the other UK nations.

Figure 27: Analysis of the potential for a Scottish TV service

Audience demand for commercial media with a Scottish focus is strong. Nearly twice as many Scottish consumers buy a newspaper each day as in England and Wales; and Scottish listeners consume 26% more commercial radio than the UK average - favouring local radio in Scotland at the expense of BBC national radio stations. TV demand is also high: Scottish viewers watch 10% more television than the UK average, and this is weighted toward commercial TV channels.

The Scottish advertising market is relatively large (£1.5bn) compared with its population size.

Heavy commercial media consumption levels, combined with strong demand for local Scottish content, has created a market with a healthy supply of commercial impacts, both across the market and particularly within Scottish press and local commercial radio. However, the press is not as strong as it was and revenue has declined in the sector in recent years.

Despite this, commercial television in Scotland appears to under-perform the local commercial media market and other UK regions. This is for a number of reasons:

- The vast majority of TV advertising expenditure (91.5%) is spent as part of UK-wide campaigns in network schedules. There appear to be relatively few advertisers wishing to target only TV viewers in Scotland.
- The cost per thousand of TV advertising on stv is lower than other ITV nations and regions, both for UK sales, and for regional sales, within the limited opt-out time available.
- Press and radio attract a greater share of local advertising available. Though facing structural changes in consumption, their cost per thousand is more competitive to advertisers than TV.

This indicates some potential to increase TV revenues if more local advertising inventory were to be available - and if more local advertisers wanted to buy it or switch to it from radio and print. This might be possible in a model closer to the local affiliate system that is successful in the US.

In this system, an affiliate station sells airtime around the local programming (typically news and some syndicated programming) that it provides, while a national network funds and sells airtime around the network schedule it provides to the affiliate, in some cases paying commission to the affiliate for carriage.

Analysis suggests that a US local affiliate model is unlikely to be feasible in the UK due to current key structural differences between the markets:

- The US has a legacy of TV stations broadcasting locally, rather than national TV stations. Several US local TV markets are larger in terms of number of households than the UK nations or regions, although many are not.
- In the US, advertising expenditure per head is almost double that of the UK. TV also takes a greater share of advertising revenues overall (32 %) compared with UK (22 %).
- Advertising in the US is often bought region by region, and there are large regional advertisers. 38 % of all TV advertising in the USA is locally generated, compared with 8.5 % that is locally generated in Scotland.
- The average US local affiliate attracts a high peak-time audience share (16 %) for its local output and broadcasts a high volume of this (around 5-6 hours per day). This allows stations both to spread the fixed costs of programming (news gathering) and also generate a high number of commercial impacts to sell.

In short, it appears that the relative scale of markets; the share of TV advertising; and the scale of operations all militate against a profitable Scottish affiliate model. Analysis of comparable markets in Europe suggests that local affiliate broadcasters almost always require very significant levels of public funding.

In conclusion, it is likely that the affiliate model could work only with a source of subsidy - either to its source of network programming, or to its non-network programming. The potential impact of different affiliate models on a Scottish affiliate and a potential network, as set out in the table below, has been tested.

Figure 28: Hypothetical affiliate modelling for Scotland

Option	Option outline	Impact on Scottish affiliate	Impact on Network
A. Base case	<ul style="list-style-type: none"> Existing Channel 3/stv arrangement 		
B. Simple affiliate option	<ul style="list-style-type: none"> Simple affiliate model where non-network affiliate retains all NAR generated around local programming Split national and local sales around both network and local schedule 	<ul style="list-style-type: none"> The NAR around non-network programming is unlikely to sustain a Scottish affiliate 	<ul style="list-style-type: none"> Network would be disincentivised to sell airtime around non-network output rather than network output where it retains revenues
C. Scottish affiliate option	<ul style="list-style-type: none"> Affiliate retains all non-network NAR (ITV retains network airtime) and the affiliate receives a subsidy/commission from ITV plc for access to the audiences 	<ul style="list-style-type: none"> Non-network TV advertising revenues are not high enough to sustain a Scottish affiliate without further subsidy 	<ul style="list-style-type: none"> Network retains greater proportion of revenues Network might have to pay a growing contribution to maintain Scottish affiliate
D. Independent PSB channel	<ul style="list-style-type: none"> Independent channel sources all programming independently, including local output 	<ul style="list-style-type: none"> Likely to require significant public subsidy 	<ul style="list-style-type: none"> Public investment presents some threat to Network's position in Scotland

5.33 Oliver & Ohlbaum's modelling draws the following conclusions.

5.34 A simple affiliate (option B) would transfer most advertising revenue - which is earned around network programmes - back to the network, making the loss on Scottish programming unsustainable. This would limit the benefits of the model to Scottish viewers.

5.35 A Scottish affiliate (option C) would necessitate an implicit and potentially growing contribution from the network to the affiliate for access to its audience. For a network such as ITV plc, the returns from this model are likely to prove too little, compared with the alternative of distributing and controlling all revenues for the network schedule in Scotland. However, for an alternative network – one with either lower audience share or revenues, or with limited or no distribution in, Scotland – the incentives to operate through an affiliate may be greater. If there is the potential to increase audience reach and share - or to access local advertising via an affiliate structure - a low implicit contribution may be acceptable.

5.36 Under option D, an independent Scottish PSB channel would be established. This is a key recommendation of the SBC report, although it goes beyond the assumptions

of the model here in specifying that the main channel should also be not-for-profit, with no commercial revenues.

- 5.37 The channel, which would need to fund both its own programming and an entire schedule to attract audiences, would require a significant direct public subsidy. This is the case for S4C in providing an entire Welsh schedule. The SBC suggests an indicative range for operating costs of £50-75m per annum. Oliver & Ohlbaum's model makes a similar estimate of £70m of public subsidy required. This subsidy is more than the current cost of network programming although it is likely to achieve a significantly lower audience share and impact.
- 5.38 The analysis suggests that it is unlikely that any of the affiliate models will be sustainable in Scotland without significant direct or indirect public support. This could come from a parent network, although this may be less likely in future; but could in future come from direct public funding either from the UK or Scottish government.
- 5.39 If such models do not work without public funding in Scotland, they are also unlikely to work in Wales, with its smaller population. They are only likely to work in Northern Ireland if the affiliate continued to be able to raise advertising revenue from access to audiences in the Republic of Ireland.

In other models, competitive funding may be the most appropriate approach, although Channel 4 could play an enhanced role

- 5.40 The provision of plurality in programmes for the UK nations and regions currently relies on ITV's federal structure. In the absence of ITV1, some new model will be required for delivering nations/regions programming.
- 5.41 One approach could be to use **competitive funding** to commission nations and regions news. Both existing providers such as stv, UTV and ITV Wales, and entirely new providers, or consortia of providers, could bid for these funds. It might open up new opportunities for local TV providers as well as other broadcasters.
- 5.42 Our illustration (see Figure 29) suggests it would be perfectly possible to design a tender specifying what content was required and how it should be delivered. Unlike other less measurable elements of public service broadcasting, it would also be comparatively easy to assess the delivery of such a service.
- 5.43 The weakness of all competitive funding models is the cost involved in achieving anything like the reach and impact currently achieved by the ITV nations/regions network.

Figure 29: Theoretical illustration of two bids to deliver nations, regions and local news

Contract Requirements	
<ul style="list-style-type: none"> • A cross-media nations, regions and local news service • Maximise levels of weekly reach (or equivalent impact) • Objective to drive up reach among young people. • Open to consortium bids, allowing different partners to bring different expertise • Six-year contract with up to two-year extension. • Potential for access to a slot on a digital terrestrial multiplex as part of the contract offer after 2014 • Reward of max of 10% of content budget - contingent on hitting performance targets. • Open to suggestions on how costs of delivering service can be minimised consistent with achieving reach and impact targets. • Demonstrated knowledge and experience of working within the Broadcasting Code 	
Bid 1: Former commercial PSB + online	Bid 2: Multichannel + online + local press
<p>Basis: Subsidy bid of £65m p.a. (£50m production cost & £15m opportunity cost)</p> <ul style="list-style-type: none"> • 5-minute bulletin at 18:25 on main channel linking to a further 25 mins on portfolio channel • Heavy cross-promotion between channels and other platforms from main channel • Using macro regions proposal to create a sustainable cost base • Simulcast online, active syndication (i.e. partnering) & open licensing (i.e. all takers) • Local/regional networking sites 	<p>Basis: Consortium of multichannel broadcaster and local press. Subsidy bid: £28m p.a. (£35m cost, £3m opportunity cost, £10m from RDAs/LAs)</p> <ul style="list-style-type: none"> • 30-minute nightly bulletin on broadcast channel; cross-promotion from other associated channels. • Content aggregated in collaboration with owners of local newspapers. • Proposal to assume control of some regional TV newsgathering infrastructures (ex-ITV?) • Simulcast of bulletins on local newspaper website + archive access • Greater emphasis on citizen journalism. • Additional funding through contributions from RDAs/local authorities

5.44 Alternatively, in the refined **BBC/Channel 4** model, Channel 4 could have a greater role in providing nations and regions content, either on its main channel, or on a portfolio channel such as More 4. The main benefit for supporters of the BBC/Channel 4 model – in the absence of ITV1 – was seen to be the reach and

impact that might be achieved through an institutional supplier, when compared with a model based solely on competitive funding.

- 5.45 The main disadvantages are that Channel 4 has no culture or heritage in delivering nations content, that its brand and audience profile differ significantly from nations and regions news on Channel 3, and that such an obligation would add significantly to its funding requirement at a time when its delivery of its remit already faces challenges. Charging Channel 4 with delivering programmes for the devolved nations could increase the overall funding requirement by a further £50-70m. It also seems clear that this model would deliver less reach and impact than the existing ITV network. The Scottish Broadcasting Commission report suggested that, currently, developing a Scottish service was “not high on [Channel 4's] list of priorities” and that Scottish viewers would feel less “ownership” of the Channel 4 brand than of a specific Scottish channel.
- 5.46 The deliberative research highlights some differences between audiences in the devolved nations and those in the English regions. Some participants in England believed Channel 4 might be able to produce high quality nations and regions news. Those in the nations were much more attached to stv, UTV or ITV Wales, and did not think Channel 4 had the capacity or expertise to fill the gap.

Particular issues arise in each of the four nations

- 5.47 This section reflects further on the particular issues for individual nations, in light of the analysis above.

Northern Ireland

- 5.48 As noted in phase 1 of the review, a key feature in Northern Ireland is the cultural and commercial scope for broadcasting on an all-island basis. RTÉ, and to a lesser extent other channels from the Republic of Ireland, which are widely available in Northern Ireland, already contribute to a greater degree of plurality than is found elsewhere in the UK. Ofcom's Advisory Committee for Northern Ireland, amongst others, recognised this contribution and asked that consideration be given to maintaining the availability of cross-border channels post switchover. Revenue generated from the Republic has, and may continue to retain significance for UTV, and contributes to a relatively sounder financial footing than the Channel 3 licensees based in Scotland and Wales.
- 5.49 Possibilities for development of new services may lie more in all-island solutions than in concepts of a ‘national’ channel, as in Scotland. Thus, were UTV no longer to form part of a Channel 3 network, outlets for its (or others) Northern Ireland content might well lie in association with other broadcasters on the island, rather than UK ones such as Channel 4 or Five. Given the high reach and impact of the UTV service (the highest for Channel 3 in the UK) UTV might be successful in carrying an audience with it to other distribution means. This however would be unlikely to deliver the reach and impact of UTV's Channel 3 service.
- 5.50 Were a competitive funding model to emerge in Northern Ireland possible bidders might come from established media groups and from the independent production sector.

Scotland

- 5.51 Funding issues in Scotland will become acute sooner – in relation to stv/Channel 3 – than in other nations. We believe that in order to maintain stv's services at or close to their current level, extra funding from public sources at the level of UK or Scottish Government will be needed - probably before any alternative structures of the kind mentioned earlier in this section are in place. Any future Channel 3 PSB licence, in an Evolution model after 2014, would be likely to cover the whole of Scotland including the South.
- 5.52 The SBC, among others, has proposed introducing a new Scottish channel, a proposition which merits further consideration, subject to the funding issues discussed earlier. Stv has also proposed alternative scenarios, including a new digital channel for Scotland, at times split into more localised services. This would have a mix of commercial and public funding.
- 5.53 Possible Scottish bidders for any contestable funding model within Scotland could be on a nation-wide basis or localised. Both the South of Scotland and Fife and Tayside local TV working groups, among others, have expressed interest in establishing local services.

Wales

- 5.54 Future models for Channel 3 based on the existing Wales and West of England licence or a future stand-alone Welsh licence would be unlikely to be viable. Were a future stand-alone licence to be held by ITV plc, some element of cross-subsidy from the English licence might continue to be possible. But otherwise, particularly if it were held by another licensee, some form of public funding would be required.
- 5.55 Wales has a thriving indigenous language, and a large and sustained public intervention in the market in the form of S4C. A refined **BBC/Channel 4** model could see S4C and Channel 4 operating side by side, with further competition introduced through an element of public funding. The Institute of Welsh Affairs and others have advocated a funding model heavily devolved to Wales, and possibly covering elements of funding to the BBC. Developing further English language programming is an objective, as is the development of local content. This could be addressed under a competitive funding model. A production sector has developed around S4C, with scope for further development at UK level, possibly in particular in the children's genre.

England

- 5.56 Factors unique to England are very different from the other nations. Powers devolved from central government are much more limited, and the sense of identity as a nation typically does not extend to a demand for England-only content. Audience interest in both regional and local content is strong, however, and roughly on a par for both types, although this varies from region to region. As noted above, it is possible that a new model might bring a role for Channel 4, working with partners, in regional news. But a wider competitive funding model could open up significant prospects for local content providers, a number of whom are active already – on a variety of platforms together possibly with screen agencies, local and regional government and local newspapers.
- 5.57 The production industry in England is heavily concentrated in London, and to a lesser extent in Leeds and Manchester. As in other nations, the BBC and Channel 4 have a

particular responsibility to improve the distribution of commissions and programme originations.

Channel Islands

- 5.58 Channel Television's business model is based on supplementary income from its ITV licence with income from complying (readying for broadcast in terms of the Ofcom Broadcasting Code etc.) programmes from independent producers shown on the network. The PSB licence is currently breakeven. If, either the rate paid by Channel for news to the ITV network schedule were to increase, or its substantial compliance income were to decrease, the viability of the licence would be under threat and public funding (from Channel Islands governments) might need to be considered.

Further considerations for the nations and regions

- 5.59 For all the models under discussion for the UK nations and regions, there needs to be some consideration of other forms of public service content (whether PSB or not). In particular, there is a need to consider requirements for content in indigenous languages in Scotland and Northern Ireland (Welsh is well delivered through S4C), and to consider the potential for **local content** (as opposed to services on a regional scale).
- 5.60 As regards **portrayal** of the different geographic communities of the UK there is an expectation amongst audiences in the nations and regions that their lives will be appropriately reflected on UK public service television by public service broadcasters. The promise of greater spend outside of London generally, as well as more specifically in the devolved nations, by both BBC and Channel 4 will contribute to addressing the concerns that exist in this area. (Please see annex 1.)

New opportunities are emerging for provision of local public service content, but public funding may be needed to exploit them

- 5.61 Until now, television at a local scale (city, town or community) has been significantly less widespread in the UK than in most other European countries. It has developed elsewhere because of factors that have not applied in the UK, such as high levels of penetration by local cable companies; a permissive approach to the informal use of terrestrial spectrum; and – perhaps most importantly – the existence of direct public funding.
- 5.62 Ofcom has considered how the potential for public service purposes to be developed at a local scale in the UK might become reality. Research carried out in connection with the Digital Dividend Review (DDR) identified audiences' interest in digital media services on such a scale – although there were also concerns about the likely quality of local TV.
- 5.63 Further research conducted by Ofcom in the light of ITV plc's plans for streamlining regional programmes³² also highlighted a public interest in news and information at a local level for many people. This is obtained at present mainly from terrestrial television and newspapers. But the development of digital television (including terrestrial) and other delivery platforms (e.g. broadband) has opened up fresh options for developing and delivering local content.

³²See PSB review phase 2 annex 16: *Regional news*. A quantitative report by Holden Pearmain. Among 3706 people aged 16+.

- 5.64 At present, around a dozen organisations hold licences that allow them to deliver local video content using analogue terrestrial broadcasting (Restricted Service Licences). However, a number of these terrestrial licensees are not active. Among the more notable local TV channels in the UK are Channel M in Manchester (backed by Guardian Media Group); Northern Visions in Belfast (supported by arts/education grants); and MATV in Leicester (targeting the South Asian ethnic group). Most local channels produce limited volumes of new output each week.
- 5.65 There have also been a number of attempts to offer local TV via cable networks. Most of these have been unsuccessful. The sole survivor is Channel Seven in Immingham, a community-based not-for-profit model on cable. In Manchester, Channel M is distributed using the satellite, cable and terrestrial platforms.
- 5.66 Through the Digital Dividend Review (DDR), we will create new opportunities for current and potential local TV operators to gain access to spectrum. In our December 2007 statement on the approach to awarding the digital dividend³³, we set out our decision to adopt a market-based approach to awarding most of this spectrum. Our analysis showed that if we released only UK-wide packages of spectrum, local TV operators would find it difficult to coordinate a bid. So we responded to the demand suggested by our research by deciding to package some spectrum in geographic lots, based on main transmitter sites serving major towns and cities including where local TV operators already provide analogue services.
- 5.67 We have now identified up to 81 potential geographic lots of spectrum that could be released in this way. These lots are drawn from the interleaved (white space) spectrum within frequencies that are 'in-group' (i.e. services can be delivered to viewers without altering TV aerials). However, more work is needed to finalise this list.
- 5.68 We considered arguments for intervening more extensively, to reserve spectrum exclusively for local TV across the UK, and decided against this approach. It would have a high opportunity cost, displacing other potential uses of the spectrum that could generate high value for citizens and consumers. It would not ensure that local TV was economically viable. And it would reduce incentives to use spectrum efficiently. We therefore decided that the spectrum should be released in a way that would allow users to decide the use of spectrum by making the spectrum rights flexible and tradable, and awarding them by auction.
- 5.69 Further spectrum suitable for local TV may also become available through the 'band manager' arrangements we have proposed to meet the spectrum needs of programme making and special events (PMSE)³⁴. In many areas of the country, the interleaved spectrum available could exceed demand from PMSE.
- 5.70 Alongside these considerations about terrestrial TV, major broadcasters (the BBC and ITV) have begun developing broadband as a medium for local content services, offering an element of linear scheduling alongside text, interactive, and on-demand content. ITV Local provides services covering England and Wales, and the BBC has proposed to launch local video services for 60 or so centres based on local radio footprints across the UK. Elsewhere, Kent TV is delivering video content online, as are some other smaller scale ventures funded through local authority grants. Local newspaper groups are also increasingly looking to broadband ventures including on-demand video streams.

³³ www.ofcom.org.uk/consult/condocs/ddr/statement/statement.pdf

³⁴ www.ofcom.org.uk/consult/condocs/bandmgr/condoc.pdf.

- 5.71 Ofcom's *Digital Local*³⁵ report in 2006 identified the great potential for broadband delivery of local content services. This platform provides significantly enhanced opportunities for on-demand content and interactivity alongside any elements of linear delivery, and could be a more cost-effective means of distributing local video content. Broadband is likely to be more significant in future, as convergence leads to online and terrestrial content being delivered through the same living room TV sets.
- 5.72 The main unresolved question may be whether funding models for local video content services are sufficient to exploit the opportunities now opening up on DTT and broadband. It must be a matter for potential providers to evaluate the business case for local services. However, the evidence available to date suggests that the economics of local content services could be challenging. Local content providers in the UK will be operating in a competitive market where audiences can choose from many alternative sources of video content, and advertisers can choose many alternative media, including local newspapers and online listings and exchange sites.
- 5.73 Views vary on the likely commercial viability of local television. Economic modelling carried out for *Digital Local*, suggested that city-scale operations could be commercially viable on DTT and other platforms, particularly if they are part of a mini-network of stations run by a single company. In any event these operations may have limited budgets for the creation of new content.
- 5.74 MTM's analysis for this review of online business models for local content concluded that a new layer of local and 'hyper-local' content could emerge from local businesses and user communities, and that regional and local newspaper groups were increasingly investing in broadband offerings including video and user-generated content. However their analysis suggested that it was currently unclear whether these models would prove commercially sustainable.
- 5.75 It is therefore likely that at minimum smaller local TV stations and community models will need to attract public or voluntary funding in order to be viable. In our second and third refined models, new competitive funding could be used to secure local content services. Alternative sources might include regional development agencies and local authorities.
- 5.76 One further issue is whether the BBC's proposals for local video services will go ahead. This is ultimately a decision for the BBC Trust, informed by a market impact assessment carried out by Ofcom, which will be completed later this year.

Indigenous language broadcasting will benefit from the transition to digital

- 5.77 Indigenous language broadcasting forms an important part of the public service broadcasting ecology of the nations of the UK, reflecting aspects of our cultural heritage unique to these islands.
- 5.78 There are seven officially recognised UK indigenous languages - Welsh, Gaelic, Irish, Scots, Ulster Scots, Manx and Cornish³⁶.
- 5.79 The Communications Act 2003 places obligations on Government, Ofcom, the Welsh Authority and MG Alba (formerly Gaelic Media Service) relating to broadcasting in

³⁵ http://www.ofcom.org.uk/tv/psb_review/digital_local/

³⁶ The European Charter for Regional or Minority Languages was signed by the UK in 2001. Part III Status (Gaelic, Irish and Welsh) includes a range of actions in the area of broadcasting. Part II Status (Scots, Ulster Scots, Manx and Cornish) provides general levels of protection. The Charter excludes the languages of migrants.

Welsh in Wales and Gaelic in Scotland. In addition, the Belfast/Good Friday Agreement 1998 includes broadcasting commitments concerning the availability of TG4 in Northern Ireland and support for Irish language film and television production in Northern Ireland.

- 5.80 Indigenous language broadcasting is one of the few forms of public service broadcasting which receives funding directly from government. The nature and amount of funding for each language varies considerably as does the source, and although broadcasting is a reserved matter, in the case of indigenous languages the devolved administrations sometimes play a role.
- 5.81 The BBC also makes a sizeable contribution to indigenous language broadcasting but again this contribution varies by language.
- 5.82 The result is that there is a different model in use for broadcasting each of the languages. The languages with European Charter Part III Status feature a combination of public funding coupled with input from the BBC.

Figure 30: Comparative data on indigenous languages

	Welsh	Gaelic	Irish ³⁷	Ulster Scots
European Status		Part III (specific broadcasting requirements)		Part II (general requirements only) ³⁸
UK Status	Welsh Language Act 1993 (Westminster)	Gaelic Language (Scotland) Act, 2005	Belfast/Good Friday Agreement 1998 (broadcasting commitments)	Mentioned in Belfast/Good Friday Agreement, 1998
Language ability	580,000 speakers – 20.8% (2001 Census)	92,000 - 2% have some Gaelic language ability; 2% c 60,000 fluent speakers (2001 census)	167,500 have some knowledge - 10% in NI (2001 Census) 1.6m - 42% in RoI (2006 Census)	30,000 – 100,000 + or 2% - 6% (no question in 2001 Census) ³⁹
Public Funding (per year)	£94m – DCMS to S4C	£12m - Scottish Government to MG Alba (formerly GMS)	£3m via DCAL to ILBF until 2009, from UK Government 2009 - 2011	DCAL funded but not for broadcasting ⁴⁰
BBC/PSB input (per year)	c. 520hrs of content to S4C (value £22.5m)	£9.7m funding in content	£950,000 of content from BBC NI from 2009 (365hrs from RTÉ to TG4 in RoI)	£400,000 of content from BBC NI from 2009
Channel Availability	S4C analogue; S4C Digidol/S4C2 on all platforms	BBC Alba launching Sep 2008 on dig sat, dig cab & FreeSat TeleG - DTT BBC Scotland/stv - all platforms	BBC NI - all platforms TG4 and RTÉ from RoI available in NI on analogue spillover, dig sat and dig cab TG4 - also analogue boost from Divis	BBC NI – all platforms (and BBC Radio Ulster)
	Ofcom's <i>The Future of DTT</i> proposed making space on PSB mux for S4C in Wales, GDS (BBC Alba) in Scotland and TG4 in NI			
Content	S4C - 6hrs daily S4C Digidol - 12hrs daily S4C2 - Welsh Assembly	BBC Alba - up to 7hrs daily TeleG - 30-60 mins per day stv - 2hrs per week	BBC NI - 12 hrs for whole of 2007 TG4 - 6hrs min. daily	BBC NI - 5hrs for whole of 2007

³⁷ A minority language only in UK - official language of RoI and official working language of EU

³⁸ Also applies to Scots, Manx and Cornish

³⁹ 30,000 or 2% (NI Life & Times Survey, 1999; more according to other sources including the Ulster Scots Agency

⁴⁰ Ulster Scots Agency supports some short-term RSLs

Welsh

- 5.83 Of all the languages, Welsh has the largest number of speakers and the future of broadcasting in Welsh seems to be the most assured. The Welsh Assembly Government said that broadcasting in the Welsh language had generated a range of public benefits and had significantly contributed to making Wales a bilingual society; none of the respondents sought any changes to the current arrangements.
- 5.84 In 2006 S4C and the BBC agreed a 'Strategic Partnership', which included a funding commitment from the BBC of £22.9 m in 2007 for its statutory supply to S4C, rising to £25.1m in 2009. The partnership also made provision for the BBC Trust and the S4C (Welsh) Authority to agree programme commitments and core obligations in line with both the BBC's public purposes and Charter obligations and S4C's programme strategy. In June S4C launched the first phase, Cyw, of its proposed enhanced provision for children. Further services may require digital capacity on DTT, possibly replacing the S4C-2 service, which currently carries bilingual coverage of the National Assembly and other events. (Unlike S4C Digidol, S4C-2 is not a PSB service but a commercial channel licensed by Ofcom.)

Gaelic

- 5.85 The launch of a new Gaelic digital service, BBC Alba, which is supported by partnership arrangements between BBC Scotland and MG Alba is a major boost for Gaelic broadcasting in Scotland and was widely welcomed by respondents. However, concerns were expressed, including by the Scottish Government, at the BBC Trust's decision not to agree to the carriage of the new service on DTT until the channel should prove its ability to appeal to an audience beyond the core Gaelic speaking one. The decision will be made prior to digital switchover in the stv area in 2010. Ofcom has asked the Trust for transparency in how it evaluates whether the service might be carried on DTT. Future funding was a concern too, with more than one respondent saying that it needed to be index-linked. There was also a call from the Scottish Parliament's Cross Party Group on Gaelic that the new channel be given PSB status.
- 5.86 The 1990 Broadcasting Act requires Channel 3 licensees in Scotland (stv Central and stv North) to broadcast programmes in Gaelic - currently one hour per week of licensee-funded programming (which forms part of the shared minimum non-news requirement) and one hour of MG Alba-funded Gaelic programmes (not part of the non-news requirement).
- 5.87 We believe that stv's Gaelic obligations need to be considered within the context of the Channel 3 service for Scotland as a whole and should strike the right balance between English language and Gaelic programming. We propose, subject to the relevant legislative changes being made, that stv should lose its requirement to broadcast licensee-funded Gaelic as well as the requirement to broadcast MG Alba-funded Gaelic in peak from 2009 but should continue to broadcast one hour per week of MG Alba-funded programming until switchover in Scotland is complete (Please see annex 1).

Irish

- 5.88 The Government is committed to making TG4 available on DTT in Northern Ireland at DSO in 2012. The Irish Language Broadcast Fund received additional funding of £6 m in June from the UK Government, but only for a further two years until 2011. This was a matter of concern for many respondents who pointed to a lack of equity in the

funding arrangements for the broadcasting of Irish in Northern Ireland – whether on the part of government or the BBC – as compared to those in place elsewhere in the UK for other indigenous languages.

- 5.89 BBC Northern Ireland's contribution to Irish language programming is set to double over the next three years, admittedly from a low base. As regards partnerships, it hopes to work more closely with the ILBF and with colleagues in BBC Scotland as appropriate; there is still the potential for greater co-operation with TG4.
- 5.90 These various developments mean that viewers in Northern Ireland have a wide choice of Irish language programming available to them - from BBC Northern Ireland, TG4 and, for those with access to it, from RTÉ as well. However, public funding for Irish language programming in Northern Ireland remains uncertain in the long term.

Ulster Scots

- 5.91 Ulster Scots is a variant of Scots and has a similar status in Northern Ireland as Scots in Scotland (Part II European Charter recognition and some use by the devolved authorities). Many within the Ulster Scots community believe that a sense of Ulster Scots identity is as likely to be based on an association with wider cultural factors as with language and that broadcasting should reflect this and not just capture Ulster Scots language.
- 5.92 BBC Northern Ireland is producing, and intends to produce more material in Ulster Scots and relating to Ulster Scots than ever before.
- 5.93 Ofcom's Advisory Committee for Northern Ireland believed that coverage of Ulster Scots cultural activities should be acknowledged as Ulster Scots content and that Ulster Scots would benefit in terms of profile and self-esteem from being mainstreamed in Northern Ireland broadcasting.

Conclusion

- 5.94 Viewers of indigenous language programming have access to more and higher quality content than ever before, provided by a vibrant production community, based both within the BBC and in the independent sector. However, there is perceived concern at the lack of consistency and equity, and sometimes certainty, in the current arrangements for funding and delivery which are in place in different parts of the UK. Circumstances differ from nation to nation and language to language and an entirely uniform approach would be inappropriate; nonetheless, many respondents believed that indigenous language broadcasting would benefit from a UK-wide strategy.

Consultation questions

- 1) Do you agree with our findings that nations and regions news continues to have an important role and that additional funding should be provided to sustain it?
- 2) Which of the three refined models do you think is most appropriate in the devolved nations?
- 3) Do you agree with our analysis of the future potential for local content services?

Section 6

Funding options

Introduction

- 6.1 Our phase 1 consultation document recognised the declining value of implicit subsidies for commercial PSB. It concluded that new sources of funding would be required to maintain the plural supply of public service broadcasting content.
- 6.2 We identified four possible sources of additional funding:
- regulatory assets;
 - the licence fee;
 - industry levies; and
 - direct government funding.
- 6.3 Since the phase 1 consultation document was published, we have received a variety of stakeholder responses on these funding sources. We have reviewed the future need for funding in the light of our further analysis and the evidence provided by stakeholders. We have also examined public attitudes towards potential funding sources using deliberative consumer research and have conducted quantitative research on viewers' attitudes towards different funding sources.
- 6.4 This section begins with an analysis of the amount of funding which is likely to flow out of public service content over the next few years and concludes that additional funding is likely to be required to meet audiences' needs. It then considers each funding source in turn to assess its merits and drawbacks bringing together stakeholder responses, consumer research and additional Ofcom analysis and concludes with a comparative analysis of the sources.
- 6.5 This section concludes with a discussion of possible approaches to the future funding of Channel 4.

Estimating the cost of future provision of public service content

- 6.6 In phase 1 of the PSB Review, we set out changes to the levels of direct and indirect funding available for public service broadcasting (See Figure 31). We estimated that the commercial PSBs' investment in content to deliver their remits had declined by around a quarter – from around £520m to around £390m – between 2003 and 2007. We also estimated that the value of funding looked likely to fall even more rapidly through digital switch over to around £185m by 2012, roughly half of the 2007/08 level or a third of the 2003 level.

Figure 31 Funding available for investment in public service content under the current model, 2003-2013, £ million (2007 prices)

	2003/04	2007/08	2012/13
BBC Television and Online	2,700	2,865	3,010
S4C/MG ALBA	105	110	110
ITV plc	180	140	45
Channel 4	175	175	80
Five	40	50	50
Other licensees	25	25	10
Total	3,325	3,365	3,305
Commercial PSBs	520	390	185

Note: BBC data for financial years 2003/4, 2007/8, 2012/13; others for 2003, 2008 and 2013 respectively

Source: Ofcom estimates, BBC annual reports, financial data from broadcasters

- 6.7 Preliminary analysis in phase 1 suggested that the reduction in the value of commercial funding would have most impact on certain types of programming. These include nations and regions news and UK children's programming - unprofitable genres where the commercial public service broadcasters have already either made, or are proposing to make, reductions in their output on their main channels. In the short to medium term, other genres that are likely to come under similar pressure include specialist factual programming, international and investigative current affairs, UK scripted comedy and challenging UK drama. All of these have direct links to delivering the PSB purposes.
- 6.8 Our recommendation in phase 1 was that new funds should be found to replace the decline in indirect funding where this puts commercial investment in programming at risk. The previous section also highlights the areas that for audiences are a priority for PSB investment.
- 6.9 Since phase 1, we have carried out further analysis to assess the level of additional investment that would be required to meet audiences' needs in future. Given the degree of uncertainty about audiences' changing needs and market evolution. It is impossible to specify exactly how much funding of public content might be necessary in the long term. But it is possible to put a figure on the loss of value of commercial investment in the short to medium term. This analysis needs to be by genre rather than by public service purpose as programme economics vary largely by genre.
- 6.10 To quantify the shortfall in commercial investment, we asked Oliver & Ohlbaum to carry out a three stage analysis:
- first, to identify the level of investment the commercial PSBs would be likely to make in a range of different types of programming in future, based on their

relative profitability, including an assessment of the primary and secondary revenues different types of content are likely to earn;

- secondly, to identify the amount of content audiences would want assuming that current demand does not change (while this is an over-simplified assumption, it is impossible to predict how audiences' needs might change in future); and
- thirdly, to assess whether the wider market is likely to make a greater or lesser contribution to each type of content in future.

6.11 The analysis has been conducted on two of the different scenarios set out in phase 1 – gradual transformation and stagnation – to allow analysis under different market conditions, and at two different time-points – 2012 and 2015 – to allow analysis for the short and medium term.

6.12 Oliver & Ohlbaum's analysis of profitability broadly supports their initial findings in phase 1. While variations between individual broadcasters on the profitability of different types of programmes will continue, the genres that are likely to be increasingly unprofitable are fairly consistent across broadcasters: UK single drama, UK comedy, UK children's programming, documentaries, current affairs, education and regional and national news. The availability of secondary revenues and the ability to distribute content over a number of channels and platforms is likely only to offset, rather than prevent, reductions in the first three genres. Commercial PSBs are likely to seek to reduce greatly or cease provision in the other genres.

Figure 32: Analysis of gross margin, by genre, in 2012 / 2015 under scenarios

	Analysis of Gross Margin 2012 / 2015 by Scenario			
	Gradual Transformation		Stagnation	
	2012	2015	2012	2015
Factual Entertainment	Very Profitable	Profitable	Profitable	Profitable
Entertainment	Profitable	Profitable	Profitable	Marginally Profitable
Feature Films	Profitable	Profitable	Profitable	Marginally Profitable
Acquisitions	Profitable	Profitable	Profitable	Profitable
Major Sport	Marginally Profitable	Marginally Profitable	Marginally Profitable	Marginally Profitable
Other Sports	Profitable	Profitable	Profitable	Marginally Profitable
UK Drama (Soaps)	Very Profitable	Very Profitable	Very Profitable	Profitable
UK Drama	Profitable	Marginally Profitable	Marginally Profitable	Marginally Unprofitable
UK Comedy	Marginally Profitable	Unprofitable	Unprofitable	Unprofitable
National News	Marginally Profitable	Marginally Profitable	Marginally Profitable	Marginally Unprofitable
Regional News	Unprofitable	Unprofitable	Highly Unprofitable	Highly Unprofitable
Current Affairs	Marginally Profitable	Marginally Unprofitable	Marginally Profitable	Unprofitable
Documentaries	Profitable	Marginally Profitable	Marginally Profitable	Unprofitable
UK Children	Unprofitable	Highly Unprofitable	Highly Unprofitable	Highly Unprofitable
Religion	Marginally Unprofitable	Marginally Unprofitable	Unprofitable	Unprofitable
Arts	Marginally Profitable	Marginally Unprofitable	Marginally Unprofitable	Unprofitable
Educational programming (non schools)	Unprofitable	Unprofitable	Unprofitable	Unprofitable

Source: Oliver & Ohlbaum analysis

- 6.13 In some of these genres, such as children's programming, reductions in investment have already occurred. As noted in phase 1, the exceptions may be where a genre becomes less profitable (e.g. national news) or unprofitable (e.g. UK innovative drama or comedy) in itself but remains important for the channel brand or to maintain broad audience scale to the schedule. However, in the future the loss that such a decision implies will increase and the situation may be reappraised.
- 6.14 Audiences' priorities may also change, but our research at this point suggests that audiences would prioritise UK children's content and documentaries for investment above current levels. By comparison, religion or arts may be lesser priorities. In other areas, our research suggests audiences want broadly the same level of provision as they get today.

- 6.15 Growth in delivery by the wider market may partially offset reductions by the commercial PSBs in some “unprofitable” genres, such as UK drama, UK comedy and some factual categories, but this is likely to be limited. In most cases, multichannel broadcasters lack the scale to invest significantly in these relatively high-risk genres.
- 6.16 Taking these factors into account, Oliver & Ohlbaum estimated the difference between the level of investment that the commercial PSBs would make in each area of content in 2012, and the level of investment that would be required to meet audiences’ present-day needs. This ‘shortfall’ for each area of content is shown in Figure 33.
- 6.17 Clearly these are highly provisional, indicative estimates. They are necessarily subject to a wide margin of error. These estimates represent a like-for-like replacement of investment for broadly the same level and kind of linear TV programmes broadcast today. Under a number of scenarios, it is possible that the value of funding required to achieve particular purposes could vary significantly depending on a range of factors related to audiences’ needs, funding models and means of distributing content. For example, delivery on non-linear platforms may have very different operating and opportunity costs compared with mainstream linear TV channels.
- 6.18 Nonetheless these estimates provide an indication of the level of additional funding that may be required to meet audiences’ needs in some scenarios. The analysis suggests that the potential shortfall in commercial provision could be between £145 million and £235 million by 2012. By 2015 this shortfall could be between £170 million to £280 million as more genres become less profitable. The shortfall could be greater in scenarios in which there is much more rapid fragmentation of audiences.

Figure 33: Potential shortfall in commercial PSBs' investment by genre in 2012 / 2015, under different scenarios⁴¹

	Potential Reduction in Commercial Investment 2012 / 12 by Scenario			
	Gradual Transformation		Stagnation	
	2012	2015	2012	2015
UK Drama	£27m	£24m	£46m	£52m
UK Comedy	£4m	£3m	£8m	£9m
National News	£5m	£5m	£15m	£20m
Regional News	£50m	£75m	£75m	£100m
Regional Non News	-	£12m	£12m	£12m
Current Affairs	£3m	£3m	£6m	£6m
Factual/ Documentaries	£20m	£15m	£33m	£40m
UK Children	£35m	£33m	£38m	£38m
Religion	-	-	-	-
Arts	-	-	-	-
Education	£1m	£1m	£2m	£2m
Total	£145m	£171m	£235m	£279m

Source: Oliver & Ohlbaum analysis

- 6.19 This shortfall assumes that the PSBs retain their existing regulatory assets, and that Administered Incentive Pricing (AIP) is not levied on their use of spectrum. These assets will fund investment of around £185 million in public service content by the commercial PSBs in 2012. Beyond 2012, the value of these assets is increasingly uncertain. The shortfall in investment could be greater if the PSBs did not retain these assets, or if AIP is levied from 2014.
- 6.20 This implies that by 2012 the total level of investment by commercial PSBs needed to deliver what audiences tell us they want might be somewhere between £330m and £420m, depending on trends in the advertising market, audience fragmentation and market provision. By 2015, this could rise to between £355m and £465m. This compares with current investment of around £390m (see figure 31).
- 6.21 Any additional funding could theoretically run the risk of crowding out – that is, displacing investment by commercial broadcasters that would have taken place absent public funding. The Satellite and Cable Broadcasters Group (SCBG) submitted to us analysis prepared by Deloitte of the potential impact on cable and satellite broadcasters of increased funding for public service content that sheds light on this risk.

⁴¹ This chart takes into account audience priorities and the potential contribution from multichannel broadcasters

- 6.22 While Deloitte's analysis recognises the uncertainty regarding how new models might be put into practice, and how the market might evolve, it suggests that the impact of additional funding on cable and satellite broadcasters is likely to be relatively limited. In a hypothetical scenario in which both ITV1 and Channel 4 receive an additional £100m a year in direct or indirect funding from 2012, the combined revenues of SCBG's members could fall by £29m a year, resulting in reductions in their investment in UK content by around £13m a year (on average).
- 6.23 In a second hypothetical scenario in which Channel 4 receives an additional £500m per annum, Deloitte estimates that the impact on SCBG members' revenues would be around £37m a year, resulting in a £17m per annum reduction in their UK content investment.

No funding option is a clear favourite amongst audiences or stakeholders

- 6.24 In deliberative research with members of the public, no one funding option emerged as a complete or fair solution. Instead, participants like the idea of using two or more options jointly to fund public service content. The same can be said of stakeholders who, through their responses to Ofcom, revealed different preferences.

Figure 34: Public attitudes to funding sources for public service content

In the phase 2 deliberative research conducted by Opinion Leader⁴² participants were presented with a range of possible ways of funding the required increased investment to provide PSB on channels other than the BBC. These were

- Direct funding from central or local government via taxes, or national lottery funding
- The licence fee (it was first of all made clear to participants that the current licence fee funds the BBC services only)
 - Taking the switchover surplus⁴³ and either redistributing it to other channels or using for BBC programming.
 - Redistributing some of the existing licence fee to cover costs of PSB on channels other than the BBC which could affect the BBC.
 - Increasing the existing licence fee to cover the costs of PSB on channels other than BBC.
- A charge on industry organisations.
- Increasing the amount of advertising that the commercial PSB channels show.
- Using gifted spectrum.

Understandably, most members of the public were not actively keen to pay extra on top of the current licence fee to fund public service content in future. However, they recognised the

⁴² See PSB review phase 2 annex 7: *The future of public service broadcasting*. A deliberative research report by Opinion Leader.

⁴³ Participants were informed that from the start of 2008 the current licence fee increased by 50p a month per household and the money is used to help older and disabled people prepare for digital switchover. After 2012 this money could be used in other ways.

value of this provision and believed that the benefits of maintaining public service provision beyond the BBC outweighed the costs to them. They were also realistic, believing that a change to the way PSB is funded would ultimately cost the public something, whatever funding mechanism was used. Many accepted this as fair given they believed that a new model of PSB delivery would benefit the public.

Participants did not believe that any single funding option was a complete and fair solution and therefore they supported the idea of using two or more options jointly to fund PSB in the future. Overall, participants were in favour of mechanisms which would involve the public paying directly to fund PSB in the future (i.e. through the licence fee) rather than indirectly (i.e. through taxation) as they wanted to ensure there was a direct and transparent link between the amount viewers paid and the amount being spent on PSB programming.

The options to use the licence fee (potentially through an increase) or to levy a charge on industry were seen as the most appropriate long-term solutions, although there was also support for using gifted spectrum while it is a viable solution. Figure 35 summarises participant attitudes towards the funding mechanisms.

Figure 35: Participant attitudes towards funding mechanisms

	Appropriateness	Reasons why
Licence fee	High	<ul style="list-style-type: none"> Perceived to be one of the most appropriate long-term solutions Provided clear and direct relationship between funding and PSB obligations Given association with television, seen to be appropriate means to fund PSB on non-BBC channels Considerable support for licence fee switchover surplus to fund non-BBC PSB, particularly as participants thought public would not expect money back Mixed views on increase to licence fee - some believed it small price to pay for PSB, whereas others were anti-licence fee anyway Idea of giving some existing licence fee to other providers not controversial. May in part be due to participant uncertainty about what the licence fee currently funds. However, once informed licence fee funded BBC only, participants still open to the idea But minority though commercial PSBs should not get funding given ability to raise funding elsewhere
Industry levy	High	<ul style="list-style-type: none"> One of the most appropriate long-term solutions Perceived as a fair way to fund PSB by taking money from industry to reinvest into industry (although there was a belief that ultimately consumers would pay)
Gifted spectrum	High	<ul style="list-style-type: none"> High support as would not cost the viewer anything directly But not perceived as sustainable long-term funding option as value declining
Increased advertising	Medium	<ul style="list-style-type: none"> Mixed views; some participants supported it as it would not cost the viewer anything, whereas others were against as could detract from enjoyment of watching TV Not perceived as sustainable long-term funding option as value declining
Direct public funding	Low	<ul style="list-style-type: none"> Lottery perceived to be for distinctive purpose and participants thought there were 'better causes' the money should go to Against general taxation as thought it was too high currently, general lack of trust in taxation, and not transparent enough as a mechanism

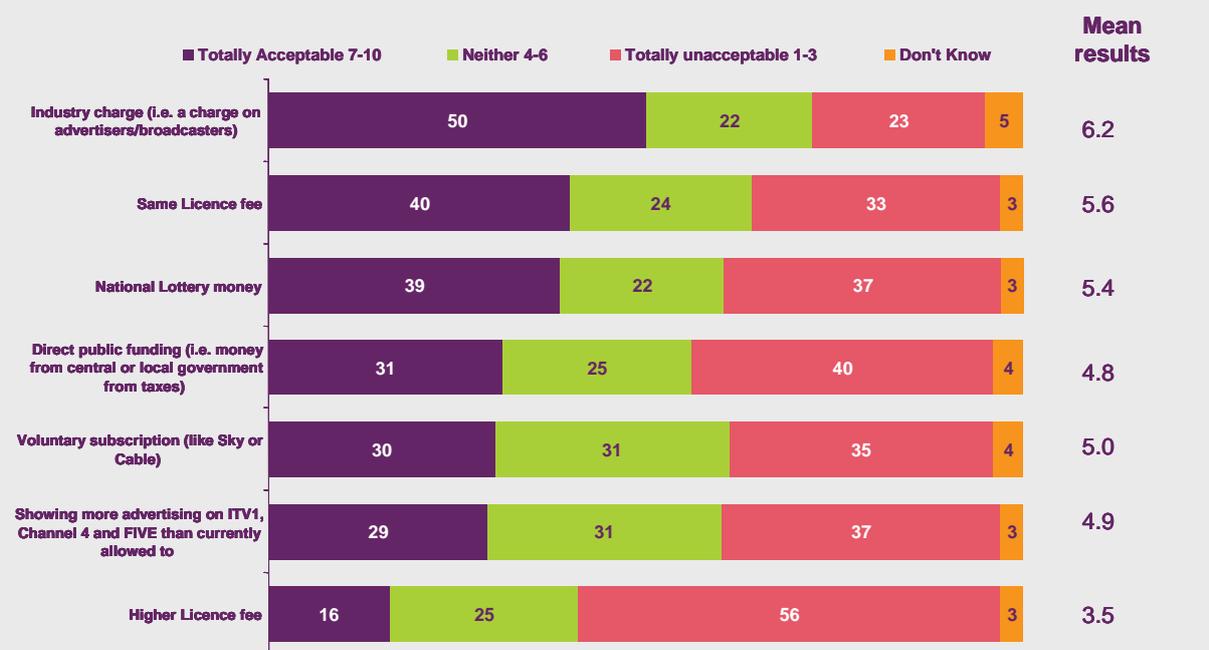
In our phase 2 quantitative study: *Assessing the value of public service programming on ITV1, Channel 4 and Five*⁴⁴ we asked respondents about their attitudes towards funding mechanisms for PSB on ITV1, Channel 4 and Five in the future. Respondents had already been informed about each channel's current PSB obligations, as well as their funding via gifted spectrum.

Figure 36 shows that an industry charge was the most popular option with 50% of people in favour. This was followed, in terms of acceptability, by the current licence fee (40%) but with some money allocated to ITV1, Channel 4 and Five and National Lottery money (39%). Somewhat more qualified acceptability was noted for direct public funding (i.e. money from

⁴⁴ See PSB Review phase 2 annex 6: *Assessing the value of public service programming on ITV1, Channel 4 and Five*. A quantitative research report by Holden Pearmain.

local or central government from taxes), voluntary subscription (like Sky or cable) or funding by showing more advertising on ITV1, Channel 4 and Five than is currently allowed; with the option of a higher licence fee seen as acceptable by just 16% of the sample, compared with 56% who saw this method as unacceptable.

Figure 36: Respondent attitudes towards the acceptability of funding mechanisms for PSB on ITV1, Channel 4 and Five in the future



Source: PSB review phase 2 quantitative survey among 2474 people aged 18+ in the UK. Question: How acceptable do you feel each of the following methods of funding PSB on ITV1, Channel 4 and FIVE would be?

Means of funding - regulatory assets

6.25 Regulatory assets fall into two categories. First, privileged access to DTT spectrum – the principal source of commercial PSB funding at DSO. Second, other assets such as the relaxation of PSB advertising minutage, EPG prominence and must carry status on cable.

Access to DTT spectrum

6.26 Our phase 1 analysis suggested that while changes in the market were eroding the value of access to broadcasting spectrum⁴⁵ there will remain some value in privileged access to DTT for commercial PSBs. This has three forms:

- privileged access to DTT capacity and the underlying spectrum, currently free of charge;

⁴⁵ PSB spectrum benefits include two categories: (i) privileged access to spectrum used for DTT (for the BBC on Multiplexes 1 and B, for ITV, Channel 4 and Teletext on Multiplex 2, and reserved capacity for Five on multiplex A); and (ii) in common with commercial multiplexes, spectrum reserved for PSBs is not currently subject to Administered Incentive Pricing

- guaranteed near-universal coverage⁴⁶; and
 - PSB multiplex configuration, which allows regionalised advertising sales.
- 6.27 We estimate that the current allocation of capacity to the commercial PSBs (primarily ITV plc, stv, UTV, Channel 4 and Five) will be worth around £120m in total in 2012/13.
- 6.28 In the long term the value of spectrum benefits is increasingly uncertain. A range of developments could enhance or reduce this value, including:
- the ability of the DTT platform to continue to compete effectively with cable, satellite and IPTV;
 - the impact of the potential for HD services to launch on the platform, and of more efficient compression technologies;
 - the possible expansion in DTT capacity using spectrum awarded through the DDR process;
 - trends in audience behaviour and the related shifts in levels and distribution of advertising spend; and
 - broadcaster business strategies.
- 6.29 Due to these uncertainties it is difficult to predict the aggregate long-term impact of these changes on the value of the PSBs' spectrum. However, it is quite possible that it will fluctuate over time as the impact of the factors waxes and wanes. The reorganisation of the DTT platform currently underway will tend to increase the share of DTT capacity allocated to the commercially funded PSBs (see Figure 37); the long-term value to individual broadcasters is unclear but HD is likely to provide substantial value to the DTT platform overall.

Figure 37: Process for reorganisation of the DTT platform

In phase 1 we referred to the potential to upgrade multiplex B to enable it to make use of more efficient technologies and launch new services, potentially including HD services. Since phase 1 was published in April 2008 the Secretary of State has made an Order⁴⁷ which provides for this upgrade to take place⁴⁸ and for Ofcom to reserve some of the capacity on Multiplex B⁴⁹ for new services. The Order also authorises Ofcom to reorganise services on DTT which is necessary to accommodate the existing Multiplex B services.

Our objectives in reorganising services, upgrading Multiplex B and reserving capacity are to further the interests of citizens and consumers generally and specifically through:

1. promoting the efficient use of spectrum;

⁴⁶ DTT multiplex capacity currently allocated to PSBs will allow 98.5% reach of the population at digital switchover, as opposed to commercial DTT multiplexes which will reach around 90% of population

⁴⁷ 2008 No. 1420, Broadcasting. The Television Multiplex Services (Reservations of Digital Capacity) Order 2008 see: http://www.opsi.gov.uk/si/si2008/uksi_20081420_en_1

⁴⁸ Operated by BBC Free to View Ltd

⁴⁹ The BBC HD service will be carried on one of three initial HD sized slots, the remaining two slots will be allocated by Ofcom – as will a further (fourth) slot once predicted MPEG-4 coding gains are confirmed, possibly in late 2009 or early 2010

2. promoting the purposes and characteristics of PSB; and
3. promoting the range and diversity of high quality television services available on digital terrestrial television.

In July Ofcom invited applications from eligible broadcasters; two applications were received⁵⁰. The applications are now being considered against the above criteria and in the light of our general duties to further the interests of citizens and consumers. We will publish our decision once that assessment is completed; we expect that to be this autumn. If we decide to reserve capacity for the proposed services, we will proceed to licence the services as soon as possible. If that is not the case, for example if capacity is only reserved for one service, we will outline both our reasoning and how we intend to proceed.

In parallel with this capacity allocation process a major programme of work is under way led by the BBC, to implement the practical changes required and with the objective of launching the new services on Multiplex B in late 2009. Ofcom is supporting the BBC in preparing for a successful launch as soon as practically possible - as are a wide range of stakeholders including the broadcasters, transmission companies, receiver manufacturers, Digital UK and the DTG⁵¹.

- 6.30 In their responses to our phase 1 consultation, many stakeholders supported the continued use of subsidised spectrum as a means to fund public service content. Some respondents believed that “more could be made” of existing regulatory assets (principally regarded as privileged access to spectrum) and that there was long-term enduring value in them.
- 6.31 Audiences are also generally favourable towards using spectrum to fund public service provision. Participants in our phase 2 deliberative research perceived its use as a way of avoiding any additional direct cost to the viewer. It was not seen to provide a long-term solution. However, it was seen as a potential partial solution. Participants were concerned to ensure that any providers receiving spectrum benefits were committed to providing public service content and that they would spend the exact amount equivalent to spectrum benefits on doing so.
- 6.32 As an established source, funding through access to DTT spectrum has a number of advantages. It is already in place, is easily enforceable and an institutionally simple source. It is likely to attract greater support than sources that require new funds to be raised. And the long-term assignment of broadcasting spectrum provides a degree of certainty for broadcasters (despite uncertainties around its precise value) and helps to support editorial independence.
- 6.33 But there are also significant drawbacks, notwithstanding uncertainty about the value of spectrum. There is little flexibility to change the distribution of funds between providers, or to direct funding to new providers. And because PSB funding is tied to a specific platform, incentives to use alternative delivery mechanisms are weakened. This could mean the reach and impact of public service programming becomes partly determined by the success of the DTT platform, and could result in inefficient decisions concerning spectrum use which have broader societal costs. Funding through spectrum also lacks transparency and accountability as the value is difficult to quantify precisely, and is subject to variability which bears no direct relation to changes in the cost of public service content provision. Finally, reserving spectrum for the PSB purposes restricts alternative uses both currently and in the future and

⁵⁰ See http://www.ofcom.org.uk/radiocomms/digital/hd_on_dtt/ita/applications/

⁵¹ For further information see: http://www.ofcom.org.uk/radiocomms/digital/hd_on_dtt/

may prevent the most efficient use of this spectrum, with potentially significant costs for society.

- 6.34 Any future models that rely on DTT funding should consider addressing current shortcomings. This could include:
- Regular evaluation of the costs and benefits of the use of spectrum as a funding source in the light of changes in the value of the capacity and the opportunity cost for society.
 - Greater flexibility to change or withdraw allocations of spectrum to particular institutions.
 - Greater flexibility for public service institutions in the way they use their capacity.
 - Introducing governance arrangements that ensure transparent, accountable and efficient use of DTT assets.
 - Seeking opportunities to simplify and streamline the regulatory framework through which spectrum is allocated to broadcasters.
- 6.35 These issues should also be considered in the light of the regulatory framework that applies to DTT as a whole.
- 6.36 One issue with potential impact on the value of reserved spectrum is the application of Administered Incentive Pricing (AIP) to spectrum used by the existing DTT multiplexes from 2014⁵². The potential charges applicable to current commercial PSB spectrum allocations could be in the range of £16 million to £34 million⁵³. These equate to around 15-30% of the projected value of spectrum to the commercial PSBs, and form a small share of the total funding requirement for public service broadcasting beyond the BBC at digital switchover. Several respondents to our phase 1 consultation proposed waiving AIP for PSBs as a means of supporting PSB funding needs. We have already stated that we expect to apply AIP to the use of spectrum by broadcasting from 2014, putting broadcasting on an equal footing with other sectors that already pay AIP, such as defence, emergency services and radioastronomy. However we recognise the link between AIP and funding for public service broadcasting in the future⁵⁴. As noted in our 2007 statement on AIP⁵⁵ and in phase 1 of this review, we will consider carefully the potential effects on public service broadcasting output before introducing AIP, and examine policy or regulatory changes that may be appropriate to address or mitigate these.

EPG prominence

- 6.37 Ofcom's *Code of Conduct on Electronic Programme Guides* requires EPG operators to give public service broadcasters "appropriate prominence", though it is the responsibility of the EPG operator to interpret these guidelines.

⁵² *Future pricing of spectrum used for terrestrial broadcasting, a statement.*

<http://www.ofcom.org.uk/consult/condocs/futurepricing/>

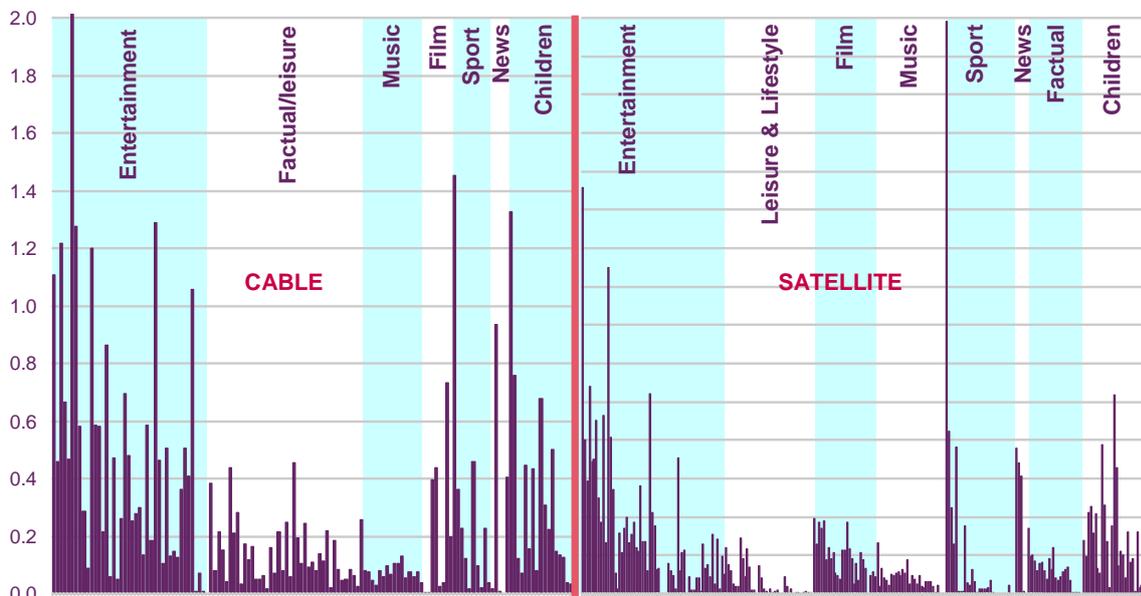
⁵³ Excluding any effects of planned Mux B reorganisation, please see Annex X for detail of estimates

⁵⁴ Please note in this context that we have recently confirmed our intention not to use the provisions in the 1996 Act that would have enabled us to set Additional Payments to be made by multiplex licences. Please see our decision on Television Multiplex Licence Renewals – Multiplex A and Multiplex 2", 4 July 2008 at <http://www.ofcom.org.uk/consult/condocs/tvmux/>

⁵⁵ <http://www.ofcom.org.uk/consult/condocs/futurepricing/>

6.38 There is no single method of valuing EPG prominence. On one hand, an active trade in EPG positions in the multi-channel sector suggests that broadcasters believe their channels can increase viewing in higher EPG positions. However, there is equal evidence that viewers will seek out particular channels and content irrespective of EPG position as the figure below illustrates – many channels attract significant share despite being absent from the first page of a particular genre category.

Figure 38: Audience share and EPG position by platform



Source: Ofcom Communications Market Report 2008

6.39 The value of EPG prominence will vary between broadcasters. ITV1 or Channel 4 carry distinctive, ‘must see’ content and attract loyal audiences. If prominence was removed, it is likely that the platform operators would still afford the channels high EPG positions due to their high audience reach and share – and were they to move down an EPG, many viewers would seek them out. But to Five, the benefit of prominence may be higher, since its schedule carries a higher proportion of acquired and repeated content that viewers might not proactively seek out were the channel lower down on the EPG.

6.40 We currently value prominence for the existing commercial PSBs taken together at a minimum of £30m a year. This lower bound is informed by what stakeholders have told us, but under models where the benefits of public service status are open to a wider range of providers, other broadcasters could value a prominent slot more highly than those that currently occupy them.

Must carry

6.41 The 2003 Communications Act gives the Secretary of State (SoS) backstop powers to order must carry of PSB services on analogue cable operators. In practice, the powers have not been brought into effect: cable operators carry the PSB channels voluntarily as they are popular with viewers.

6.42 As a result, we have placed zero value to existing commercial PSBs of the incremental benefit of must carry on cable.

Advertising minutage

- 6.43 In early March, Ofcom published a discussion document seeking views on a possible proposal to bring the limits that commercial PSBs currently face in relation to the hourly minutes of advertising that they can carry⁵⁶ into line with multi-channel licensees. This possibility of increasing advertising allowances was referred to in the phase 1 PSB review consultation document.
- 6.44 Stakeholder responses to our consultation indicated that there is no support from any quarter (including the commercial public service broadcasters) for the principle of increasing the amount of advertising on public service or commercial television channels.
- 6.45 Part of the reason for this lack of support is that the overall impact of such a change is difficult to predict. The introduction of a greater supply of commercial advertising inventory may reduce prices overall, particularly in an already depressed advertising market. It is also uncertain how the market would adjust to the increase in inventory – though it is likely that ITV1, as the market leader in terms of commercial impacts would benefit while Five and multichannel broadcasters would lose revenue. The impact on Channel 4 is uncertain.
- 6.46 Our phase 2 quantitative research identified that only 29% of UK adults agreed with the idea of funding PSB on ITV1, Channel 4 and Five by allowing these channels to show more advertising than they are currently allowed to, whereas 37% were opposed to the idea. (See Figure 36.)
- 6.47 In our deliberative research we explored attitudes towards increasing advertising on commercial PSBs. Some participants supported the idea since it was perceived to involve no additional cost to the public, many peak-time hours already contain 12 minutes of advertising, and a small increase would probably not be that noticeable, particularly as increasing numbers of households have access to technology allowing them to skip adverts, such as Sky Plus.
- 6.48 However, other participants voiced strong opinions against the idea as they believe that there is enough, or too much advertising already, which detracts from their overall enjoyment of watching TV. Participants also said that it was not a sustainable funding mechanism for the long term if the value of advertising may decrease.
- 6.49 Given the sentiment of all stakeholders, it is unlikely that changes to advertising minutage will represent a source of further funding for public service broadcasting in the short term.
- 6.50 Ofcom intends to issue a further consultation document on advertising related issues, which is likely to be published shortly after this consultation. However, while it may consult on a range of limited changes to the rules on the number of advertising breaks and the distribution of advertising over some time periods, it is unlikely that these will have a significant impact on the public service or commercial broadcasters.

Means of funding - the licence fee

- 6.51 Under the most recent six-year settlement, BBC licence fee revenue will rise by a nominal 3% for 2 years, a nominal 2% for three years and by up to 2% in 2012/2013.

⁵⁶ Review of television advertising and teleshopping regulation:
<http://www.ofcom.org.uk/consult/condocs/rada/>

For the licence payer this means that the colour TV licence fee will grow from £139.50 a year today to at least £148 a year in 2012.

- 6.52 Along with a growing contribution from BBC Worldwide, efficiency gains and the capacity to borrow up to £225 million this will enable the BBC to:
- deliver and enhance its core services;
 - fund a Digital Switchover Help Scheme (DSHS); and
 - contribute to Digital UK's marketing costs.
- 6.53 The last two will be funded by ring-fenced funds totalling £800m over the period - £200m for Digital UK and £600m for DSHS. Once switchover is complete, there will be a component of the licence fee – best described as a digital switchover surplus – that will be available for other uses if retained in the licence fee settlement from 2012/13. In the current settlement, this is equivalent to an average of £130m a year.
- 6.54 We do not believe there should be any change in the way licence fee revenues are allocated that would curtail the BBC's ability to provide high quality public service output. However a switchover surplus in the licence fee could be used for other purposes without affecting BBC services if government and Parliament decide to maintain the licence fee at the same level in real terms, or increase it, in the next settlement. Possible uses could include: investing in new BBC digital services; increasing coverage of DAB digital radio across the UK; widening access to broadband services across the UK, funding public service provision beyond the BBC. Alternatively, the licence fee could be reduced.
- 6.55 Some responses to our phase 1 consultation argued that the strong link between the BBC and the licence would be broken were if the digital switchover surplus were to be handed out to other organisations. But others, such as the Welsh Assembly Broadcasting Committee, concluded that sharing the surplus with parties other than the BBC might offer a solution to the funding deficit that will emerge in the run-up to digital switchover. Our deliberative research found that participants were open to the idea of licence fee money being spent on providers other than the BBC. Discovery provided research suggesting that 60% of pay TV subscribers would be willing to see a portion of the licence fee made available to other broadcasters.

Figure 39: Viewer perceptions of the licence fee

Our research from phase 1 and phase 2 show that the BBC is the cornerstone of PSB and is highly valued by audiences.

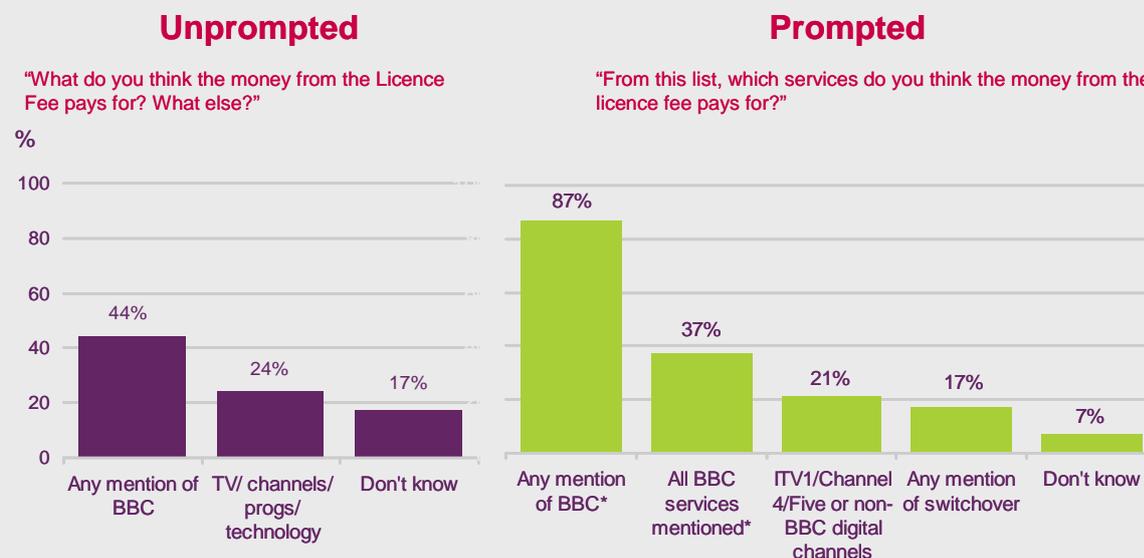
As to what the licence fee is spent on, our phase 2 research⁵⁷ suggests a degree of confusion among the public when asked unprompted. Figure 40 shows that, unprompted, 44% of respondents associated the licence fee with the BBC. (The DCMS quantitative study in 2004⁵⁸ found that 52% of people in the UK associated the licence fee with BBC TV programmes. Differences in results between surveys can be due to a wide range of reasons including the wider context of the questionnaire, where the DCMS survey focused particularly on the BBC whereas the Ofcom questions did not.)

⁵⁷ See PSB review phase 2 annex 8 – *Audience research slidepack (including research on the licence fee, BBC and plurality)*, GfK NOP face-to-face omnibus, July 2008 among 949 adults 16+ in the UK and August 2008, among 1055 adults 16+ in the UK

⁵⁸ See Quantitative research to inform the preparation of the BBC Charter Review 2004

As shown in Figure 40 below when respondents were given a list of options to choose from as to what the licence fee is spent on, collated results of any mention of the BBC show that 87% of people named the BBC.

Figure 40: What the licence fee pays for: audience responses



Mentions by 10% or more and 'don't knows' shown. *Individual BBC services were asked about - summary responses shown here.

Unprompted Q: August 2008, all adults, 16+ (1055). Prompted Q: July 2008, all adults 16+ (949).

We explored consumers' attitudes towards using the licence fee to fund third parties in our deliberative research. Participants were informed that the current licence fee funds the BBC only. Participants were presented with three options for the use of the licence fee to fund providers other than the BBC a) using the existing licence fee, which could have an effect on the BBC; b) redistributing switchover surplus post switchover, if retained; and c) increasing the current licence fee.

For the majority, the general idea of using the licence fee to fund non-BBC PSB was not deemed controversial, so long as the money was spent on high quality PSB. A minority of participants thought the licence fee should not go to commercial broadcasters given their ability to raise funds elsewhere. There were also queries about whether other broadcasters would spend all the money they were given on PSB programming.

Use of the existing licence fee to fund non-BBC PSB was seen to be a viable option. The surplus licence fee was seen to be one of the most favourable options as participants thought this was money the public were used to paying and would not expect back. It is seen as an appropriate use of licence fee money given its current association with programming and TV. Participants also believe there would be a clear and direct relationship between the licence fee and PSB remits, which makes it an attractive option as it would be easy to take money away from providers not fulfilling their obligations.

Support for an increase to the existing level of the licence fee was less popular, as it implied an increased cost to consumers. Those in favour of increasing the licence fee based this on the value they derive from PSB programming. A minority of the participants against an increase in the licence fee tended to be against any licence fee in principle. However, even these participants believed a proposed level of increase (approximately £1 per month per household) would be small enough to be affordable.

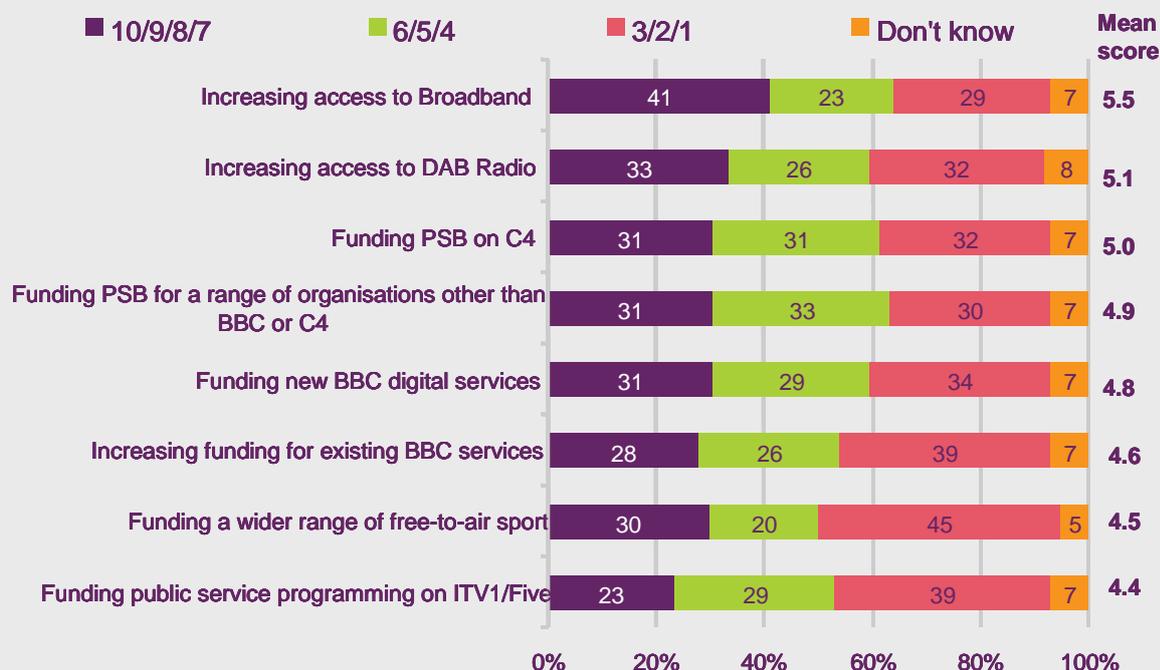
Results from our PSB Review phase 2 quantitative study showed support for the existing

licence fee as a means of funding PSB on ITV1, Channel 4 and Five in the future, with 40% in favour (See Figure 36). Support for an increase to the licence fee to fund PSB outside of the BBC was, unsurprisingly, lower with only 16% in favour and 56% against.

We also asked the general public in more detail about their views on the uses of the digital switchover surplus in our phase 2 quantitative research. This provided audiences' 'uninitiated' views (i.e. they were not subject to the detailed briefing that the consumers in the deliberative research were given) as respondents were not informed about the current pressures on public service broadcasting and possible changes to future delivery. Unsurprisingly support was highest for a rebate, with 63% in favour and 15% against, with support of an average of 7.3 out of 10.

Respondents were also asked their views on a range of PSB and other services (See Figure 41 below). Respondents supported the use of the surplus, if retained, to increase access to broadband. The results showed no clear preference for spending the surplus on the BBC.

Figure 41: General public's views of alternative uses for the switchover surplus



Source: PSB Review phase 2 quantitative omnibus among 949 people aged 16+ in the UK, June 2008. Q1. "The television licence fee is now £139.50 per year per household for a colour TV. Currently, most of the licence fee funds the range of BBC services on television, radio and online, but about £6 of this is being used to help older or disadvantaged people get prepared for digital switchover. When digital switchover is complete, this £6 could be dealt with in a number of ways. Please tell me your support for the different options, on a scale of 1-10 where 1 is no support and 10 is complete support."

6.56 Other options have been proposed. One is to seek more efficient ways of collecting the licence fee, and reducing evasion, for example by integrating collection of the licence fee with council tax bills. Alternatively, revenues raised as the number of households paying the licence increases could be set aside to fund other providers, with the BBC retaining the revenue received from all current payers. At this stage we have not carried out a systematic evaluation of the viability, strengths and weaknesses of these options.

BBC partnerships

- 6.57 In its response to our previous consultation, the BBC Executive set out proposals for providing greater assistance and help-in-kind to other public service providers through a range of partnerships, as an alternative to direct licence fee funding. These proposals include:
- sharing expertise about digital production with producers and broadcasters to facilitate more efficient production techniques;
 - working with developers and others to share R&D knowledge and developments;
 - working with creative and cultural partners to enhance discoverability of public service content online;
 - exploring ways of making the BBC's regional and local news materials available to other outlets; and
 - exploring global opportunities with the independent sector and with other PSBs.
- 6.58 The details of the proposals and the terms under which the BBC would make its resources available to others are not yet clear. Where the BBC already makes some of these services available to third parties, they might only deliver incremental value only if they were provided free of charge. We understand that the BBC Trust will be provided with more details in the autumn.
- 6.59 Our initial analysis suggests that the proposal with most value to third party providers may be 'enhancing findability'. The BBC is already required to be a 'trusted guide' on the web, helping users to navigate online largely by providing links to external websites. The BBC Trust asked the BBC to increase its emphasis on linking to third party websites in its review of bbc.co.uk earlier in 2008⁵⁹. Furthermore, MTM's analysis in annex 10 highlights the increased reach and impact that can be gained by online sites and services by cross-promotion from traditional media.
- 6.60 On that basis, we estimate that the combined value of the BBC increasing links from its website to external websites, coupled with promotion of other broadcasters' public service content on BBC television and radio lies in the low tens of millions of pounds per annum. But the actual value would be highly sensitive to the structure of the promotional relationship and could therefore be a bit lower.
- 6.61 Some stakeholders told us that while the BBC's proposals are welcome, they will not have a significant impact on the financial health of public service broadcasters.
- 6.62 We would welcome further details of these proposals, and think there may be further ways that the BBC could assist public service providers to save costs. For example the BBC's iPlayer could host or link to online programmes made by other public service broadcasters. We welcome further views on the BBC's partnership proposals as more details are made public.
- 6.63 The BBC's proposed approach raises a wider question about the scope for other kinds of partnership. For example one option that has been proposed is a partnership between Channel 4 and BBC Worldwide, which is discussed in more detail below.

⁵⁹ BBC Trust service review of bbc.co.uk:
http://www.bbc.co.uk/bbctrust/framework/bbc_service_licences/bbc_co_uk.html

There may also be further ways that commercial online providers can generate additional revenues, for example by distribution partnerships online, as suggested by Yahoo! in its response to Phase 1. We would welcome industry initiatives along these lines and views on whether any other partnerships between existing broadcasters could help build scale to support commercial investment in public service content.

Means of funding – an industry levy

6.64 Public service content could be funded from an industry levy applied at different points in the value chain for provision of content, which is shown in Figure 42 below, along with the estimated industry revenues generated at each of those stages.

Figure 42: Stages and indicative revenues of the communications market value chain⁶⁰



6.65 The levy-based approach already has precedents within many European countries.

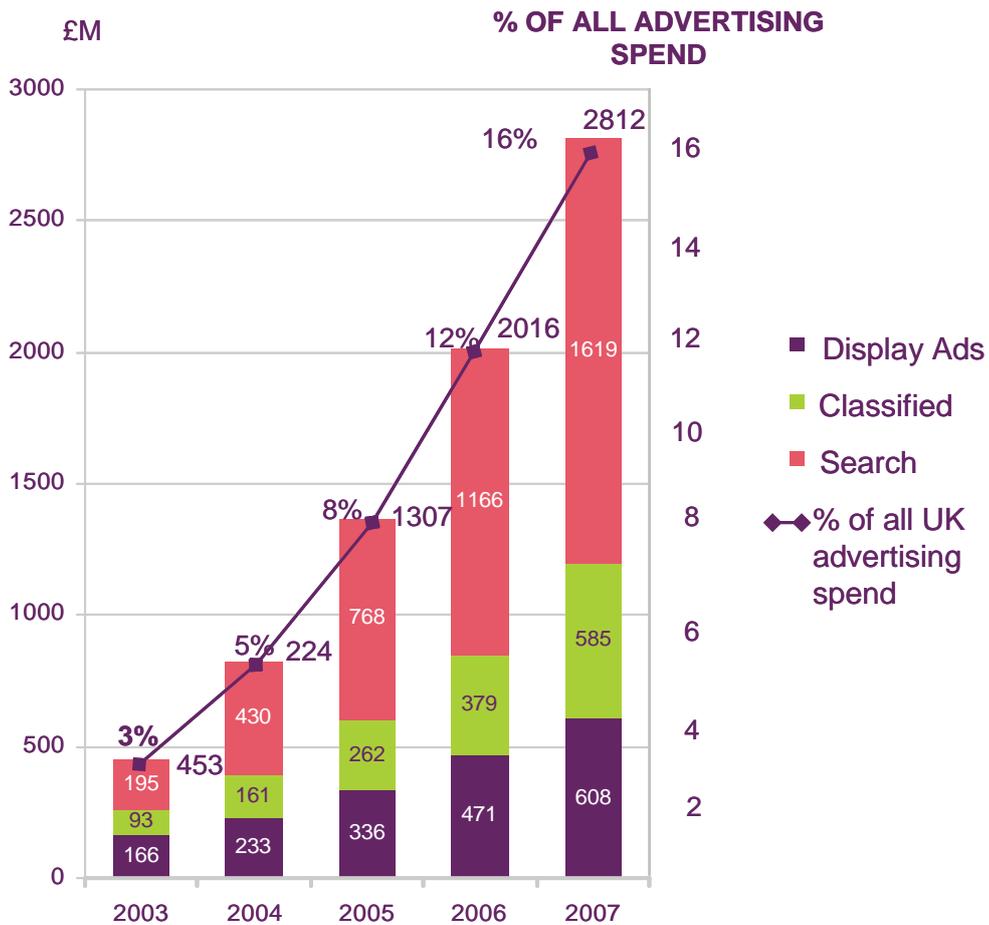
- Levies on consumer hardware and blank media are widely used to facilitate some return to content rights holders from the sale of content duplicating technologies although they are not currently in use in the UK.
- Retransmission levies require platform operators to make payments to rights holders in return for the opportunity to distribute their content. AGICOA, the international body responsible for collecting these payments in more than thirty countries, reported collecting revenue of 85 million Euros in 2006. 71% of this total was drawn from the Netherlands, Germany, Belgium and the Republic of Ireland.

6.66 The principal basis for introducing similar levies or payment collecting schemes in the UK would be evidence that content distributors and aggregators were benefiting from access to high quality UK content for which they were not paying.

6.67 Our analysis suggests that this effect has been relatively limited to date. The high growth in online advertising revenues has been driven by search and classified advertising, particularly 'response' and 'transaction' based advertising campaigns. This has led to a shift of monies by advertisers (especially in the travel, telecoms, retail and finance sectors) away from display advertising into response based advertising.

⁶⁰ Indicative estimates of total revenue at different stages of market value chain, based on data returns, company accounts and industry research. NB Revenues are not necessarily exclusive between different sectors. Source: Ofcom, Broadcaster returns, Platform operator returns, Company accounts, Market data

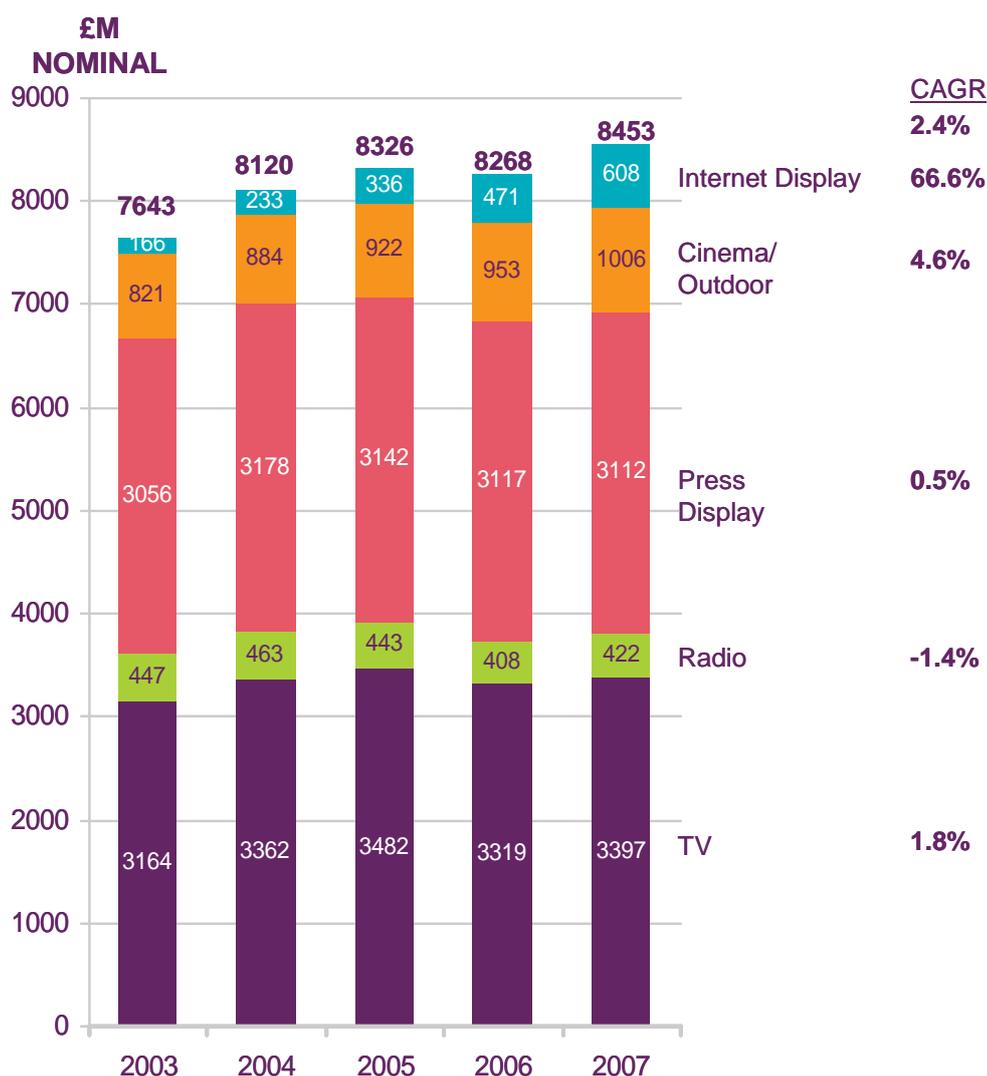
Figure 43: Composition of online advertising revenue over time



Source: Advertising Association, Oliver & Ohlbaum analysis

6.68 Nonetheless, online display advertising has risen over time to become a small but significant proportion of all display advertising. This, coupled with slow overall growth in UK display advertising, has contributed to relatively low growth rates in TV advertising. However, TV continues to account for a high proportion of total display advertising spend.

Figure 44: Composition of display advertising spend over time



Source: Advertising Association, Oliver & Ohlbaum analysis

- 6.69 Online video consumption, though growing, remains low compared with TV consumption. Consequently, there is little evidence yet that the growing number of internet-based-TV and TV clip-based services are taking significant revenue directly away from traditional TV channels or the video-on-demand spin offs (i-Player, 4oD, ITV.com) of the channels.
- 6.70 However, such services could damage the economics of content creation over time, especially where they offer unauthorised or un-monetised access to copyright material. Under these circumstances a levy might be justified to maintain levels of investment in UK-originated content.
- 6.71 Our quantitative research showed that among viewers an industry charge was one of the more favourable options for funding PSB in the future, with 50% expressing support for it (See Figure 36.) In deliberative research, support was also high for an industry charge, because this would be a charge on those organisations benefiting from the changing marketplace and it would be a fair way to fund PSB by taking money from industry to reinvest into industry. It was also seen to be a more long-term, sustainable option.

- 6.72 But many participants believe that industry organisations would ultimately pass any charge levied against them on to the general public, and that there would be no way of knowing whether increases were the cost of a levy or an additional way of raising revenue.
- 6.73 Among respondents to our consultation, there was some opposition to using levies as a means of funding public service content, partly because of the potential impact on consumers and partly because of the possible market distortions that this might introduce into the industry. But in the wider public debate that followed publication of our phase 1 document, interest in the potential use of industry levies as a new funding mechanism has grown, suggesting that these options may merit further consideration. One of the attractions of an industry levy as a funding source is that it maintains the primary single relationship between the BBC and the licence fee.

Means of funding – direct public funding

- 6.74 This option would use direct funding from central government or devolved governments to support the future delivery of relevant public service content. This approach has many precedents:
- S4C receives an annual £94m grant from the DCMS to support the origination and broadcast of Welsh language content which is made available on analogue and digital terrestrial television in Wales and on satellite/cable in Wales and elsewhere;
 - The Irish Language Broadcast Fund (ILBF) in Northern Ireland, which funds originated programmes in the Irish language. It is funded from a £12m five-year grant provided by Northern Ireland's Department for Culture, Arts and Leisure;
 - the annual £255m Foreign and Commonwealth Office Grant-in-Aid to fund the BBC World Service's radio services around the world;
 - The Department for Children, Families and Schools five-year grant to Teachers' TV;
 - estimated total government expenditure of £70m - £90m on public service content online; and
 - Scottish government funding of £12m for MG Alba to ensure the availability of a range of Gaelic programmes.
- 6.75 The major concern expressed by consultation respondents and audiences about direct public funding was the potential impact on the editorial and strategic independence of public service providers. Audiences also expressed a perception that taxation was 'too high' already, and they doubted whether tax revenues were used efficiently.
- 6.76 One alternative would be to make National Lottery funding available for public service content provision after 2012. This could ameliorate concerns about providers' independence, although audiences in our research were concerned that this should not divert funding from Lottery good causes. However, the BBC's research submitted to our consultation found that Lottery funding was one of the more favoured options for providing funding to ITV1, Channel 4 and Five to enable them to show programmes with public service aims.

- 6.77 Our quantitative research revealed differences in opinion regarding National Lottery funding and direct funding. Using the Lottery as a source of funding was “totally acceptable” by nearly four in ten respondents (39%) while funding from direct government was only acceptable to three in ten (31%).
- 6.78 Any decision on the use of direct funding for public service content rests with government and Parliament.

Evaluating potential funding sources

- 6.79 We have evaluated the potential sources of funding set out above against a consistent set of criteria.
- 6.79.1 **Scale:** how much funding could potentially be raised?
 - 6.79.2 **Fairness:** is the funding raised from those who may benefit from it?
 - 6.79.3 **Support:** would the source be supported by audiences and other stakeholders?
 - 6.79.4 **Incentives:** do the potential uses of funding complement the general objectives of those involved?
 - 6.79.5 **Enforceability:** is it effective and efficient to collect and distribute?
 - 6.79.6 **Market impact:** will the collection and distribution distort or disproportionately impact the operation of the market?
 - 6.79.7 **Editorial independence:** will the source permit or compromise the independence of content producers?
- 6.80 As regulatory assets are already in place there are likely to be minimal concerns regarding enforcement and market impact, and little opposition from audiences or stakeholders. However, these would continue to represent a general subsidy to broadcasters whose incentives vary from public purposes.
- 6.81 The digital switchover surplus, if retained, offers potentially significant and secure funding, and limited impact on the market. The case against focuses on the risk of a negative impact on the BBC and potential objections from stakeholders.
- 6.82 The BBC's commercial assets would also offer significant value to other providers, though the complexities of transferring these assets and aligning the interests of two organisations may compromise their benefit. A partnership based on cross-promotion by the BBC, though potentially less problematic, is likely to be of less and of more variable value to recipients.
- 6.83 Direct government funding offers potentially high and secure funding and reduces issues with collection and incentives of recipients. However, the alternative calls on tax revenues are great and steps would need to be taken to ensure the editorial independence of beneficiaries.
- 6.84 While levies could introduce new funding, they present challenges of enforceability (distribution is fragmented and internationally based) and incentives (industry players are unlikely to be beneficiaries and may ultimately pass on the cost to customers).

Any new funding method would require robust accountability and governance processes

6.85 New funding requires robust accountability arrangements to ensure that public resources are used effectively, proportionately and transparently, in accordance with the EU framework on state aid and public service broadcasting. A wide range of accountability arrangements could be considered, and different approaches are likely to be suitable to different models and for different levels of funding. But in all cases three principles should be paramount:

- public investment in public service content should be clearly associated with the delivery of the public service remit, and the level of funding should be transparent and proportionate to the benefits. In practice, this means decisions to provide funding should be informed by an explicit assessment of the public service objective, and the benefits and the costs of delivering it;
- public investment should not unduly impact market provision or fund activity that could be provided adequately without subsidy by other suppliers in the market - the potential impact of public intervention on the wider market should be identified and assessed as part of the benefits or costs of intervention; and
- there should be independent assessment of the performance of bodies in receipt of public funding in the delivery of their public service objectives - the body responsible for allocating funding and ensuring delivery of public purposes should be independent of the recipients of funding.

There are a number of possible approaches to funding for Channel 4, which need to be resolved by 2010

6.86 In section 3, we set out analysis that suggested that by 2012 Channel 4 could require additional funding of between £60-100m⁶¹ in order to continue to deliver its existing remit. If it were take on additional responsibilities, along the lines it proposed in its vision document, this funding requirement could increase by up to £50m. There would be further incremental costs should Channel 4 be successful in its bid for a potential new high definition service on DTT.

6.87 In models in which Channel 4 retains direct funding to support delivery of its existing or an enhanced remit, a number of funding sources are possible. These are set out in Figure 45 below. Alternatively, Channel 4 could retain its existing regulatory assets, not receive any additional funding by right, but be allowed to compete for funding with other providers.

⁶¹ As set out in Footnote 8 above, this is an estimated operating loss in 2012

Figure 45: Possible funding sources for Channel 4, in models in which it is allocated additional funding directly

If additional funding were to be provided to Channel 4, there are a number of possible sources.

First, it could be directly allocated additional public funding. This is arguably the most transparent option. However depending on how the allocation and governance of funding is implemented, this could have a significant impact on Channel 4's culture and independence, by making it reliant on political decisions about how much funding it required.

Second, it could receive direct funding from the switchover surplus in the licence fee, if retained. Again, governance arrangements would need to be carefully considered to ensure that public resources were used with appropriate accountability, while at the same time ensuring that Channel 4 remains independent, and that any link between the BBC and the licence fee is preserved.

Third, Channel 4 could be one of the recipients of any industry levy.

Fourth, in models in which ITV1 and Five no longer have public service obligations, Channel 4 could be allocated some or all of the regulatory assets that they currently hold, including access to reserved spectrum and due prominence for a second channel on EPGs. This might involve Channel 4 becoming the sole owner of Digital 3&4 and taking control of the whole of multiplex 2 (although ITV1 could continue to be guaranteed a slot on that multiplex, at commercial rates, to ensure that it remains universally available to viewers).

Fifth, Channel 4 could take control of some or all of BBC Worldwide, or receive a share of the dividends it pays to the BBC – a proposal supported by PACT in its consultation response.

BBC Worldwide has increased its revenues strongly in recent years and raised its contribution to the BBC. Of its net contribution to the BBC in 2007/08, BBC Worldwide delivered £75m in programme investment plus a £50m general dividend. Merging BBC Worldwide and Channel 4 would in principle create a single provider responsible for commercial exploitation of public service content, potentially enabling significant synergies and delivering substantial value to Channel 4; Channel 4 could undertake to continue to pay a share of Worldwide's dividends to the BBC to ensure that the loss of revenue for the BBC is mitigated.

However the relationships between BBC Worldwide and the BBC are complex, and significant care would need to be taken to ensure that such a deal did not either destroy value or jeopardise funding of BBC content. Channel 4 might need to guarantee that it would maintain Worldwide's investment in BBC programmes; it might also need to renegotiate the terms of existing key joint ventures. By the same token, the BBC would need to undertake not to set up an alternative rights exploitation business or to take its rights elsewhere. The mechanics of the acquisition would also raise issues - either requiring Channel 4 to raise sufficient finance (if a market rate were paid for the business) or address any legal implications arising from the transfer of assets.

Sixth, Channel 4 could receive cross-promotion for its content from the BBC – not dissimilar to its early years, when it was cross-promoted on ITV1. Preliminary analysis suggests this could have significant value to Channel 4 – in the tens of millions of pounds per annum, depending on the nature of the arrangement and whether cross-promotion were to be provided on all BBC services (TV, radio and online). However, the impact on the BBC, and audiences' readiness for non-BBC services to be promoted on the BBC would need to be carefully assessed.

Finally, Channel 4 has raised the possibility of a tax relief scheme on certain kinds of UK-produced independent programmes. Along with other forms of direct funding, this is a matter for the Treasury to consider.

- 6.88 Channel 4 has significant reserves, which it could use to ensure continued delivery of its remit and to implement its vision for a future role across platforms. But running down reserves would only be a rational strategy if Channel 4 was confident about its long-term funding model.
- 6.89 This analysis suggests that Channel 4 will need certainty about its long-term funding no later than 2010 and ideally significantly earlier. Otherwise, pressures on its existing funding model are likely to result in significant impact on its ability to invest in innovative public service content, potentially including news, international and investigative current affairs, documentaries, arts, religion, challenging UK drama and UK scripted comedy.

Accountability and Channel 4

- 6.90 An enhanced role and new direct funding for Channel 4 would require significant changes to its accountability arrangements, to ensure that any funding was proportionate to the benefits delivered, that it was transparent and did not unduly distort the market or subsidise activity that could be provided adequately without subsidy by other suppliers in the market.
- 6.91 Achieving these objectives requires real clarity about which of Channel 4's activities are intended to meet its public service remit and which are purely commercial services intended to generate profits to fund its public service content. Any services benefiting from public funding are likely to need independent approval and performance assessment. Therefore new accountability arrangements would need to be established.
- 6.92 There are five key risks for a new accountability model:
- compromising Channel 4's independence;
 - failing to ensure provision of content geared to audiences' needs;
 - overcompensation or lack of efficiency in use of funding;
 - complex bureaucracy and increased regulatory cost; and
 - conflict with Channel 4's organisational purpose and culture.
- 6.93 In other countries, such as France, Ireland, Germany, Canada and Australia, mixed funding models where a PSB receives both public and commercial funding are well established. Both revenue streams support a general PSB service, rather than being hypothecated to particular programmes. Complaints from commercial providers tend to focus not on the service or source of funding in general, but on specific uses of funding in which the broadcaster is perceived to be displacing the purely commercial market, for example, in bidding for sports rights or in non-PSB service commercial activities.
- 6.94 Therefore, a key premise for the design of new accountability arrangements is a clearer public service remit against which to measure Channel 4's PSB delivery and to ensure that funding is used solely for that purpose and does not subsidise commercial activity.
- 6.95 More specifically there are a number of key accountability issues that would need to be addressed. These include:

- overseeing Channel 4's use of public resources in delivering its public service remit;
- determining which services should have access to additional funding, and how much funding is appropriate (informed by a market impact assessment conducted by Ofcom); and
- reporting to Parliament on Channel 4's performance in delivering its remit.

6.96 One option would be for the Channel 4 Board to take on these responsibilities. However, the Channel 4 Board also has a duty to ensure the continued financial viability of the business. This could result in mixed incentives and potential conflicts that could prevent the Board from operating effectively.

6.97 Another alternative would be to establish an independent body with responsibility for overseeing Channel 4's use of its public resources and monitoring its performance against its remit. However, such a body might face challenges of its own – if it is exclusively remitted to fund Channel 4, it might be heavily dependent on Channel 4 management for analysis of the most effective way of using public resources, and might find it difficult to identify credible alternative uses of its funding.

6.98 Therefore it might be appropriate for the body with oversight of Channel 4's use of public funding to have the power to allow other providers to bid for funding in addition to Channel 4, to enable it to secure the benefits of competition for funding set out in the previous section. In models in which a funding body exists to allocate competitive funding, it could take on responsibility for overseeing Channel 4's performance against its public service remit.

Consultation questions

- 1) Do you agree with our assessment of each possible funding source, in terms of its scale, advantages and disadvantages?
- 2) What source or sources of funding do you think are most appropriate for the future provision of public service content beyond the BBC?
- 3) Which of the potential approaches to funding for Channel 4 do you favour?

Section 7

Regulatory decisions for the short term

Introduction

- 7.1 Decisions about long-term models for public service broadcasting – and how they should be funded – are largely issues for Parliament. But, regardless of what model is ultimately adopted, there needs to be a measure of transition between the current system and its replacement.
- 7.2 Our analysis of the models presented in previous sections is set against the ever more challenging commercial climate of a fully digital era. Those challenges are already being felt by commercial public service channels, and we need to make some difficult short-term choices about restructuring public service obligations in such a way as to ensure they are sustainable – at least until the end of the current licence period (2014).
- 7.3 This section therefore outlines the options for the PSBs' current obligations and our proposed approach, set within the framework of Tier 2 programme quotas as outlined in the Communications Act.⁶² Our aim here has been to ensure that the PSBs' continuing contribution remains tightly focused on delivering audience priorities.

ITV plc/ITV1

- 7.4 ITV1 makes an important contribution to PSB. Given necessary adjustments to its obligations, it can continue to do so for as long as the current regulatory model is in place. Without such adjustments, relinquishing its PSB licences could be a rational alternative for ITV plc. ITV1's key areas of contribution to PSB are in UK national and international news, in high levels of UK originations, in nations news for Scotland Wales and Northern Ireland, and in regional news for England. But funding for PSB within the existing model is limited. In safeguarding these objectives, we propose for consultation a number of reductions in its obligations.
- 7.5 Most of these proposals reflect specific requests for regulatory relief made by the relevant commercial licensees. We have examined the requests in the light of the pressures on commercial funding, audience priorities, and the range of alternatives open to us. These proposals for consultation draw on fresh audience research; evidence from key stakeholders; and further economic analysis conducted by and on behalf of Ofcom. **The evidence and analysis are presented more fully in annex 1 of this document; also in annexes 15 (impact assessment) and 16 and 17 (research) on our website.** This section therefore represents only a summary of the key themes underpinning the proposals.
- 7.6 ITV plc asserts that the cost of its current level of PSB obligations will exceed benefits during 2009. Ofcom's own modelling suggests the cross-over point will be during 2011 but, even on Ofcom's figures, the costs will outweigh benefits by £75m in 2013. ITV has proposed a number of adjustments to its Tier 2 quotas. The package of revisions is estimated by Ofcom to deliver savings of more than £50m a year (see

⁶² Communications Act 2003 Sections 277 (independent productions); 278 (original productions); 279 (news and current affairs); 286 (regional programme making); 287 regional programmes on Channel 3; 288 (regional programme making for Channel 4); 296

annex 1) but even these proposals may be insufficient to bring costs into line with benefits throughout the remainder of the licence period.

- 7.7 ITV plc has also suggested other changes, not included in the table below, which Ofcom has rejected and is not consulting on. We have told ITV plc that we do not believe it is appropriate to consider any reduction in the quotas for original production, which is at the core of ITV's PSB offering. We have also rejected a request for Ofcom support in pressing the government for a reduction in the quota for independent production on ITV1 (the minimum 25% quota is a statutory requirement). We believe commissions from independent producers add diversity to ITV's schedule and do not agree that this represents a significant opportunity cost to ITV plc.
- 7.8 Chief among ITV plc's other requests is its proposal to trim £40m a year from its regional budget by partially merging particular regional news operations and reducing the output of existing sub-regions. Regional production facilities would be further centralised in certain cases. ITV has stated that it will cut the budget for regional programmes by £40m, whatever the final pattern for regional output agreed with Ofcom.
- 7.9 The original requests presented by ITV plc have been considerably modified as a result of discussions with Ofcom and with regional opinion formers (see annex 1). Ofcom's principal concern has been to maximise local news-gathering and maximise a service relevant to audiences. This approach has been informed, in particular, by the results of the extensive deliberative and quantitative audience research we have conducted (see annex 1). On regional news, we therefore propose:
- Border and Tyne Tees news to be merged, but with separate 15 minute sequences in the main weekday programme for viewers in the Border and Tyne Tees areas and separate late-evening bulletins;
 - ITV West and Westcountry news to be merged, but with separate 15-minute sequences in the flagship bulletin and separate late evening bulletins;
 - Thames Valley (an amalgamation of the former Meridian West and part of Central South) to be absorbed into an expanded Meridian region, with 15 minute sequences for Meridian South/Thames Valley and Meridian South-East;
 - sub-regional output within single licence areas (Central east and west; Yorkshire north and south; Anglia west and east) to be reduced in volume, but retaining short sequences in peak-time programme and after *News at Ten*; and
 - the weekly volume of regional news to be reduced from 5 hours 20 minutes to 3 hours 45 minutes by dropping the weekday mid-morning bulletins and weekend lunchtime bulletins.
- 7.10 Further proposals relating to ITV plc Tier 2 quotas (non-news programmes in the nations and regions; out-of-London production; and network current affairs) have also been considered by Ofcom.
- 7.11 Research⁶³ suggests that English regional programming is generally less valued than regional news by viewers; and that plurality in such programmes is not considered as

⁶³ PSB review phase 1 annex 5: *The audience's view on the future of public service broadcasting* IPSOS Mori 2008

important as other programme areas. But non-news programming is of greater importance in the other nations. Network current affairs remains a high priority among viewers, who expect plurality in this area alongside the BBC. Nevertheless, the commercial pressures on ITV in this area are recognised. We propose:

- the minimum volume of 'other', non-news programmes for Wales to be reduced to 1 hour 30 minutes per week from 2009, but with the peak time⁶⁴ requirement maintained at 45 minutes, and near peak maintained at 30 minutes. There would also be no change to the minimum level for current affairs within this, which is 47 minutes per week;
- in England, the requirement for a quota for 'other' non-news programmes in the English regions to be met through an average 15 minutes per week of current affairs and other factual elements from 2009, which may be delivered within news slots (this in addition to the 3 hours 45 minutes of weekly news output);
- the minimum quota for network current affairs to be reduced from 1 hour 30 minutes per week to 50 minutes per week from 2010 (40 minutes in peak, as now); and
- ITV1's quota for spend and volume of out-of-London network production to be reduced from 50% to 35% from 2009.

Stv, UTV and Channel

7.12 The non-ITV plc licensees (stv; Ulster and Channel) are dependent on the ITV network schedule into which their geographically based programmes are slotted and around whose programmes (network and regional) they are able to sell advertising in their regions.

7.13 Ofcom's analysis suggests that the costs of holding the two stv licences will exceed benefits from 2009/10. The cost of providing news alone is greater than the benefits of PSB status. stv has suggested that it should provide non-news programmes at its commercial risk rather than as a regulatory obligation, and argued that its quota for non-news should be 30 minutes per week. However, we believe more is required to meet audiences' needs and for stv we propose:

- a reduction in the average weekly minimum provision of non-news programmes to 1 hour 30 minutes per week from 2009 - but with the peak-time requirement within this maintained at 45 minutes, near-peak at 30 minutes and current affairs at 33 minutes.

7.14 We believe UTV should be able to fulfil its commitments to news and other programmes throughout the licence period, although it too has argued for a reduction in regulatory obligations in line with increasing digital penetration. However, it is important that we maintain the right balance between the costs and benefits of PSB status. We therefore propose to adjust UTV's obligations in line with those for stv and ITV Wales as follows:

- a reduction in non-news programming to 1 hour 30 minutes per week, with effect from 2009, but with the peak-time requirement within this maintained at 45 minutes, near-peak at 30 minutes and current affairs at 26 minutes.

⁶⁴ Peak time is defined as 1800-2230 each day; 'near peak' as 1700-1800 and 2230-2330

- 7.15 As with all quotas, licensees may of course over-deliver if they wish.
- 7.16 Channel TV – the smallest of the Channel 3 licensees – relies heavily at present on profits generated through handling network 'compliance'⁶⁵ for Channel 3. This is unlikely to be sustained at the current level, and without it the licence would appear to be unviable. In the short term, we propose:
- a reduction in Channel's combined news and non-news quota (its sole regional PSB obligation) to 4 hours per week, in line with reductions in other Channel 3 regions. This is the lowest Channel's quota could be set because these slots would be in the network schedule for English regional news under our proposals.

Channel 4

- 7.17 Ofcom welcomes Channel 4's stated intention to increase out-of-London production as part of its on-going public service contribution. In line with this intention and aligned to new long-term funding arrangements for Channel 4, we propose to 'lock in' the commitment and propose:
- an increase in Channel 4's quota for out-of-London production from 30% to 35% from 2010, with a quota of 3% for production from the devolved nations within this from 2010.

Five

- 7.18 For Five, the benefits of PSB status are likely to outweigh the cost of its obligations up to and beyond digital switchover. Five has fewer regulatory obligations than other commercial PSBs, but contributes to plurality through news; UK-originated programming in some underserved genres (arts; history); and programmes with a UK voice for pre-school children.
- 7.19 The channel has asked for only minor regulatory adjustments in the short-term. It has, in addition, expressed a willingness for its commitment to children's programmes to be formalised within the framework for annual statements and reviews of PSB policy, and to broaden the target age range upwards. We propose:
- a reduction in Five's quota for original production from 53% to 50% from 2009, with a reduction from 42 to 40% in peak-time.

Teletext

- 7.20 Teletext has proposed some changes to its PSB obligations from 2009. We propose to allow Teletext to:
- reduce regional news regions from 19 to 13; Teletext states that it will increase the number of regional news stories in the new regions by 40%;
 - reduce the minimum page count of non-news regional pages on the analogue service to the level of the digital service; and
 - reduce national /international news from 30 pages to 20 pages.

⁶⁵ Ready to broadcast programmes in terms of compliance with the Ofcom Broadcasting Code and other legal matters

Summary

7.21 The table below (Figure 46) summarises the Ofcom proposals outlined above. As stated, a full account of the evidence, analysis and reasoning is contained in Annex 1 and Annex 15 (impact assessment) of this report, and on our website.

Figure 46: Summary of short-term issues and Ofcom proposals

Licensee/ channel	Issue	Summary of Ofcom proposal
ITV plc	Pattern of regional news programmes	Allow ITV plc to reduce the number of separate news regions and sub-regions (subject to significant modification of original proposals).
All Channel 3 regions	Volume of regional news	Allow reduction in volume by cutting mid-morning and weekend daytime bulletins, from 2009
ITV plc	Volume of non-news programmes for Wales	Reduce quota to 90 min per week, from 2009 (as now 45 min in peak, 30 min in near-peak, 47 min of current affairs).
ITV plc	Volume of non-news programmes for English regions	Reduce quota to 15 min per week, all in peak/near-peak, from 2009
stv/UTV	Volume of non-news programmes in Scotland and NI	Reduce to minimum of 90m per week, from 2009 (within this, peak-time, near-peak and current affairs elements to remain at present levels.
Channel TV	Volume of combined news/non-news	Reduce to a minimum of 4hr per week
Channel 3 network	Volume of network current affairs	Reduce from a minimum of 90 min per week to 50 min from 2010 (40 min in peak, as now)
Channel 3 network	Out-of-London network production quota	Reduce minimum spend and volume quotas from 50% to 35% from 2009
Channel 4	Out-of-London production quota	Increase spend and volume quotas from 30% to 35% from 2010, of which a minimum 3% from outside England from 2010, aligned to new long term funding arrangements for Channel 4
Five	Original production quota	Reduce minimum quota for original productions from 53% to 50% (42% to 40% in peak)
Teletext	Licence obligations	Allow Teletext to reduce number of regional news services from 19 to 13; reduce regional non-news minimum page count on analogue; reduce national news volume

Children's programming

7.22 Ofcom sees limited scope for using its current powers to maintain provision by the commercial PSBs under the existing legislative framework. We believe there are four areas for focus in the short term to help maintain the quality and plural provision of children's public service broadcasting and fill the identified gaps in online provision and content for older children and teenagers.

7.23 First, Ofcom welcomes the BBC's stated commitment to improving and extending its own children's services, as well as its announcement of c£10m investment in content for young teens. Ofcom sees the BBC continuing to play a leading role in the provision of a wide range of new, high quality, UK content for children under 12, and recognises the need to safeguard future BBC investment in programming for children, including older children and teenagers. In Ofcom's submission to the BBC Trust's consultation on BBC's children's services we identified the following specific issues:

- The overall decline in volume by the PSB channels as a whole places increased weight on the BBC's valued contribution and makes it critical that the BBC delivers a range and variety of high quality and innovative programmes for children.
- Ofcom would welcome any move by the BBC Trust to establish greater certainty in the BBC's overall levels of investment in children's programming during the period of the current licence fee settlement.
- Our research shows that parents and older children would value increased provision of new UK drama content and the extension of CBBC to 8-9pm to make children's PSB available at a time when the majority of older children's viewing takes place.
- Continuation of the BBC One and BBC Two terrestrial blocks is an important contribution to overall reach until digital switchover.
- Audiences would welcome initiatives to cater more effectively for older children aged 10 and above and teenagers aged 12-15, and feel there is a shortfall in PSB provision for this age group.
- Our research suggests that children under 12 see online services as a complement to rather than a substitute for television, whereas importance and usage increased with the over-12s. Ofcom welcomes the BBC's existing online services and planned increased investment to £8m per year.

7.24 Second, supporting Channel 4 in its new vision for 10-16 year olds, which will help to address older children's and teenagers' expressed interest in PSB provision for this age group. Ofcom also acknowledges Channel 4's consultation feedback that new platforms will be important in the future.

7.25 Third, Ofcom welcomes S4C's moves to extend its role in developing programming for a broader English-speaking children's audience. S4C has already indicated that it would like to extend distribution of its children's services across the UK.

7.26 Lastly, Five has agreed to make a more formal commitment to children's programming in its annual statements of programme policy, including extension

upwards of the target age range, which will help to address the gap in provision for older children.

Consultation questions

- 1) Do you agree that our proposals for 'tier 2' quotas affecting ITV plc, stv, UTV, Channel TV, Channel 4, Five and Teletext are appropriate, in the light of our analysis of the growing pressure on funding and audiences' priorities? If not, how should we amend them, and what evidence can you provide to support your alternative?

Section 8

Next steps

Introduction

- 8.1 In our previous report we concluded that medium-term challenges to public service broadcasting would require new legislation to be in place by 2011 at latest. Responses to our consultation confirmed this view; indeed many stakeholders argued that legislation should ideally be in place well before 2011.
- 8.2 ITV plc argued that the phase 1 consultation document does not fully recognise the urgency of its situation. In its response Channel 4 claimed that a new legislative and regulatory framework is urgently needed and that legislative proposals should be introduced by early 2009. Other responses argued that pressures on children's and nations and regions programmes were already substantial and that immediate action was required to address them.

Many of the long-term issues are questions for government and parliament

- 8.3 It is for government and Parliament to consider the issues our analysis has identified and to put in place appropriate funding and statutory provisions to address them. This document has sought to set out the main options. The major questions, as we see them, are:

Models

- What is the most appropriate model for ensuring the long term provision of public service content beyond the BBC?
- What roles should ITV1, Five and Teletext play after their existing licences come up for renewal in 2014?
- What role Channel 4 should have in the future, and how should it be funded? What accountability arrangements should be introduced in tandem with any additional funding?
- Where, if anywhere, should competitive funding be introduced to allow a wider range of providers to contribute to public service purposes?
- How is continued provision of content for the devolved nations, especially news, best secured?
- How should public service broadcasters' remits be revised to ensure the exploitation of emerging digital opportunities?

Funding sources

- 8.4 The key issues for consideration regarding funding sources for public service broadcasting are:
- Which is the most appropriate funding source, or combination of sources, to ensure the long term provision of public service content under a new model?

- Should the switchover surplus in the licence fee be retained from 2012 and if so what should it be used for?
- Should any further direct funding out of taxation be made available for public service content, either on a UK wide basis or for nations-specific services?
- Should existing regulatory assets be retained by the broadcasters, and if so on what terms? If not, how should they be reallocated?
- Is there a case at the current time for industry funding for public service content, through levies or copyright licensing arrangements?

8.5 We will consult on our analysis of these questions, as set out in this document, and publish our final advice to government and Parliament early in 2009. For that report, we will also carry out further work on the refined models described in this document, to set out what would be involved in putting them into practice and what sources of funding might be available.

Regulatory decisions are required in the short term

8.6 We are consulting on the specific changes to regulatory quotas proposed in this document, with a view to publishing our decisions as part of our final report in early 2009. Some of these changes, if confirmed, would take effect from the start of 2009.

8.7 The key issues for consultation are:

- a new pattern for ITV regional news programmes;
- a reduction in ITV nations/regions news minutage;
- a reduction in ITV nations/regions non-news quotas;
- a reduction in ITV out-of-London production quota;
- a reduction in ITV network current affairs quota;
- a reduction in Five's originations quota;
- an increase in Channel 4's out-of-London production quota; and
- introduction of a new out-of-England production quota for Channel 4.

About our final statement

8.8 The statement we issue following this consultation will represent the conclusion of the current PSB Review. When we publish our final statement in early 2009, in accordance with our duties, we will report on the extent to which the public service broadcasters have fulfilled the purposes of public service broadcasting and will set out our advice regarding options to maintain and strengthen the quality of public service television broadcasting in the UK in the future. This consultation period therefore presents an important final opportunity for stakeholders to present their views on the issues raised in this document.

8.9 In relation to our recommendations about new potential long-term models, the final statement will act as a guide for government and Parliament in taking forward the

recommendations that we make in developing their policies for the future of delivering and funding public service broadcasting in the UK. Our final statement will therefore set out a range of options, including the pros and cons associated with these options and the key policy trade-offs that each involve. We also aim to set out in more detail the practical steps that might need to be taken in order to put each model into effect. Consultation responses on these issues and on the policy approaches that we have set out in phase 2 will form an important element of our final statement.

- 8.10 The short-term proposals upon which we have consulted in this document are within the scope of Ofcom's powers. The final statement will confirm our conclusions on these issues.
- 8.11 Throughout the course of this final phase of the PSB review we will continue to encourage and engage in a wide-ranging external debate about the issues set out in this document.

Next steps

- 8.12 The key next steps are:
- Phase 2 consultation closes – 4 December 2008.
 - Publication of final statement - early 2009.

Annex 1

Detailed analysis of short-term regulatory options

- A1.1 A number of significant issues affecting commercial PSB channels need to be addressed now, in order to maintain the delivery of public service content before any new legislation is put in place. It is Ofcom's aim to maximise public service delivery by trying to ensure the continuation of an appropriate contribution from the commercial PSB channels. This inevitably means making difficult decisions about restructuring some of the PSB obligations to ensure that they are sustainable, at least until the end of the current licence period (2014).
- A1.2 This annex sets out the decisions that Ofcom needs to make in terms of the regulatory obligations placed on these PSB broadcasters. It puts forward detailed proposals for consultation - based in part on what broadcasters have told us, and formulated in the light of the extensive deliberative and quantitative research carried out by us in the nations and regions. It offers a more detailed analysis of the issues and initial conclusions that are summarised in section 7 of the review.
- A1.3 A brief summary of the key issues for consultation is set out in Figure 47 below. We would value further evidence from stakeholders about the advantages and disadvantages of these proposals.

Figure 47: Summary of short-term issues and Ofcom's proposals

Licensee/ channel	Issue	Summary of Ofcom's proposal
ITV plc	Pattern of regional news programmes	Allow ITV plc to reduce the number of separate news regions and sub-regions (subject to significant modification of original proposals). (See Figure 48 below for full details)
All Channel 3 regions	Volume of regional news	Allow reduction in volume with loss of mid-morning and weekend daytime bulletins, from 2009
ITV plc	Volume of non-news programmes for Wales	Reduce quota to 90 min per week, from 2009, maintaining as now 45 minutes in peak (1800-2230hrs), 30 min in near-peak (1700-1800, 2230-2330). Current affairs within this to remain at present level of 47min per week.
ITV plc	Volume of non-news programmes for English regions	Reduce quota from 30 min per week previously agreed for 2009 to 15 min from 2009, all in peak and near-peak
stv/UTV	Volume of non-news programmes in Scotland and NI	Reduce to minimum of 90 min per week, from 2009 (as with ITV Wales, peak, near-peak and current affairs elements within this to remain at present levels)

Channel TV	Volume of combined news/non-news	Reduce quota to 4h per week
Channel 3 network	Volume of network current affairs	Reduce from 90 min per week to 50 min from 2010 (40 min in peak, as now)
Channel 3 network	Out-of-London network production quota	Reduce spend and volume quotas from 50% to 35% from 2009
Channel 4	Out-of-London production quota	Increase spend and volume quotas from 30% to 35%, of which a minimum 3% from outside England from 2010, aligned to new long-term funding arrangements for Channel 4
Five	Original production quota	Reduce quota for original productions from 53% to 50% (42% to 40% in peak)
Teletext	Licence obligations	Reduce number of regional news regions from 19 to 13, while increasing page count in each region by 40%; cut non-news regional coverage on analogue; reduce national news volume

- A1.4 Most of the issues identified arise from specific requests for regulatory relief made by the relevant commercial licensees, as their PSB benefits decline towards digital switchover. Phase 1 of the PSB Review acknowledged the rapid drop in the value of PSB status in relation to the cost of fulfilling public service obligations.
- A1.5 For Channel 3 in particular, the cost of meeting those obligations at their current levels is likely to exceed the value of the benefits very soon. The licences will then be in deficit, and it might be in ITV plc's interests to surrender them if obligations are not reduced accordingly. Ofcom believes that ITV has key PSB contributions to make, for as long as the current regulatory model continues. These contributions are particularly in the areas of UK national and international news, original UIK productions, and nations and regions news. However, funding will not be available to enable all of these contributions to continue at their current levels.
- A1.6 The exact point when the ITV plc licences dip into deficit is not agreed between ITV and Ofcom, but both accept that it will occur well before the completion of switchover in 2012. Ofcom believes that it is in viewers' interests to retain public service delivery from ITV at a level that is aligned with the benefits to the company. Therefore, while it is open to Ofcom to take no action, we believe that this would be inconsistent with our duty to maintain and strengthen the quality of public service broadcasting.
- A1.7 Historically, commercial broadcasters' privileged access to the analogue broadcast spectrum also allowed them virtually unchallenged access to the lucrative TV advertising market. Now, with digital penetration at around 87% of households and analogue advertising revenues falling yearly, the scope for delivering PSB obligations – with their concomitant opportunity costs - is very much curtailed. Under the current legislation, some benefits of PSB status will continue into the fully digital age - including guaranteed spectrum and EPG prominence – but these are worth very much less than the privileges in a previous era.

- A1.8 In view of the balance between the costs and benefits of PSB status and the particular commercial pressures on ITV, ITV plc has asked Ofcom to consider a wide range of changes to the regulatory requirements that impact on ITV1 and ITV plc, as included in the list above. Most of the ITV plc proposals included within this consultation relate to specific public service quotas and obligations placed on the ITV1 channel and the regional licensees. Other proposals are outside the scope of this PSB review, and may be considered by Ofcom separately. For example, ITV plc has made specific proposals relating to the regulation of advertising and teleshopping on public service broadcasters, which Ofcom will consider as part of its further consultation on the rules on advertising, to be published later this autumn.
- A1.9 The non-ITV plc owned companies (stv, UTV and Channel) face economic challenges of their own - with the Scottish licences in particular approaching deficit within the next year or so. For these companies, the surrender of their PSB licences makes little sense, because their business models revolve around delivering their own services within an ITV network schedule. This sustaining service would be likely to be lost if they gave up their PSB status.
- A1.10 For now, all the purely commercial PSB broadcasters - ITV1, Five, GMTV and Teletext - say they are keen to retain their status, if their regulatory obligations can be matched to the residual benefits of PSB. In Five's case, its PSB benefits will actually outweigh costs up to and beyond the current licence period. GMTV also feels that its obligations go with the grain of its own commercial objectives. Teletext has asked for a relaxation of requirements in the short term.

Costs/benefits and ITV quotas

- A1.11 Ofcom is currently required by statute to impose tier 2 quotas⁶⁶ in a number of areas that might disappear under new legislation. Having assessed the specific quota relaxations requested by the broadcasters, we are now seeking stakeholders' views on Ofcom's proposals.
- A1.12 ITV plc asserts that its current level of PSB obligations will exceed benefits during 2009. Ofcom's own modelling suggests that the cross-over point will be during 2011 but, even on Ofcom's figures, the costs would outweigh benefits by £75m in 2013. ITV has proposed a number of adjustments to its Tier 2 quotas. The package of revisions is estimated by Ofcom to deliver savings of more than £50m a year (see Figure 48 below) - but even these proposals are not sufficient to bring costs into line with benefits throughout the remainder of the licence period. ITV has also suggested other changes, not included in the table below, which Ofcom has rejected and is not consulting on.

⁶⁶ Communications Act 2003 Sections 277 (independent productions); 278 (original productions); 279 (news and current affairs); 286 (regional programme making); 287 regional programmes on Channel 3; 288 (regional programme making for Channel 4)

Figure 48: Estimated savings resulting from proposed changes to ITV Tier 2 quotas

Proposed changes to ITV Tier 2 quotas	Ofcom estimate of savings to ITV plc
Changes to pattern of regional news	£40m
Reduction in volume of regional news	Included in above
Reduction in volume of non-news programmes in Wales	£2m
Reduction in volume of non-news in English regions	£4m
Reduction in network current affairs	£3m
Reduction in spend and volume quotas for out-of-London production	£5m

Regional news

- A1.13 In considering and developing the proposals put forward here, Ofcom's objective has been to maximise PSB delivery, aligned as far as possible to viewers' requirements, within the resources available. Chief among the ITV plc proposals is the plan to trim £40m a year from its regional budget, by partially merging particular regional news operations and reducing the output of existing sub-regions. Regional production facilities would be further centralised in certain cases. Given the economic situation described at the opening of this chapter, Ofcom accepts that it is necessary to make savings of this kind. ITV has stated that, in any event, the budget for regional programmes will be cut by this amount.
- A1.14 ITV plc currently offers 17 separate main regional news programmes across the 11 regional licences that it holds. Additionally, the two smallest ITV regions in terms of population – Border and Westcountry – offer short variations within their respective services at sub-regional level – four in Westcountry, and a split between the English and Scottish parts of Border.
- A1.15 ITV plc indicated in autumn 2007 that it would like to make changes to its regional news provision. In December, the company submitted formal proposals to Ofcom for a revised regional map for news, comprising nine main programmes (London; Granada; Central; Meridian; Yorkshire; Anglia; Westcountry/West; Tyne Tees/Border and Wales). The proposals involved the merger of ITV Tyne Tees and ITV Border regions; the West and Westcountry regions; and the absorption of the Thames Valley news programme into Meridian (the latter programme currently covers part of Central and part of Meridian).
- A1.16 Under these proposals, there would be no separate (sub-regional) main programmes within single licence areas. At present there are two programmes in Central (east and west); two in Meridian (south and south-east); two in Yorkshire (north and south); two in Anglia (west and east); and two in Tyne Tees (north and south). Instead of these full sub-regional programmes, ITV originally proposed much shorter sequences for Central east and west; Meridian east and south/west; West and Westcountry; Tyne Tees and Border.

- A1.17 In addition to regional mergers and loss of sub-regional programmes, ITV plc also proposed a reduction in news minutage from the current 5 hours and 20 minutes per week to "no more than 4 hours". In proposals to Ofcom, ITV plc suggested that this would be achieved through the loss of bulletins on weekday mornings and weekend lunchtimes. Finally, ITV plc proposed to save further costs by merging production of two or more programmes within centralised studio facilities (known as 'hubbing').
- A1.18 Regional programming, and regional news in particular, has been a leading part of ITV's contribution to the purposes of PSB. But the unavoidable fact is that regional obligations represent the single biggest PSB cost to ITV, by a significant margin. They are therefore the biggest factor in the balance between the costs and benefits of ITV's PSB status. As noted above, the company itself has made it clear that a cost saving of £40m will be made from regional news in any event – whether Ofcom agrees any changes in licence requirements or not. Under the terms of the Communications Act, Ofcom has no power to enforce any budgetary requirement on ITV, but ITV must ensure that regional programmes continue to meet the statutory criteria, including that they are of high quality and of particular interest to the regional audience.
- A1.19 In response to dialogue between Ofcom and ITV plc and dialogue with stakeholders in the regions, the original proposals have been repeatedly modified. Ofcom's principal concern has been to maximise local news-gathering and targeted output, in line with the statutory requirement for programmes to be made in the region and to be of particular interest to the regional audience. Ofcom's input has been informed, in particular, by the results of the extensive deliberative and quantitative research described below. As a result, ITV plc has increased the durations planned for a number of sub-regional variations in main programmes and now plans to retain separate late-evening bulletins in all sub-regions. A significantly greater number of sub-regional services have been retained in the proposals for consultation, compared with ITV's original proposals. A summary of the proposals on which we are now consulting is set out below in Figure 49.

Figure 49: ITV plc proposals on regional programmes

Details of proposed changes to ITV regional news patterns

Existing pattern is shown in italics

The nine news regions would each run pan-regional bulletins at lunchtime on weekdays and at weekends. At 6pm they would all run a half-hour flagship programme. In news regions with sub-regions they would run alternate 15-minute or six-minute sequences for the different parts of the region, within the 6pm programme, enabling the delivery of a greater volume of local news. The late weekday bulletins would be distinct in the 15 sub-regions, running material centred on the sub-region but including strong stories from the wider region.

News regions with 15-minute sub-regional variations in main programme

- 1) Border/Tyne Tees (One 15-minute sequence for Tyne Tees and one for Border, also separate late evening bulletins)
Currently Tyne Tees has separate North/South programmes at 6pm, and Border has an entirely separate service, with short variations for Scottish and English/Manx sub-regions
- 2) West/Westcountry (One 15-minute sequence for Westcountry and one for West, also separate late evening bulletins)
Currently the West and Westcountry services are entirely separate, and Westcountry has short bulletins for four sub-regions
- 3) Meridian (One 15-minute sequence for Meridian South with Thames Valley and one for Meridian South East, also separate late evening bulletins)
Currently Thames Valley is entirely separate, and Meridian South and Meridian South-East largely so

News regions with six-minute sub-regional variations in main programme

- 1) Yorkshire (one six-minute sequence for west of ITV Yorkshire and one for east of ITV Yorkshire, also separate late evening bulletins)
Currently East and West have separate 6pm programmes
- 2) Central (One six-minute sequence for west of ITV Central and one for east of ITV Central, also separate late evening bulletins)
Currently East and West are largely separate throughout
- 3) Anglia (One six-minute sequence for west of ITV Anglia and one for east of ITV Anglia, also separate late evening bulletins)
Currently East and West are largely separate throughout

Single service regions (as now)

ITV London
ITV Wales
ITV Granada

A1.20 Ofcom conducted a programme of quantitative and qualitative (deliberative) research across the UK, focusing in particular on the regions that are affected by the ITV proposals. ITV also supplied Ofcom with the results of research that it had itself undertaken to inform its news proposals. Ofcom research defined different

scales of news provision – ITV region; ITV sub-region; and more local area. The full reports of Ofcom's research are published on our website as annexes 16 and 17. But the box and the paragraphs below summarise the methodology and main findings from the research and the conclusions we have drawn from it.

Figure 50: Audience research on regional news and proposed ITV changes

Ofcom commissioned two studies to explore audience attitudes towards regional news and ITV plc's proposed changes, both from a consumer and a citizen perspective.

Quantitative research⁶⁷ was commissioned from independent agency. Holden Pearmain, which undertook a 15-minute face-to-face survey in all ITV regions in the UK with a total sample of 3,706 adults aged 16+. The data were weighted to be representative of the demographics of the UK as a whole. The survey took place during June 2008 and covered a range of topics including sources of regional news and priorities for regional news provision.

Deliberative research⁶⁸ was commissioned from independent agency. Essential Research, which undertook full-day sessions with participants in the ITV regions that would be affected by the ITV proposals. Eight deliberative sessions were held in six ITV regions: Bedford (ITV Anglia), Bath (ITV West); Torquay (ITV Westcountry); Oxford (ITV Central licence area; ITV Thames Valley news service); Darlington (ITV Tyne Tees); Penrith (ITV Border); Dumfries (ITV Border); Galashiels (ITV Border). Each session involved 21-25 participants and took place during April/May 2008.

It is important to note that the deliberative research was designed to explore participants' reactions to a version of ITV's regional news proposals that ITV has subsequently modified. The full research report (annex 17) sets out the specific details of what was explored in the research and how the ITV proposals have subsequently changed.

The importance of regional news

The deliberative research for phase 2 supported the findings of the PSB phase 1 research, which identified that the general public value regional news, and this importance increases when thinking from a citizen perspective. Regarding plurality of supply, the quantitative research showed that it was important for regional news to be shown on more than one of the main PSB channels – this was a view shared across the regions. The deliberative findings supported this view, with participants believing that plurality of regional and local news sources was a good thing, from a consumer and a citizen perspective, for choice, convenience, impartiality of news reporting and accessibility.

The importance of different elements of regional news

In the quantitative research, respondents were asked to prioritise different elements of regional news. In those English regions with ITV sub-regions (and thus most likely to be affected by the proposed changes to ITV provision), people consistently prioritised a "quick response to breaking stories" and "a focus on the local area", as highly important, while 'coverage of news across sub-regions' was the lowest priority. The pattern of responses in English regions without sub-regions was similar, although "coverage of news across my region" moved ahead of "focus on my local area".

⁶⁷ See PSB Review phase 2 annex 16: *Regional news*. A quantitative report by Holden Pearmain.

⁶⁸ See PSB Review phase 2 annex 17: *Regional news*. A deliberative report by Essential.

The deliberative research showed that local news was of greater personal importance to the majority of participants than regional news. People tended to be more interested in their immediate surroundings than in events occurring within the broader context of their region.

Sources of local and regional news

In the quantitative research respondents named a range of sources for regional news, with television the most commonly cited. News at a more local level tended to be accessed via a wider range of sources, with newspapers on a par with television in most regions.

Proposed changes to ITV regional news

The quantitative survey provided a snapshot view of potential changes and assessed respondents' top-of-mind reactions. Results overall showed general resistance to potential changes.

When asked about the statement “I am not interested in regional news, so I would not be affected by any changes”, very few respondents agreed. In fact, more than half in almost all regions disagreed. This was most strongly felt in the Border Scotland area, where 71% disagreed with this statement. (See Figure 51). Only in London did less than half disagree.

Figure 51: Agreement with statement “I am not interested in regional news, so I would not be affected by any changes”



Source: PSB Review phase 2 quantitative research on nations/regions news. Base: Total sample size n=3,248, minimum sample in any region n=200

The quantitative research shown in Figure 52 also showed that a relatively low proportion of respondents felt they would struggle to find alternative sources. In most regions at least two-fifths of respondents agreed in total with the statement “I would easily find alternative sources for regional news and information”. This may be linked to the broad ranges of sources people say they use for regional and local news. Respondents in Border Scotland were least likely to agree (35%) and most likely to disagree (43%), making this the only region where there was a negative balance of opinion.

Figure 52: "I would easily find sources for regional news and information"



Source: PSB Review phase 2 quantitative research on nations/regions news. Base: Total sample size n=3,248, minimum sample in any region n=200

The deliberative research provided the opportunity for participants to discuss potential changes and implications at length, over the course of the day, from a more informed perspective. Specific details of proposals for change differed in each location, and as a result, responses to potential mergers and the alternative cost-saving measures varied considerably across the sites, and no two locations were the same. Commonly, respondent reactions were broadly influenced by: their perceptions of ITV, their satisfaction with the existing footprint of ITV regional news, quality of ITV regional news, and the equivalent BBC footprint, and their level of engagement with regional news.

The table below summarises findings by location with regard to current satisfaction with ITV regional news delivery and reactions to potential mergers. As stated earlier, the deliberative research was designed to explore participants' reactions to specific ITV proposals, which have subsequently been modified by ITV. It is important to bear this in mind when considering the findings detailed below.

Figure 53: Summary of reactions to potential mergers

Location	Satisfaction – current ITV news footprint	Satisfaction with current delivery of regional news	Reactions to the potential mergers
ITV West/ Westcountry (Bath/ Torquay)	<p>Bath: Satisfied.</p> <p>Torquay: Satisfaction mixed, due in part to patchy coverage, but accepted due to low population</p>	<p>Bath: No major issues. Participants liked different styles BBC and ITV news.</p> <p>Torquay: Satisfied with regional news, although issues surrounding ITV regional news quality</p>	<p><i>Research explored idea of ITV West and ITV Westcountry merger, with three six-minute sub-regional opt-outs (Cornwall, Devon/West Dorset/West Somerset, Current ITV West).</i></p> <p>Bath: Opinions split. Those in favour assumed their news interests would be looked after. Those against felt size of new region would be too large to be relevant.</p> <p>Torquay: Majority accepted</p>

			merger and thought proposed sub-opt would provide more relevant local news. Minority who rejected merger felt news would be dominated by Bristol.
ITV Tyne Tees/Border England (Darlington/ Penrith)	Satisfied, prefer ITV news footprint to BBC	Darlington: majority felt quality of ITV regional news poor. Penrith: no major issues.	<i>Research explored idea of ITV Tyne Tees/ITV Border region merger with six-minute sub-opts for Cumbria, South Scotland, and current Tyne Tees region.</i> Darlington: Potential merger was tested in three stages: with Tyneside, Cumbria, and South Scotland. Mergers with Tyneside and Cumbria were broadly accepted. There were split views on merger with Southern Scotland. Those against felt it was geographically too large. Penrith: Majority rejected merger with Tyne Tees as area was considered too large; concerns that news would be dominated by more urban North East.
ITV Border Scotland (Dumfries/ Galashiels)	Dissatisfied: felt underserved by ITV and BBC. This was linked to complex regional/national definitions	Majority felt quality very poor. Note: Quantitative research indicated expectations and requirements complex in Scottish parts of the ITV Border region. Local area and regional coverage had higher relative importance than other regions; also satisfaction levels with ITV news particularly low.	<i>Research explored idea of ITV Tyne Tees/ITV Border region merger with six-minute sub-opts for Cumbria, South Scotland, and current Tyne Tees region</i> Dumfries: Just over half in favour of merger; hoped regional news might improve with wider coverage; six-minute sub-opt of particular appeal. Those indifferent preferred Scottish or more local news. Those against felt current delivery already poor. Galashiels: Majority rejected merger, citing potential reduction in already poor quality, likely domination of news stories from urban centres, and likely focus of southern Scotland sub-

			<p>regional opt on Dumfries and Galloway. All would prefer to merge with STV.</p> <p>Note: The quantitative research showed opinions were divided when asked whether existing regional news should be merged across Scotland, with the balance of opinion slightly against this option</p>
ITV Anglia (Bedford)	Satisfied	No major criticisms of quality, although appeared to be low engagement with regional news generally.	<p><i>Research explored the idea of phasing out full sub-regional services within ITV Anglia but retaining East/West Anglia sub-regional opts.</i></p> <p>Most respondents either in favour or indifferent to merger, due to low engagement with regional news and with ITV news. Those against felt merged East and West regions would no longer be a 'regional programme'.</p>
ITV Thames Valley (Oxford)	Dissatisfied. Uncertain regional identity and no clear consensus on formal regional definitions, compounded by historical changes in ITV regional news coverage	No major issues.	<p><i>Research explored idea of merging ITV Thames Valley service with Meridian South and South East subregions, creating a single Meridian region with six-minute sub-opts including one for Thames Valley</i></p> <p>Opposed to merger. Main objections included new region would be too large to be relevant, and current programme on Thames Valley would be replaced with six-minute opt.</p>

Reduced minutage

The quantitative research showed that opinion was generally split in each English region when respondents were asked their preference for *"one regional news programme presented in the evening versus several bulletins throughout the day and late night"*. Across all English regions, the quantitative data indicated relatively low levels of claimed viewing for mid-morning and lunchtime news during the week, and for early afternoon news at the weekend. In the deliberative research across all locations the vast majority of participants accepted the proposal to reduce the news minutage, by dropping the mid-morning weekday and mid-afternoon weekend bulletins.

- A1.21 In the deliberative research conducted in the Border ITV region, there was considerable resistance to a merger with Tyne Tees. But there was a mixed picture of desired solutions. Viewers in Cumbria were keen to retain the existing service, in spite of reservations about its quality. A 'Save *Lookaround*' campaign was instituted and included a vigorous political and write-in lobby, from both sides of the English/Scottish border, to support the programme's retention.
- A1.22 In the Scottish Borders and SW Scotland administrative areas, some said they would prefer a service from Scotland to a merged service which they felt would be dominated by the urban centre of Newcastle-upon-Tyne. But opinions are clearly divided on this issue, with the quantitative research showing similar levels of agreement and disagreement on whether news about the region should be part of a merged service across Scotland.
- A1.23 The research indicates that expectations and requirements are complex in the Scottish parts of the ITV Border region: local area and regional coverage have higher relative importance than in other regions, while satisfaction levels with existing ITV news provision are particularly low. It was evident from the deliberative research that people felt underserved by the existing news provision, particularly in terms of news coverage for their local area, but this appeared to be linked to complex regional and national definitions and boundaries. Specifically, in the deliberative research, ITV's regional news footprint did not appear to match viewers' definitions of 'their region' in the ITV Border region locations of Penrith, Dumfries or Galashiels. Respondents in each location described their region as being separate from the others and, in many cases, excluding the others. Regional distinctions in these locations were either based on nationality (English v Scottish locations), municipal boundaries, or a suggested regional rivalry (Scottish Borders v Dumfries & Galloway).
- A1.24 There was less concern about the merger of ITV West and Westcountry – despite a feeling that the combined region covered a very large geographical area. According to the deliberative research, the relative indifference in Westcountry appeared to stem in part from a feeling that the ITV service did not currently serve the area particularly well. However, the quantitative research conducted across the whole of the region does not indicate any significant differences in satisfaction levels compared with other regions.
- A1.25 Viewers in the Thames Valley area also tended to have little attachment to the current service. In the deliberative research this appeared to be linked to an uncertain regional identity, with no clear consensus on formal regional definitions or boundaries, as well as a series of previous changes to the ITV regional coverage which had confused viewers and resulted in some claimed migration to BBC news.
- A1.26 When they were aware of the issues being faced, participants in the deliberative research in every location accepted the proposed reduction in news minutage through the loss of mid-morning and weekend lunchtime bulletins. This reflects the quantitative data on claimed viewing, with relatively low viewing levels for the mid-morning and lunchtime news during the week, and for the early afternoon news programme at the weekend.
- A1.27 Informed by these research findings, Ofcom identified a policy objective to maximise news-gathering/reporting as locally as possible within the practical constraints. Considerations include the requirement for economic sustainability and the limitations of existing transmitter patterns, which dictate broadcast 'footprints'.

- A1.28 Over the course of the past year, continuing dialogue with Ofcom and with other stakeholders has resulted in ITV making considerable improvements to its original proposals. Its revised plans are now more closely aligned with Ofcom's research findings. Greater distinct output for sub-regions is proposed, including separate late-evening bulletins, and the revised plans are, in our view, consistent with the requirements for high quality, and for programmes to be of particular interest to those living in the area.
- A1.29 In the merged Tyne Tees/Border main news programme, ITV plc has now committed to 15-minute dedicated sequences for the two separate licence areas, and to retain the *Lookaround* title within the ITV Border region. In addition, there is a commitment to deliver an average of six minutes of South of Scotland news within that ITV Border sequence. A similar 15-minute split is now proposed within the combined West and Westcountry region. This represents a considerable increase from the six to eight minutes variations proposed earlier.
- A1.30 ITV has now committed to at least 24 minutes of material per week-day devoted solely to the Border region (plus inclusion in other material shared with Tyne Tees) within a combination of the 6pm and late-evening bulletins. Given this, we propose that transmitters on the Isle of Man should remain with the Border region, rather than transferring to Granada. ITV has made a commitment to continue inclusion of material from the island in the Border service, and we believe it is more realistic to expect stories to be carried here, rather than within a service covering the much more urban and populous Granada region. However, we recognise that transport links from the island tend to be with the North-West of England rather than with the Border area, and we would welcome views from the island on this point.
- A1.31 ITV aims to retain its plans for 'hubbing' of production. This will involve combining the production of two or more regional bulletins at centralised studios, while retaining actual newsgathering resources at a more targeted local level. Ofcom's overall view on this is that the maintenance of local news-gathering and the presence on the ground of reporters and crews is more important than the physical location of production centres. We believe this conforms to the requirement (in the terms of the Communications Act) that an appropriate amount of programmes should be made within the area. But we propose, if necessary, to consider what modifications may be appropriate to the guidance on how programmes may qualify as being 'made in the region' to allow the studio origination to take place outside the region - provided journalistic resources are maintained in all parts of all regions.
- A1.32 In line with ITV plc's revised plans, and in the light of research findings, Ofcom now proposes the following in relation to regional news mergers:
- Border and Tyne Tees news to be merged, but with separate 15-minute sequences in the main weekday programme for viewers in the Border and Tyne Tees areas and separate late-evening bulletins. We welcome assurances that the separate output will be more evenly split than in the present programme between English and Scottish news. The Border and Tyne Tees programmes may be 'hubbed' from studios in Gateshead.
 - ITV West and Westcountry news to be merged, but with separate 15-minute sequences in the flagship bulletin and separate late evening bulletins. We believe that the very large geographic area of the proposed merged West and Westcountry regions demands more than the 6-minute splits first proposed by ITV. The programmes may be 'hubbed' (initially from Bristol, but possibly from alternative studios in due course).

- Thames Valley (formerly an amalgamation of Meridian West and part of Central South) to be absorbed into a single Meridian region. There would be a two-way split for 15 minutes between Meridian South/Thames Valley and Meridian East in the main weekday evening programme, and separate late evening bulletins after News at Ten.
- In other areas where there are currently separate (sub-regional) programmes within single licence areas (Central east and west; Yorkshire north and south; Anglia west and east) the programmes would be merged but with separate sub-regional bulletins retained.

A1.33 The overall volume of regional news within the schedule will be reduced from 5 hours 20 minutes to 3 hours 45 minutes on average per week, by dropping the weekday mid-morning bulletins and weekend lunchtime bulletins. This is consistent with the findings of both deliberative and quantitative research as discussed above: in the deliberative research, viewers were untroubled by the loss of these bulletins.

A1.34 Based on our analysis and research, we believe these proposals represent an appropriate balance between the maintenance of regional news output and plurality, which is clearly important to viewers, while reducing the cost of a regulatory obligation which is no longer sustainable at current levels. We invite comments on these proposals.

Other ITV quotas

A1.35 ITV plc's other proposals relating to Tier 2 quotas (non-news programmes in the nations and regions; out-of-London production; and network current affairs) have also been considered by Ofcom. The Act requires the delivery of a suitable range of programmes which are of particular interest to people living within each Channel 3 regional licence area, and that they should be of high quality (section 287). The Act further requires Ofcom to set quotas for a sufficient level of network current affairs and for an appropriate amount of production outside the M25 area (section 286).

A1.36 Phase 1 research⁶⁹ showed that English regional programming was generally less valued by viewers than regional news; and that plurality in such programmes was not considered to be as important as in some other programme areas. The phase 1 quantitative survey showed that just under three-quarters (73%) of respondents in England thought it important that the main TV channels provide "other programmes about my region", whereas 63% thought it important that more than one of the main channels did so (ranking tenth out of fifteen genres researched).

A1.37 But non-news programming is of greater importance in the other nations. Our phase 1 research showed that over 80% of respondents in each of the other nations thought it important that the main channels provide other nations programmes, with over 70% thinking plurality important. As indicated in phase 1, we consider plurality of supply to be important in the UK nations, particularly in respect of their separate (devolved) political and cultural institutions. As a result, we seek stakeholders' views on the following proposals, which would have effect from 2009:

- The minimum volume of 'other' (non-news) programmes for Wales to be reduced to 1 hour 30 minutes per week, but within this the peak-time, near-peak and current affairs elements would remain at current levels. These requirements

⁶⁹ See PSB Review phase 1 annex 5: *The audiences' view on the future of Public Service Broadcasting* (IPSOS Mori 2008)

would be mirrored for stv and UTV in Scotland and Northern Ireland respectively. We propose to maintain Scottish non-news programmes for the ITV Border Scotland area.

- In England, the statutory requirement for a quota for 'other' non-news programmes in the English regions to be met through current affairs and other factual-programme elements, which may - if ITV plc chooses - be delivered within the news slots. We believe that this would continue to ensure a suitable range of programming which is of particular interest to those living in the area, and that delivering the requirement in this way would better achieve this aim than by following ITV's proposed alternative – showing a small number (26) of half-hour programmes per year. The inclusion of a minimum average requirement of 15 minutes per week of non-news material in addition to the minimum 3 hours 45 minutes of news would bring the total duration of these slots to 4 hours per week.

A1.38 Ofcom announced earlier that the quota for English regional non-news programmes would reduce to 30 minutes per week for 2009, with 3 hours per week of programmes in Wales, as in Scotland and Northern Ireland. The quotas from 2010 onwards would be subject to consideration, in this review. We now feel that the further rapid changes in economic circumstances necessitate action with effect from 2009, and are therefore making proposals for change from this date.

A1.39 Network current affairs remains a high priority among viewers, who expect plurality in this area alongside the BBC. Our phase 1 research⁷⁰ showed that 85% of respondents thought the main channels should provide this content, and over three-quarters (77%) thought it important to provide current affairs on more than one of the main channels (ranking second out of fifteen genres researched) and our deliberative research identified it as a key PSB priority.

A1.40 Nevertheless, we recognise the commercial pressures on ITV in this area. At present, the channel's current affairs output is fulfilled chiefly through its twice-weekly *Tonight* programme. However, plurality in this genre is also supplied on PSB channels by Channel 4 (e.g. *Dispatches*) and by Five (e.g. *The Wright Stuff*). We therefore propose that:

- the quota for network current affairs should be reduced from 1 hour 30 minutes per week to 50 minutes per week from 2010. However, the quota for peak-time should remain at its current level of 40 minutes per week.

A1.41 The Channel 3 out-of-London production quota was set at 33% of volume and 40% of expenditure prior to 2005. However, these figures were subsequently increased to 50% of both volume and spend, in line with conclusions reached in Ofcom's *Public Service Broadcasting Review of 2004/5*.

A1.42 This review had suggested that production in, and portrayal of, the different parts of the UK were more highly valued by viewers than some non-news programmes produced in and for the nations and regions. As a result, quotas for non-news nations and regions programmes were reduced and quotas for out-of-London production were raised.

A1.43 In practice, ITV has consistently struggled to deliver the higher quota, and the requirement itself has not consistently delivered the additional diversity in portrayal

⁷⁰ See PSB Review phase 1 annex 5: *The audiences' view on the future of public service broadcasting* (IPSOS Mori 2008)

and representation that would be desirable to viewers. PSB broadcasters, including ITV, have tended to fulfil the quota through long-running series – including quiz and other studio-based programmes, such as entertainment. These programmes effectively deliver the quota, without necessarily delivering nations/regions diversity on screen. We propose:

- that ITV's quota for spend and volume of out-of-London network production should be reduced from 50% to 35% from 2009. This would be on a par with the levels in 2004.

A1.44 We have rejected a request for Ofcom support in pressing the Government for a reduction in the quota for independent production on ITV1. The minimum 25% quota is a statutory requirement applied to all public service broadcasters. We believe that this minimum is appropriate in securing diversity of production on all the public service channels, although this is ultimately a matter for DCMS. Ofcom has also informed ITV that it does not believe that any reduction in quotas for original production would be appropriate.

A1.45 In addition to the formal Tier 2 proposals already addressed, ITV believes that a further structural review of some of its programme commitments will be required in 2011 – unless new funding mechanisms can be found. It says that it remains committed to guaranteeing provision of the revised regional news proposal to 2012 and to delivering plurality of news voice in the UK, but that, given ITV and Ofcom's conclusions about the value of the ITV plc licences in 2012, there will have to be a review of the economic sustainability of the regional news service in 2011, in addition to a review of the level of the current obligation to provide national and international news in off peak hours. We recognise these issues and will be prepared, if necessary, to commence a dialogue with ITV in due course.

ITV networking arrangements

A1.46 The proposals to reduce ITV1 Tier 2 quotas, if agreed, will have a small beneficial impact on the non-ITV plc owned licensees as well as on those owned by ITV plc. However, this will not be large enough to have any significant effect on the net cost of PSB status or the underlying profitability of the non-ITV plc owned licensees.

A1.47 Of more immediate concern to the non-ITV plc licensees is the suggestion that ITV plc might seek a higher rate for the sustaining network schedule. At present the rate which these licensees pay for access to the network schedule and the right to sell airtime around ITV network programmes in their regions is highly regulated. According to ITV plc, the effect of this regulation is that the price that the non-ITV plc licensees pay is some £25m per year below the amount that they would pay based on their share of the advertising revenue that is sold on ITV1. The price paid by the ITV plc-owned licensees for access to the network schedule in their regions is correspondingly higher – some £25m above the cost based on their share of advertising revenue – which represents a subsidy to the non-ITV plc owned licensees.

A1.48 The non-ITV plc licensees strongly dispute this. They reject the notion of a 'subsidy' at the level claimed by ITV plc, and argue that the sum they are paying for programming is above market rates. Even so, ITV plc has argued that, over time, it wishes to adjust the mechanism so that the non-ITV plc licensees pay what ITV plc considers a 'market rate' for access to the network schedule.

- A1.49 The commercial relationship can only be changed if there are changes: firstly, to the undertakings given by Granada and Carlton on their merger in 2003, and secondly, to the networking arrangements between the Channel 3 regional licensees. The merger undertakings were given to the OFT and cannot be changed other than by the Competition Commission. The networking arrangements are subject to annual review by Ofcom, but any change to the cost sharing arrangements would have no practical effect until there has also been a change, or removal, of the merger undertakings on this issue.
- A1.50 It is out of the scope of this PSB review to make changes to either the merger undertakings or the networking arrangements, but Ofcom expects ITV to approach the OFT in due course to seek a revision of this aspect of the merger undertakings. Ofcom would expect to open a discussion on the licensees' contributions to the network programme budget in due course as part of its duties to undertake regular reviews of the networking arrangements.

Stv, UTV and Channel

- A1.51 As stated above, the non-ITV plc licensees (stv, Ulster and Channel) are dependent on the ITV network schedule into which their geographically based programmes are slotted and around whose programmes (network and regional) they are able to sell advertising in their regions. The overall economics of the non-ITV plc licensees are affected by the level of their contribution to the network programme budget. Also, as indicated above, if ITV plc no longer held its PSB licences, the current business models of the non-ITV plc licensees would be very seriously challenged.
- A1.52 Even without change in these areas, Ofcom's analysis suggests that the costs of holding the two stv licences will exceed benefits from 2009/10. The cost of providing news alone is greater than the benefits of PSB status. If stv were asked to pay significantly more for the network schedule, the company would immediately go into deficit.
- A1.53 Phase 1 of the PSB review identified the particular importance of plurality in the supply of news and other programmes for the UK nations, but it seems unlikely that any arrangement for public funding from the Westminster or Scottish governments will emerge before the licence slips into deficit.
- A1.54 Stv stated that the current level of non-news regional programme obligations is beyond its cost capability to deliver. It has argued that while it wishes to continue to deliver non-news regional programmes, the minimum level of output should be half an hour per week and over-delivery should be at the company's own commercial risk. This view of the economics of non-news programme provision is consistent with Ofcom's own economic analysis. Nevertheless, non-news programming is important; especially, as pointed out by the Scottish Broadcasting Commission, current affairs. Recognising this, we propose the following:
- To allow the average weekly minimum for non-news programmes to reduce to a minimum of 1 hour 30 minutes per week from 2009 but with the peak-time, near-peak and current affairs elements remaining at present levels.
 - Stv may provide a merged service of non-news programmes for the North and Central regions, without requirements for production from each of the two regions separately, as long as it remains of particular interest to viewers in all parts of the regions.

A1.55 We hope that this will allow greater flexibility, in the light of changed economic circumstances. But even with these changes, and with the quota on news minutage reduced, the costs of PSB obligations will still exceed the PSB benefits of the licences. This suggests that stv should consider alternative sources of funding for the intermediate period.

A1.56 The 1990 Broadcasting Act requires Channel 3 licensees in Scotland to broadcast programmes in Gaelic, both funded (i.e. by the Gaelic Media Service) and non-funded (i.e. paid for by the licensees themselves). Currently stv North and stv Central are together required to broadcast one hour per week of licensee-funded Gaelic programming (which forms part of the stv licensee's current shared four hour per week minimum non-news requirement) and a further one hour per week of GMS-funded Gaelic programmes (which sits outside that four hour minimum non-news requirement).

A1.57 We believe that stv's Gaelic obligations need to be considered within the context of the Channel 3 service for Scotland as a whole, and they should strike the right balance between English language programming and Gaelic programming. We therefore propose that (subject to the relevant legislative changes being made):

- stv should lose its requirement to broadcast licensee-funded Gaelic and to broadcast GMS-funded Gaelic in peak from 2009 - but it should continue to broadcast one hour per week of GMS-funded programming until switchover in Scotland is complete. This is in addition to the non-news requirement proposed above.

A1.58 The new Gaelic service BBC Alba launched on 19 September 2008, on cable, broadband and satellite. This is a partnership between MG Alba (formerly the Gaelic Media Service) and the BBC. We recognise the concerns of Gaelic viewers that the BBC has given no commitment at this stage to availability on DTT. We will seek to input to the BBC Trust process, which will review whether DTT carriage is to be approved.

A1.59 UTV's financial position is more assured, and we believe it will be able to fulfil its commitments to news and other programmes throughout the licence period – although this position is dependent on continued receipt of the ITV network schedule at current cost. If costs were much higher, the UTV licence could also go into deficit. However, UTV has argued that while it remains committed to delivering a wide range of non-news programmes, the regional non-news obligations within its licence should reduce as digital penetration in Northern Ireland increases. We recognise that pressures do exist and therefore propose:

- to reduce the quota for non-news programming to a minimum of 1 hour 30 minutes per week, with peak-time, near-peak and current affairs elements remaining at present levels.

A1.60 Channel TV – the smallest of the Channel 3 licensees – is also vulnerable. Its profitability relies heavily at present on profits generated through handling network compliance for Channel 3. This income is likely to reduce significantly, in which case, the licence would appear to be unviable and in need of direct funding to sustain regional news delivery. In the short term, we propose:

- to reduce Channel's combined news and non-news quota to 4 hours per week, in line with the English Channel 3 regions. In the nature of the slots within the

network schedule, Channel would need to provide its own material to fill these slots in any case.

- A1.61 In summary, these proposals will mean that the minimum weekly non-news requirement for stv, UTV and ITV Wales is reduced from four hours in 2008 to one and a half hours per week from 2009. Unlike in England, the non-news quota will continue to be delivered outside the news slots.
- A1.62 We propose that the minimum news requirement will fall to 4 hours per week on stv, UTV and ITV Wales, in parallel with the changes in the English licences, since all the regional licensees insert their regional news bulletins into the same network schedule.

Out-of-London quotas (including Channel 4)

- A1.63 Under the legislation, PSB broadcasters are each required to comply with requirements relating to the volume and range of production outside the M25 ('out of London'). Production must also be referable to a range of different production centres. (Sections 286, 288 of the Act and clause 51 of the BBC Agreement).
- A1.64 Achieving an appropriate volume of out-of-London production should remain an important ambition for public service television. We accept that commercial pressures mean that ITV requires a greater degree of flexibility in this area. However, even after a proposed reduction of ITV's quota from 50 to 35 per cent (volume and spend) the channel would retain a higher quota for out-of-London production than any other PSB.
- A1.65 Having considered the issue carefully, we do not believe that ITV is the appropriate broadcaster on which to place specific requirements for productions from Scotland, Wales and Northern Ireland, and therefore do not propose to introduce any such quota. It is clear that meeting the existing quota for out-of-London production imposes a significant cost on ITV; a factor leading us to consider reduction of this quota. To impose an out-of-England obligation within the overall quota would increase these costs further, at a point when the costs of holding a PSB Channel 3 licence are already expected to exceed the benefits ahead of switchover. We believe such an obligation is more appropriate to the BBC and Channel 4, with whose public objectives it is more closely aligned. In the case of Channel 4, which has already made some proposals on this issue in *Next on Four*, we recognise that imposition of this new quota may have some impact on the level of their funding gap.
- A1.66 We welcome the BBC's target to reach 50% out-of-London production, with 17% from the nations – although we hope this might be achieved sooner than 2016. Spend in the nations is low in relation to population, across all the PSBs, but the BBC spends significantly more in the nations than all the other PSBs taken together, the BBC quotas cover all of its channels whereas the commercial PSB quotas apply only to the main PSB channel.
- A1.67 We also welcome the BBC's adoption of Ofcom's guidance on the definition of 'out of London', which is more tightly drawn than the one formerly used by the Corporation. Meeting this definition will have the effect of significantly increasing the volume of BBC production outside London. The newly adopted standard requires two out of three key criteria to be met:
- a substantive business/production base outside the M25;

- more than 70% of production budget spent outside London; and
- more than 50% of production staff employed outside London.

A1.68 The BBC's new out-of-London commitments are very significant, particularly in the nations, where the commitment to spending 17% of the programme budget is more than double the current level of PSB nations spend. We also welcome Channel 4's initiatives to increase out-of-London expenditure, and propose a quota of 3% for production from the devolved nations from 2010, combined with a quota of 35% for total out-of-London production, both from 2010, in line with the Act sections 288 (c) and (d). Recently, the Channel has comfortably exceeded its current 30% quota (by volume and spend), but the increase would serve to 'lock in' the current delivery. We hope and anticipate that the volume of production in the nations will rise in future years, and we will consider whether future upwards adjustment of the quota is required.

A1.69 Changes to Channel 4's out-of-London quotas influence where the programme budget is spent, rather than necessarily requiring any increase in the budget. They therefore represent modest opportunity costs, rather than adding significantly to direct costs. Introduction of the 3% devolved nations quota from 2010 is more stretching than Channel 4's own proposal to deliver this from 2012. Nevertheless, it is a figure which Ofcom – like the Scottish Broadcasting Commission – believes should continue to grow substantially. In the longer term, this would need to be aligned with new funding arrangements for Channel 4. Development is more challenging for the Channel than for the BBC, which has its own production bases in the nations to draw on. But the BBC is also committed to developing independent production sectors in the nations; acceleration of the BBC timetable would also assist Channel 4 in jointly increasing these sectors.

Five

A1.70 Five has fewer regulatory obligations than other commercial PSB channels, but contributes to plurality in a number of ways. It provides news targeted at a younger audience than the other channels, UK-originated programming in some underserved genres (arts and history), and in particular, programmes with a UK voice for pre-school children.

A1.71 The channel says it is keen to remain as a PSB up to and beyond the expiry of its current licence (2014), and has asked for only minor regulatory adjustments in the short term. Five broadly agrees with Ofcom's analysis that the costs and benefits of its PSB status are aligned even beyond the current licence period.

A1.72 Five has proposed that its commitment to the delivery of children's programmes be formalised, and Ofcom believes that this could also usefully apply to factual programmes. Five has also agreed in discussions with Ofcom to consider extending the target age range for its children's programmes to embrace more fully primary age as well as pre-school children. Although there is no statutory basis to set quotas for these under current legislation, the channel envisages fulfilling the commitments within the framework for annual statements and reviews of PSB policy (Tier 3).

A1.73 In the meantime, Five has sought some relief from its current Tier 2 quota for original productions, which Ofcom must set in accordance with section 278 of the Act. This requires that an appropriate proportion of the schedule includes original

productions and that these should be split in an appropriate manner between peak and off-peak.

- A1.74 Five's quota for original productions has been a recurring issue for the broadcaster over the past few years. One reason is that a significant number of Five programmes – especially children's – are re-versioned forms of acquired overseas productions. Typically, this involves replacing US voices with UK accents and amending cultural references in factual programmes and within children's animation.
- A1.75 Ofcom has allowed such programmes to count as original productions to the extent of Five's investment compared to the cost of acquisition, up to a maximum of 50%. This formula conforms to a statutory order made by the Secretary of State defining original production. Five has sought Ofcom's support in lobbying for the definition to be redrawn.
- A1.76 We accept that Five's current quota of 53% is challenging in relation to its overall programme budget, and propose:
- to revise this down to 50%, with a reduction from 42% to 40% in peak time, from 2009. We believe that this would remain consistent with ensuring the channel is consistently of high quality. However, we have rejected Five's arguments in relation to the definition of original production, on the grounds that allowing a re-versioned programme to count 50% towards origination is not ungenerous, within the spirit of setting targets for UK origination.
- A1.77 We also agree with Five that the Original Productions Order should be redrafted so that programmes 'previewed' on PSB portfolio digital channels shortly before transmission on the main channel may count as original productions for the latter. This would bring commercial PSBs into line with the BBC. It is a matter for DCMS consideration.

Teletext

- A1.78 Teletext has proposed some changes to its PSB licence obligations from 2009 as a result of the falling value of its PSB licence, due to a decline in analogue viewing and revenues which have not been offset by its DTT service.
- A1.79 In particular, Teletext wants to:
- reduce regional news regions from 19 to 13 (while increasing the number of regional news stories in the new regions by 40%);
 - reduce the minimum page count of non-news regional pages on the analogue service to the level of the digital service; and
 - reduce national /international news from 30 pages to 20 pages.
- A1.80 We propose to accept these changes to the current licence obligations. In Ofcom's first PSB Review, Ofcom concluded that Teletext "should be given greater flexibility in meeting obligations through the DSO period". The proposed changes would continue to ensure the availability of material of particular interest to those in different parts of the UK (in accordance with section 289 of the Act) while helping to reduce the costs of Teletext's obligations. We believe such changes would also

allow greater flexibility in delivery. The rationalisation of regions in this way is also consistent with ITV regional proposals.

- A1.81 In the long term, Teletext argues that intervention, in the form of a continued PSB licence, is justified to ensure that wide-ranging, high-quality editorial TV text information remains available for those who need and want it. Teletext believes that the commercial markets on this platform would not supply the same range or quality of content, and online services would not offer replacement value.
- A1.82 We have considered whether intervention via a public teletext licence will be necessary to secure public purposes after 2014. Continuing intervention might be justified where the market will not deliver a plurality of information service providers, or where these market-provided services do not deliver content related to the public purposes. Based on current evidence, we think that any such concerns will be limited and addressable under alternative models.
- A1.83 There is already plurality of provision of information services on all digital TV platforms. This includes the BBCi services, Teletext's own purely commercial services, and other commercial TV services such as SkyText. Additionally, there are numerous information service providers in print, on the internet, and on other non-broadcast platforms. Our analysis suggests that, both collectively and within individual services, these offer a fairly broad range of high quality content meeting the public purposes.
- A1.84 While not all households currently choose to receive such services, we expect that by 2014 most households will have access to multiple platforms, with most information services on them being free at the point of use. And increasingly, non-broadcast technologies will be used to deliver content to a number of platforms, including the TV via an internet connection.
- A1.85 While we recognise that there may be households who choose to rely exclusively on the TV for text information services, and that these may include those with lower incomes and those with sensory impairments for whom text services may be particularly important, we think the services available to them, while more limited than others, will deliver public purposes. In the long run, we do not think that the particular needs of these groups would justify the intervention of a public service licence.
- A1.86 Therefore we consider that intervention via a public teletext licence is unlikely to be necessary. Under most future models, Teletext would continue as a purely commercial provider within the wider market. Under some models, there may be additional potential for Teletext (and other commercial providers) to bid for competitive funding for public service content - such as regional news - where the market may provide less competition to the BBC.

GMTV

- A1.87 No further regulatory changes are sought or required in relation to GMTV. As with Teletext, however, we are considering the longer-term position of the channel in the wholly digital era.
- A1.88 We believe the logic that led to the creation of a separate breakfast-time licence no longer applies, and that any future Channel 3 PSB licences would probably best operate on a 24-hour basis. The three and a half hour per day GMTV licence, while viable, is a structural intervention in the advertising market that seems anachronistic

in a multichannel, on-demand world. Our post-2014 view is that there should be no separate breakfast-time licence and the airtime should revert to the main regional channel 3 licences, if these are still in place. This will contribute to the economic viability of the regional licences.

- A1.89 It is unlikely that the nature of the breakfast-time content – principally news, soft current affairs and children's programmes – would be much changed in a 24 hour Channel 3 structure. The licensee (with ITV plc as a 75% shareholder) suggests that the current mix of programming is optimal for the day part. However, it would be necessary to adjust existing Tier 2 obligations for a 24-hour Channel 3 service, to accommodate the high level of news and current affairs in the breakfast-time output.

Annex 2

Responding to this consultation

How to respond

- A2.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 4 December 2008**.
- A2.2 Ofcom strongly prefers to receive responses using the online web form at http://www.ofcom.org.uk/consult/condocs/psb2_phase2/howtorespond/form, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 4), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A2.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email PSBReview@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A2.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Yiannis Theodorou
PSB Review
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- Fax: 020 7981 3706
- A2.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A2.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at the end of section 1. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

- A2.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please email PSBReview@ofcom.org.uk.

Confidentiality

- A2.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether

all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A2.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A2.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>

Ofcom's consultation processes

- A2.11 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in annex 3.
- A2.12 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A2.13 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash
Ofcom
Sutherland House
149 St. Vincent Street
Glasgow G2 5NW

Tel: 0141 229 7401
Fax: 0141 229 7433

Email vicki.nash@ofcom.org.uk

Annex 3

Ofcom's consultation principles

A3.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

A3.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

A3.3 We will be clear about who we are consulting, why, on what questions and for how long.

A3.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A3.5 We will consult for up to 10 weeks depending on the potential impact of our proposals.

A3.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.

A3.7 If we are not able to follow one of these principles, we will explain why.

After the consultation

A3.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 4

Consultation response cover sheet

- A4.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, www.ofcom.org.uk.
- A4.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A4.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A4.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at www.ofcom.org.uk/consult/.
- A4.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing	<input type="checkbox"/>	Name/contact details/job title	<input type="checkbox"/>
Whole response	<input type="checkbox"/>	Organisation	<input type="checkbox"/>
Part of the response	<input type="checkbox"/>	If there is no separate annex, which parts?	

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

Annex 5

Glossary

AIP (Administered incentive pricing) a fee charged to users of the spectrum to encourage them to make economically efficient use of their spectrum.

AVMS (Audio-Visual Media Services Directive) The successor to the Television Without Frontiers directive, adopted by the European Council in 2007.

Average weekly reach the number of adults aged 4+ who watch at least 15 consecutive minutes of a specified TV channel or genre in a specific week (or in an average week over a longer period).

BARB the pan-industry body which measures television viewing (Broadcasters' Audience Research Board).

Broadband a service or connection which capable of supporting always-on services which provide the end-user with high data transfer speeds. Large-capacity service or connection allowing a considerable amount of information to be conveyed often used for transmitting.

Channel 3 the 15 regional ITV licensees and one licensee (GMTV) providing the national breakfast-time service (see also ITV1, below).

Commercial PSB main terrestrial channels ITV1, GMTV, Channel 4, Five.

Commercial PSB portfolio channels refers to channels that are owned and operated by the same parent company as the commercial public service broadcasting main terrestrial channels, but which do not have public service broadcaster status, e.g., ITV2, ITV3, ITV4, E4, More 4, Film 4, Five US, Five Life.

Communications Act Communications Act 2003, which was passed in July 2003.

DAB (Digital audio broadcasting) A set of internationally accepted standards for the technology by which terrestrial Digital Radio multiplex services are broadcast in the UK.

DCMS Department for Culture, Media and Sport.

DDR Digital Dividend Review.

Deliberative research a qualitative methodology whereby participants are provided with a wide range of evidence in different formats and given time for in-depth informed discussion from a citizen as well as personal perspective.

DSHS Digital Switchover Help Scheme.

DSO (Digital switchover) the process of switching over the current analogue television broadcasting system to digital, as well as ensuring that people have adapted or upgraded their televisions and recording equipment to receive digital TV.

DTT (Digital terrestrial television) currently most commonly delivered through the Freeview service.

EPG (Electronic programme guide) A programme schedule, typically broadcast alongside digital television or radio services, to provide information on the content and scheduling of current and future programmes.

Free-to-view TV Channels or services for which no payment is required at the point of reception (excluding the licence fee), except for the initial cost of reception hardware.

Genre a category of television programming, for example current affairs or entertainment.

HDTV (High-definition television) A TV system which provides a clearer, sharper picture than standard definition through higher resolution. HD transmission format must display at least 720 lines on screen.

Hours transmitted Transmission time by the broadcaster, excluding simulcasts or time-shifted transmission, but including all advertising and promotional time. Therefore, for a channel broadcasting 24 hours per day, 365 days per year, total hours should be 8,760.

Independent production Programmes made on behalf of the broadcaster by a producer that qualifies under the Independent Production Order.

In-house production Programmes made entirely or largely using staff employed or otherwise contracted to the broadcaster. This excludes programmes made by a broadcaster's parent company or international affiliate.

Interactive media digital media such as text, graphics, video and sound, which users can interact with, typically delivered via the internet.

IPTV (Internet protocol television) The term used for television and/or video signals that are delivered to subscribers or viewers using internet protocol (IP), the technology that is also used to access the internet. Typically used in the context of streamed linear and on-demand content, but also sometimes for downloaded video clips.

ITV1 Refers to the Channel 3 service, apart from GMTV. ITV plc operates 11 licences in England, Wales and the Scottish Borders, known collectively as ITV1. Other ITV licences are operated by stv, UTV and Channel TV. At times in this document we have used the term ITV1 to cover the network and nations/regions services throughout the UK and Channel Islands. This is to distinguish it from ITV plc's other channels, ITV 2, 3 and 4. (See also Channel 3, above).

Long term past the end of current commercial broadcasting licences - beyond 2014 (usually but to 2020).

Medium term from 2011 to the end of current commercial broadcasting licences in 2014.

Multichannel In the UK this refers to the provision or receipt of television services other than the main five channels (BBC One & Two, ITV1, Channel 4/S4C, Five) plus local analogue services. 'Multichannel homes' comprise all those with digital terrestrial TV, satellite TV, digital cable or analogue cable, or TV over broadband. Also used as a noun to refer to a channel only available on digital platforms (or analogue cable).

Multiplex A device that sends multiple signals or streams of information on a carrier at the same time in the form of a single, complex signal. The separate signals are then recovered at the receiving end.

NAR (Net advertising revenue) Revenue received by a channel for the sale of airtime (usually spot advertising) to advertisers. This is expressed in real terms at 2006 prices.

Network programmes The programme is produced for broadcast to households across the UK.

Non-network programmes The programme is produced for broadcast to households within a specific region or number of regions within the UK. This is only possible where a programme is broadcast in a regional slot on BBC1, BBC2 or ITV.

Non-PSB channels refers to channels other than the public service broadcasting channels.

Ofcom's first PSB review (2003-5) Ofcom's first statutory review into public service television broadcasting, undertaken in 2003-5.

Ofcom's second PSB review (2007-9) Ofcom's second statutory review into public service television broadcasting, the terms of reference for which were published on 11 September 2007.

Originated programme A programme commissioned and either broadcast for the first time or repeat broadcast by a UK broadcaster.

PACT The trade association which represents the commercial interests of the independent production sector.

Pay-per-view TV Programmes, channels or services for which a one-off payment is required to enable reception or use.

Pay TV channels or services typically available in a package or bundle for which a regular subscription or other payment (excluding the licence fee) is required to enable viewing.

Peak time The period during which a television station broadcasts its early and mid-evening schedule, typically used by Ofcom to refer to the period between 18:00 and 22:30 each day (including weekends).

Platform the mechanism through which content or services are delivered to the home, for example digital terrestrial television, satellite, cable, IPTV and broadband.

Plurality the delivery of PSB content by more than one provider.

Portfolio channels refers to channels that are owned and operated by the same parent company as the public service broadcast channels, but which do not have public service broadcasting status, except in the case of the BBC.

PSB Public service broadcasting, or public service broadcaster.

PSB channels BBC One, BBC Two, ITV1, GMTV, Channel 4, Five, S4C, CBBC, CBeebies, BBCNews24, BBC Three, BBC Four, BBC Parliament.

PSB main five channels BBC One, BBC Two, ITV1, GMTV, Channel 4, Five, S4C.

PSB purposes, the public purposes Objectives of programming set out by Ofcom in its 2004 public service broadcasting review, which are used to measure how well public service programming is being delivered by the public service broadcasters.

Purpose 1: Informing our understanding of the world - To inform ourselves and others and to increase our understanding of the world through news, information and analysis of current events and ideas.

Purpose 2: Stimulating knowledge and learning - To stimulate our interest in and knowledge of arts, science, history and other topics, through content that is accessible and can encourage informal learning.

Purpose 3: Reflecting UK cultural identity - To reflect and strengthen our cultural identity through original programming at UK, national and regional level, on occasion bringing audiences together for shared experiences.

Purpose 4: Representing diversity and alternative viewpoints - To make us aware of different cultures and alternative viewpoints, through programmes that reflect the lives of other people and other communities, both within the UK and elsewhere.

PVR (Personal video recorder) a device, usually built into a set-top box or TV set, which records content digitally onto a hard disk. The unit may have several tuners to record programmes simultaneously, as well as enabling facilities such as live pausing.

Reach (TV) proportion of total TV households viewing a particular channel over a specified time, expressed as a percentage of total available TV households.

Reach and impact ensuring that public service content reaches the maximum possible audience, or reaches a smaller audience but in a way that has maximum personal and social value to that audience.

Regional production programmes that meet the regional production definition. This stipulates that programmes should meet at least two out of the following three criteria:

- i) the production company must have a substantive business and production in the region;
- ii) at least 70% of the production budget (excluding the cost of on-screen talent, archive material and copyright costs) must be spent in the region;
- iii) at least 50% of the production talent (i.e. not on-screen talent) by cost must have their usual place of employment in the region.

Share (TV) proportion of total TV viewing to a particular channel over a specified time, expressed as a percentage of total hours of viewing.

Short term before the completion of digital switchover - from now to 2011.

Tier 1 refers to broadcasting standards, such as avoidance of harm and offence, and maintenance of due impartiality. Tier 1 applies to all UK-licensed broadcasters.

Tier 2 refers to programme and production quotas. These mainly apply to PSB channels, and include news, current affairs and regional programmes; also originally-produced and commissioned programmes, independent productions and production outside London, for example.

Tier 3 refers to the other PSB genres, where the PSB channels themselves are mainly responsible for determining delivery: arts, drama, religious and children's programmes, for example.

TV programme rights the definitions of primary and secondary rights to programming vary slightly by purchaser. The major terrestrial broadcasters (BBC, ITV, Channel 4, Five) all publish their definition of what these rights constitute in their respective codes of conduct for contracting with independent producers.

VoD (Video on demand) a service or technology that enables TV viewers to watch programmes or films whenever they choose to, not restricted by a linear schedule. Also Near Video on Demand (NVoD) is a service based on a linear schedule that is regularly repeated on multiple channels, usually at 15-minute intervals, so that viewers are never more than 15 minutes away from the start of the next transmission.