Channel 4 Response to Ofcom questions on Out Of England quota

a) Following the close of consultation, does the 9% quota level by 2020 remain C4C's preferred option? If not, what is C4C's new proposal?

9% remains C4C's preferred option. We continue to believe this is a proportionate and realistic figure that takes into account C4C's status as a publisher broadcaster and its multi-faceted public service remit as given to it by Parliament. 9% is a stretching but achievable proportion of network spend – which is appropriate given the formally binding nature of a licence condition with formal consequences if they cannot be delivered.

In addition to this formal licence condition, under a 9% quota C4C would consider making additional voluntary commitments aimed at supporting production in the Nations (reflecting the difference between the public 'commitments' and 'aspirations' made by the BBC in this area, and the formal licence condition that C4C would be subject to). This could include:

- Stating publicly that we see the 9% as a base minimum and our aspiration will be to exceed this quota where possible.
- Developing partnerships with broadcasters and other partners to develop skills and genre expertise in the independent production sector.
- Publishing the breakdown by spend and by hours for each Nation
- Meeting annually on a formal basis with Nations stakeholders to review progress

C4C would report on the outcome of all of these voluntary commitments on an annual basis through its formal accountability framework, the SMCP.

b) For C4C's proposal, did C4C conduct any projections or financial impact analysis, or analyse the costs and benefits of alternative options, in reaching the proposal? If so, could C4C share that analysis with Ofcom?

C4C did not conduct a full 'financial impact' or cost/benefit analysis of the 9% target or any other target, as the central considerations that led to this proposal are primarily logistical rather than financial. The proposal put forward takes into account the commissioning flexibility required to fulfil all the various aspects of the remit.

The implications of an increased Nations quota beyond 9% raise potential consequences both in relation to C4C's public service remit delivery and our ability to operate our cross-funding model effectively. As such, the analysis behind the 9% proposal is more complex than can be captured through a simplistic quantitative analysis.

In order to reach our proposal, we looked at our existing commissioning across each genre and identified what opportunities there were for growth, based on our analysis of the skillsets in each sector and their scope for further development. This is in line with C4C's broader strategy of focusing on the indigenous production sector. It included an analysis of the independent production companies in each Nation, their expertise, capacity for growth and 'fit' with C4C, as well as the availability of slots within the schedule (See p8) and the potential scope for increased commissioning in each genre (Redacted). Based on this detailed analysis, it was agreed that 9% would be a stretching but realistic target for C4C based on the genuine strengths and opportunities in each production sector in each genre.

With any regulatory intervention, it is necessary to establish where the 'tipping point' is between fixing a market imbalance and the risks associated with undermining free competition. C4C's analysis of the sector's ability for growth has concluded that 9% by 2020 is this tipping point – we believe that with time and resource the indigenous production sectors in each Nation will be of such a size, scale and range by 2020 that commissioning at this volume will be possible without disproportionately limiting our creative and commercial choices. However, if C4C were forced to deliver a quota above this figure, C4C could be forced to make commissioning decisions solely for the purposes of delivering to the production quota rather than any other considerations – potentially having to displace or decommission other shows that delivered strongly to our remit or provided commercial revenues, but which were made in other parts of the UK.

C4C's status as a commercially funded broadcaster with a wide ranging public service remit means that it must constantly balance competing objectives – to deliver its public service remit, to sustain a diverse supply base, and to generate commercial revenues to sustain its investment. It is important that C4C is not charged with so many competing elements that this model is undermined.

c) Has C4C conducted any analysis of the costs and benefits that have resulted from the increase in Out of England production following the introduction of the quota i.e. from 2010 to date? If so, could C4C share that analysis with Ofcom?

Channel 4 has not conducted any retrospective analysis of this kind.

Impact of the options

Ofcom has outlined four main areas that they think increasing the Out of England quota would impact on in relation to C4C. These are:

- C4C's direct programme costs for programmes on Channel 4, specifically:
  - spend on original commissions,
  - spend on commissions in the UK Nations,
  - spend on commissions in the English regions and London.

- C4C's indirect costs and overheads e.g. producer development or seed-funding; C4C's labour or property costs; or C4C's need for commissioning meetings in the Nations;

- The creative quality and commercial performance of programmes produced in the Nations, compared to programmes from other sources;

- Delivery of Channel 4's other licence obligations and C4C's wider media content obligations, including any impact on the diversity and range of programming available to Channel 4 viewers.

d) Do you agree that the four categories we identify above are the most important ones when considering the impact of different quota levels? Would you change any of these or suggest other types of impact?

We agree broadly with Ofcom's assessment categories. However, we would emphasise the importance of **flexibility** as the central principle as opposed to the ability of companies in the Nations to deliver programmes both of creative quality or that are commercially successful. Where there are companies in the Nations with strong expertise in particular genres, they are as likely to produce shows with the same level of quality and commercial success as companies from any other part of the UK. However, reducing our flexibility to commission the best ideas, along with the availability of slots and the relatively *narrow range* of genre specialisms amongst companies in the Nations, means that reaching a higher quota or a quota sooner is unrealistic. As outlined in more detail below, reducing our flexibility has both commercial and creative considerations – although C4C believes these two points should be considered separately as the creative quality and commercial performance of a programme are not always intrinsically linked.

With regards to the category of 'C4C's wider media content obligations' – we assume that this is in reference to Channel 4's broader statutory public service remit, in addition to the specific obligations outlined in the main channel licence. C4C's primary reason for existence is the remit given to it by Parliament, and it is important that delivering to one specific component of our licence, on terms set by Ofcom, does not have a disproportionately negative impact on our ability to deliver to this statutory remit.

e) For each of the categories we identify above and any other types of impact you consider relevant, please describe and, where possible, quantify the impacts of increasing the out of England production levels quota to: 9%, 12%, 17% against the volume and spend delivery for out of England production in 2012 (as submitted to Ofcom). If you are able to quantify the difference in either financial terms (cost of £Xm per year) or estimated percentage terms (increase cost of X% per year) that would be very helpful. We appreciate in places this may either be an estimate, or not possible: please indicate where this is the case. Where there is no incremental impact from an additional % change, please indicate this.

Impact on direct programme costs:

Channel 4 does have some evidence to suggest there are likely to be some increases to its direct programming costs as a result of an increased Out of England production quota. This would be more likely under a 12% or 17% production quota, where Channel 4 would be forced to relocate existing titles rather than allowing for indigenous growth. For example, based on 2013 first-run originated spend on the main channel, the difference between delivering a 9% quota and a 12% quota would be £10.8m worth of spend that would have to be relocated to the Nations (redacted). This would demand that we change our strategy from focusing on indigenous growth to a 'lift and shift' strategy. We would have to move an existing long-running, high volume title from London or the English regions to the Nations. Relocating existing titles is likely to increase costs as we would have to develop new contractual relationships, find new premises and suppliers and relocate staff. As C4C has historically favoured organic growth over a 'lift and shift' strategy, it does not have concrete examples of these kinds of relocation costs. However, C4C has worked up an example of the estimated cost implications of relocating (redacted) and we have other recent anecdotal evidence of some producers of other shows increasing production budgets by an average of around 5-10% per episode when asked to relocate series to meet regional or national criteria, as a result of having to find new premises, include crew travel costs etc.

(Redacted)

- Impact on C4C's spend on original commissions:

Any increase in costs of this kind would directly impact upon Channel 4's overall commissioning budget, forcing us to make savings in other areas. (Redacted). This would therefore directly impact on our ability to deliver to our wide-ranging remit.

- Impact on spend on commissions in the English regions and London:

Ofcom is right to indicate that an increase in investment in the UK Nations is likely to have an impact on investment in the English regions. Based on pure programming costs alone, and as outlined in Appendix 1 in detail, our analysis suggests that in order to deliver incremental increases of around 0.5% each year in the Nations (if growth was linear in this way), and thereby meet the 9% figure (as it applies to network spend, defined by first-run originations on the main channel excluding news), we will have to increase our investment in the Nations every year by around £1.8m on average. Between 2014 and 2020, this means diverting £12m (in addition to the £20m C4 currently invests in the Nations) to the Nations, away from either the English regions or London in order to achieve the 9% quota. (This is based on current origination spend, assuming that there is no change in Channel 4's commissioning budget).

Delivering to a 12% quota would require an incremental increase of c.1% per annum from our base spend in 2013, therefore moving an extra £3.3m of spend to the Nations every year away from another part of the country (in addition to 2013's base spend) – a total of around £23m explicitly moved from the English regions or London between 2014 to 2020.

Delivering to a 17% quota would require an increase of 1.6% per annum to the Nations – the equivalent of £5.9m in additional spend relocated to the Nations every year (additional to 2013's base spend). This would mean diverting around £41m of investment away from England to the UK Nations over the 7 year period.

Although some stakeholders may desire that this spend would be relocated from London to the Nations, rather than impacting upon the English regions, given Channel 4's significant investment Outside of London, it is likely that regional economies outside of London may be disproportionately affected by an increased Out of England production quota. Most (redacted) of Channel 4's returning series are already made outside of London – for example *Hollyoaks, Channel 4 Racing, Deal or No Deal, Countdown and Unreported World*. If C4C were subject to a higher quota, and therefore forced to relocate a long-running high volume title to the Nations, it is likely that this would be a regional title. Furthermore, in some genres where we are planning to grow investment in the Nations, we already spend a majority of the budget outside London – for example, 52% of our documentaries spend in 2013 is outside of London, and 66% of our daytime spend is also regional. In drama, 82% of our spend in 2013 was outside of London. Therefore the likelihood is that relocating spend in these genres would detract from regional spend rather than London spend.

Impact on C4C's indirect costs and overheads

To support C4C's commitment to broadening its supply base and building relationships with emergent talent, since 2010 Channel 4 has administered a dedicated Creative Diversity team. This team is comprised of 5 full-time posts and a total content related spend of (redacted) per annum, as well as associated office and administrative costs. While the Creative Diversity team does have a regional remit, its primary objective is to build relationships with new and emergent talent from across the UK, including those from regional backgrounds, BAME backgrounds and companies run by producers with disabilities. The team are focused on identifying talent currently working at a grassroots level and providing them with the long-term support to develop and grow over time. Their work is therefore not focused on building companies of scale in the Nations over a short period of time, or on building expertise in particular genres. To deliver this different objective, the Creative Diversity team would either have to be replicated (at an equivalent cost of (redacted) including overheads and development budget), or their focus would have to shift away from emergent talent – to the detriment of C4C's diversity of supply strategy, the wider spread of companies it supports and our overarching remit to support new talent.

The creative quality and commercial performance of programmes produced in the Nations

As noted above, it is not that companies in the Nations are inherently less capable of producing programmes of creative quality or commercial performance, in comparison to programmes from other sources. It is more that our **flexibility** would be constrained by a higher Out of England production quota.

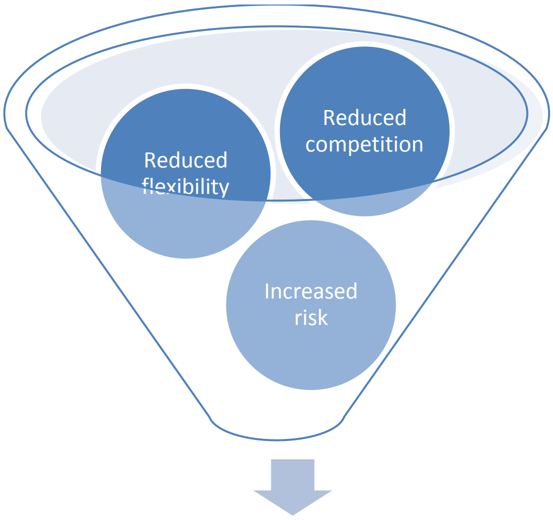
The greater Channel 4's flexibility to commission the best ideas, wherever they are from, the greater our ability to generate commercial revenues and deliver to our public service remit. C4C's flexibility is already limited by its need to deliver to a wide-ranging public service remit whilst remaining commercially self-sustaining. However, this flexibility will be narrowed by an increased production quota (redacted).

In terms of impacts, while evidence based quantifiable impacts are not possible due to the complex and subjective nature of the issue, economic principles suggest that there is likely to be a negative impact on C4C if our supply base was reduced in this way:

- **Reducing competition** (by requiring us to select from a narrower pool of suppliers, potentially increasing the prices charged by suppliers and reducing the range of ideas C4 has to choose from)
- **Reducing our flexibility** (we will have less freedom to commission the best ideas, as we may have to commission programmes in order to meet a quota rather than their creative or commercial merits)
- **Increasing our risk** (by requiring us to work with a greater volume of smaller, untested companies than we may do otherwise).

All of these components have the consequence of increasing pressure on C4C and limiting our ability to operate our cross-funding model effectively.

Figure 2: Implications of a reduced supply base on C4C



Increased pressure to C4C

Delivery of Channel 4's other licence obligations and C4C's wider media content obligations, including any impact on the diversity and range of programming available to Channel 4 viewers.

We have already outlined the implications of an increased Out Of England production quota on some of the components of our public service remit and licence obligations – for example, the impact on our support for regional companies (as required by our Out of London quota) and the impact on our support for grassroots talent (as required by our statutory remit to 'nurture talent'). Clearly narrowing the pool of suppliers is also likely to impact upon the range and diversity of idea available to viewers, as C4C will only have a narrower range of ideas to choose from.

Although evidence based quantifiable impacts are not possible due to the complex and subjective nature of the issue, there are a number of scenarios where an increased Out of England production quota may be in conflict with other elements of C4C's remit:

- Cultural diversity: Several of C4C's programmes aimed at reflecting and appeal to culturally diverse communities are made in England – for example *Top Boy* and *Youngers* are filmed in London council estates, *Make Bradford British* and *4Ramadan* were filmed in the English regions. (redacted)
- Innovation: Narrowing the pool of suppliers may mean that C4C is forced to commission ideas from the Nations, even if more 'innovative' ideas are developed from companies in England.
- Distinctive: Forcing C4C to commission a significant portion of its schedule from a small pool of suppliers could risk the distinctive nature of C4C's schedule.

C4C has a multi-faceted wide-ranging public service remit and it is vital that one component does not disproportionately impact on our abilities to deliver other elements – particularly if it is the case of an industry-facing intervention impacting negatively on the viewer-facing elements of C4C's public service delivery and which are central to the statutory remit given to us by Parliament.

Practical constraints on C4C's ability to meet an increased quota

Ofcom has identified the following four possible constraints on C4C's ability to meet an increased quota at an earlier point in the licence than 2020:

- The volume of programme hours or proportion of the schedule that are available, in a given year, to new commissions and the balance of these that would need to go to Nations production to meet the requirement;
- The requirement to deliver against other licence conditions (that are otherwise unchanged) and C4C's ability to manage a downturn in revenues (as set out in its submission).
- The number of producers in the Nations that C4C would expect to have to use to meet the requirement, compared to English regions and in-London production.

f) Do you agree that the four constraints we identify above are the most relevant when considering C4C's ability to meet an increased quota? Would you change any of these or suggest other constraints?

We broadly agree with Ofcom's assessment categories. However, we would broaden the point referencing "C4C's ability to deliver against other licence conditions" to include its broader public service remit, and we would separate this point from C4C's ability to manage a downturn in revenues (which we would broaden out to reference commercial performance more generally).

<u>The volume of programme hours or proportion of the schedule that are available, in a given year, to new commissions and the balance of these that would need to go to Nations production to meet the requirement;</u>

Given the dynamics of the schedule the 9% effectively equates in practical terms to a 15% quota on C4C's uncommitted budget. Under this analysis, a 12% quota would effectively be a 20% quota, and a 17% would be effectively be a 28% quota. This is a very significant proportion of spend given the need to retain creative flexibility and deliver a diverse schedule - and would mean that we may have to displace other successful shows that delivered strongly to our public service remit but are not made outside of England. This analysis is also based on 2012 figures, which was at a peak of creative experimentation with new titles. The proportion of our committed budget is therefore likely to increase further in the coming years as C4C's looks to stabilise its schedule, meaning that these figures are likely to be even higher.

<u>The requirement to deliver against other licence conditions (that are otherwise unchanged) and Channel 4's broader remit.</u>

As noted, C4C must balance a wide variety of competing demands, and in particular, as stated on p8, C4C would have to manage its ability to deliver a higher Out of England production quota with its broader licence conditions and public service responsibilities – such as appealing to the tastes and interests of a culturally diverse society, being distinctive and being innovative. C4C has a multi-faceted wide-ranging remit and it is vital that one component does not disproportionately impact on our abilities to deliver other elements – particularly if it is the case of an industry-facing intervention impacting negatively on the viewer-facing elements of C4C's public service delivery.

<u>C4C's ability to manage a downturn in revenues (as set out in its submission).</u>

C4C's 10 Year Plan as submitted to Ofcom is based on retaining maximum creative and commercial flexibility in order continue operating our unique cross-subsidy model, with profits from our more commercial activities allowing us to invest in content that is more risky, or less commercially focussed, but which delivers high public value. As noted above, there is a risk that an increased Out of England production quota would reduce the strength and success of this cross-subsidy model.

There is a further risk that an increased production quota could limit C4C's abilities to employ the cost-reduction measures outlined in its 10 Year Plan in the event of a shortfall in revenues, albeit at a small level. (Redacted)

The number of producers in the Nations that C4C would expect to have to use to meet the requirement, compared to English regions and in-London production.

As reflected to Ofcom throughout the consultation process, as a publisher broadcaster, Channel 4 is uniquely dependent on the strengths and weaknesses of the independent production sector, and does not have the same flexibility to move in-house capacity around the UK as the BBC. This means that there is additional risk that C4 incurs in delivering to these targets, that the BBC does not. Channel 4 is not privy to the breakdown of the in-house/independent split of the BBC's Nations spend, as it does not publish this information, however Pacts own 'Out of London' report published in June 2013 suggest that the trend broadly favours in-house production. Given that the BBC are obliged to spend 50% of its budget on in-house production, this suggests that only 8.5% of its 17% commitment is available to the independent production sector – which is less than Channel 4's commitment. Ofcom may want to consider gathering more data on the scale of the BBC's investment in the independent production sector in the UK Nations.

Evidence suggests that there are considerably fewer companies in the Nations compared to other regions in the UK, and that these are of smaller scale. Pact data suggests that there are around 90 companies in the Nations. Broadcast Greenlight database contains 823 companies, suggesting therefore that Nations companies comprise of 10.8% of the total production sector, with the below breakdown:

- 48 companies in Scotland (5.8% of total sector)
- 19 companies in Northern Ireland (2.3% of total sector)
- 23 in Wales (2.7% of sector)

According to this analysis, 72% of the sector are based in London. While these are estimates, they are in line with 2009 figures published by Ofcom, which showed that:

- 5% of the production sector was based in Scotland
- 4% in Wales
- 1% in Northern Ireland
- 67% were based in London.

Of the total number of companies, not all develop ideas for network production (redacted), and not all pitch ideas to Channel 4. (redacted).

There is also not a geographically even spread of genre expertise – as outlined to Ofcom throughout the consultation process, including in our February note on Nations, the independent production sector in each of the nations is stronger in some genres than in others. In areas of production strength Channel 4 already commissions a substantial proportion of its budget in the nations - for example features (8.8%

of 2013 departmental spend), specialist factual (16.5%) and daytime (11%). However, Channel 4 needs to commission across all genres to deliver a mixed schedule in line with its public service remit. Unfortunately, some of the genres where there are gaps in scale or expertise in the UK Nations, account for a large component of C4C's schedule. (Redacted). If C4C had to deliver to an Out of England production quota higher than 9%, this would therefore either place even greater pressure to commission from the Nations in the genres where there is existing expertise, or demand that we commission from companies that do not have such expertise – and thus have to incur substantial risk.

Finally, of the companies that do exist, very few are of the same size and scale as companies located elsewhere in the UK, and therefore are likely to be riskier propositions than more established companies. According to the Broadcast Indie Survey, only 9 of the largest 100 independent production companies in the UK were based in the Nations, and as noted in our original submission to Ofcom, these companies have seen little growth or consolidation in comparison to the rest of the production sector. It is our long-term ambition to build companies of scale – and we have several success stories. For example, Cardiff based company Rondo Media received development support from the Alpha Fund for a documentary project *My Tattoo Addiction* in November 2011, which was broadcast as a single documentary in August 2012 and recommissioned for a 3 part series, broadcast in October 2013. Most growth takes longer, however- the period of growth from start up to returning series is typically 5 years – and considerably longer for a multi-million budget, high volume series of the kind that would be needed to reach a 12% or 17% quota. In some genres this can be even longer - the cycle of series production in scripted programming can typically be 3-5 years just for one programme. A long-term approach is therefore important – if C4C was forced to commission large-scale ideas from companies that are not yet ready to deliver them, there are significant risks both to C4C and the production company.

Given all of these factors, the pool of suppliers that Channel 4 therefore has to commission network-ready ideas from in the Nations is therefore much narrower than the total population that lives there, and as compared with the rest of the sector. C4C has undertaken analysis of companies in the Nations with potential in order to inform its plans for delivering the 9% quota. C4C's analysis indicated a disconnect between the number of companies in the sector, and the number that C4C believes have potential to develop scaleable, network ideas for Channel 4. Its analysis suggests that there are [redacted] companies based in the Nations with current potential to develop and produce programmes for Channel 4, which is only [redacted] of the total. As noted elsewhere in this note, narrowing the pool of suppliers to a smaller field with a narrow set of specialisms applies additional pressure to our business by reducing competition and increasing our risk. It may ultimately force us to prioritise commissions from the Nations over other programmes that may deliver more strongly to our remit or deliver commercial revenue, but which come from other parts of the UK.

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