



Radio – Preparing for the future

Phase 1: Developing a new framework

Appendix D: The economic and social policy arguments for intervention in the radio market

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In considering the immediate priorities for this review - the development of digital radio and the regulation of local material on analogue commercial radio - we believe it is necessary to consider the bigger issues of what it is that society wants from radio and whether regulatory intervention might be required to deliver it. We do not attempt to provide definitive answers in phase 1 of this review, but aim to raise the right questions and to sketch out a framework for debate.

D1 What are the possible reasons for intervention?

The main review argues that radio is important in people's lives and considers research into how much people listen, what they listen to, and what they think of the overall provision of radio in the UK today. Based upon these findings, we suggest that radio is a highly pervasive medium, in a way that other forms of entertainment and information sources (with the exception of television) are not, and that its impact on people's lives is considerable.

But does that mean that radio is important enough to justify the level of intervention in the market that takes place at present? And what might any intervention be trying to achieve? This appendix considers these questions from a number of perspectives.

There are two distinct approaches when considering why it might be appropriate to intervene in the radio market:

- **A consumer-led approach.** This focuses on the extent to which the market might fail to deliver certain types of radio broadcasting which consumers want to listen to, or want to have an option to listen to, and considers what might need to be done to correct any such market failures.
- **A citizenship-led approach.** This would argue that, even where commercial providers are able to satisfy consumers, there are certain aspects of the provision of radio broadcasting where it would be preferable to have public provision - for example, to provide the programming that we, as citizens, want to be widely available for as many people as possible to listen to.

In practice, there is some overlap between these two approaches, which are discussed in more detail below.

Intervention in the radio market in the UK over time has aimed to do three things:

- To make sure that radio delivers to most **consumers** a sufficiently broad choice of programmes which, because of constraints such as spectrum scarcity, could otherwise be under-provided. This is currently achieved through the existence of publicly-funded radio in the form of the BBC and through format regulation obligations on national and local commercial radio;

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- To ensure the provision of specific types of programming that we, as **citizens**, want to be widely available for everyone to listen to but that may not necessarily be provided on a commercial basis. This is currently achieved by:
 - Licensing commercial radio in such a way as to ensure the provision of local material in programmes. This includes local content obligations included in stations' formats (in addition to those obligations aimed at broadening choice), local input obligations ("locally made") and the geographic coverage of radio licences. (Note: the requirement for "localness" could also be justified in terms of broadening consumers' choice);
 - The BBC's publicly-funded provision of news, educational and cultural programmes, both at the national and local level;
- To prevent the emergence of excessive ownership concentration at the national and local level. This was based on an economic concern of potential excessive market power, and a public policy concern about the effects of excessive media ownership on plurality of media. The latter is currently specifically addressed by the communication legislation, while market power concerns are addressed by competition law.

We want to assess whether, and to what extent, market failure arguments are relevant to radio – both now and in the future - and whether they require some form of regulatory intervention. If regulatory intervention is considered necessary, we will have to consider the appropriate form and scope of intervention. In doing so, we will have to assess whether the current regulatory intervention in radio is appropriate.

In drawing up this framework, it is worth bearing in mind three considerations to help guide future policy:

- Time – While regulation might still be justified today, it might not be so in the future. Critical changes in technology, demand or market conditions might alter today's conclusions. For example, mass take-up of digital radio and potentially the development of pay radio may reduce the need for intervention. However, any such change is likely to be some years away;
- Geography – The level of competition and the number and variety of services offered vary from area to area. In areas where there is a high level of competition, intervention may be less justified than where there is little competition. We consider later in this section what is provided in markets with a higher level of radio competition than the UK; and
- Extent – Even if intervention is warranted on the grounds that we will consider in this section, it might not be justified in its current form or extent.

D2 Why might we intervene in the market? – A possible consumer rationale

There are several reasons why intervention in the market to protect consumers' interests (in addition to the regulation of standards of taste, decency, etc) may be required. Most of these reasons are related to public good arguments.

Public goods are those which can be consumed by more than one person at a time, without reducing the amount that is available to other consumers (non-rivalrous in consumption) and where, once made available, it is not possible to exclude consumers (non-excludable). In the extreme, public goods could lead to the good not being provided at all, as there is no funding mechanism.

Radio broadcasting exhibits some of the characteristics of a public good. The fact that programmes, once made and broadcast, can be consumed by additional consumers without diminishing the ability of other consumers to listen, indicates that radio is non-rivalrous in consumption. Additionally, in the absence of encryption and conditional access technology in radio, it is not possible to prevent consumers from listening to a programme which is broadcast in their area.

Lack of an effective market mechanism

The lack of a direct charging mechanism was part of the original justification for BBC radio being funded by the licence fee. The licence fee is one mechanism for avoiding the extreme outcome of no radio provision; another is the presence of an indirect payment method, in the form of advertising.

Advertising is currently the only realistic mechanism for the funding of commercial radio. In this model, broadcasters are motivated by the need to deliver listeners to advertisers in sufficient numbers, rather than by satisfying the preferences of different groups of listeners, whether by their demographic group, range of interest or geographic location. If, for example, spectrum is scarce, this is likely to cause broadcasters to cluster around the most attractive demographic group for advertisers, so depriving some listeners of the sorts of services they want.

In television, the arrival of subscription services has significantly reduced the argument that television is a public good, as it is now possible for people to pay for what they want to receive and for those who do not pay to be excluded. This is not currently the case in radio, where (with the exception of the Music Choice service on digital television) there is no sign of pay radio becoming a realistic prospect in the UK over the next few years. As a result, everyone with a radio set can pick up all of the stations available and there is no way to exclude them from listening.

Spectrum scarcity, the level of demand and the availability of alternatives

The degree to which market failure might occur in this way, and so justify regulatory intervention, depends on factors such as the degree of spectrum scarcity, which acts as a barrier to entry, and the scope for the presence or the emergence of alternative means of satisfying consumers demand (for example listening to music over other technologies, such as compact discs). As spectrum scarcity is reduced, for example as the extra choice offered by digital radio becomes more widespread, there may still be a misalignment between advertisers' and consumers' preferences (for example, if the strength of preference that a smaller number of listeners has for a particular programme or range of programmes is not captured by the price that advertisers are willing to pay to broadcast it) but the justification for regulatory intervention may decrease.

Concerns about under-provision of variety may lessen as spectrum scarcity reduces – i.e. especially in a digital environment – and it becomes commercially viable to pursue niche audiences. An unregulated and advertiser-funded commercial market may therefore, in principle, be capable of delivering a wide range of programming. However, a look at the experience of US radio suggests that, even with relatively unlimited spectrum, the market will not deliver a full range of services (see below). Moreover, digital switch-over in radio is many years away and many consumers will remain in an analogue world of limited choice for the foreseeable future.

In considering these issues, we looked at a possible counterfactual, considering markets in other countries. Our analysis and conclusions are given in section C4 of this appendix.

D3 Why might we intervene in the market? – A possible citizenship rationale

Even if the radio market was working effectively for consumers, there may be an argument for intervention for citizenship reasons, on the grounds of radio being a merit good or providing externalities:

Merit goods

Merit goods are those such as educational programmes, for which consumers do not recognise the full value they could derive from their consumption. Merit goods could offer a justification for regulatory intervention if there is evidence that consumers are unable to assess the value that they could derive from consumption. The risk is that of under-provision of that specific type of programmes. In radio regulatory terms, programmes such as educational or news programmes could be considered as merit goods, and action might have to be taken to ensure that such programmes are provided and consumed in a way that ensures that consumers realise the full benefits.

The presence of externalities

Externalities arise when consumers making individual decisions do not take into account the benefits or costs that their action has on other consumers. Positive externalities arguments are captured in the Communications Act 2003 under the discussion of citizens' and consumers' interests. For instance, listening to news, both national and local, on the radio helps to make listeners better informed and therefore better able to participate in a democratic society to the benefit of everyone. Similar considerations may extend to the value of such programmes that improve or enhance access to information, cultural identity, knowledge building and common shared values.

When there are externalities, there is a risk of under-provision of certain types of radio programmes which could be addressed by mandating a specific amount of provision. Our research has demonstrated that citizens and consumers demand a wide range of output from radio (figure 27 in the main document). We believe that there may be elements of current radio provision which represent externalities and that we need to intervene in the market to ensure they are delivered.

So, in economic terms, there may currently be strong reasons to intervene in the radio market, both on consumer and citizenship grounds.

D4. What might the market deliver without intervention? – A counterfactual

Intervention in the UK radio market is significant. The existence of BBC radio, which accounts for over half of all radio audiences and almost half of all radio funding (via its share of the licence fee) is itself a major intervention. In addition, the way that commercial radio has been licensed over the past 30 years, as a system of primarily local stations, each tied to a format and required to offer distinctive services with local content, is a major intervention. The national commercial analogue stations are also tied to specific formats, designed to increase choice.

But what would the radio market in the UK look like if left to its own devices? What if the BBC didn't exist and commercial radio had no restrictions on ownership, format or local programming requirements? We should point out that we are not proposing the abolition of the BBC or of all regulation on commercial radio. But, in trying to understand what it is we want regulation of the radio market to achieve, it is useful to think about what a lack of all regulation might mean in an extreme case.

In considering alternatives, it might be useful to consider two other countries where regulation is less than in the UK: France and the United States; France, because the regulation around localness has been significantly relaxed; the United States, because there is no publicly-funded radio.

However, in both of these countries, there is still some significant intervention and so it is impossible to know what a market with no intervention would deliver in practice. Nevertheless, the exercise may provide a useful starting point in the debate.

Radio in France

France has its equivalent of the BBC, Radio France, which offers four national networks: France Inter (a mix of music and speech, a cross between BBC Radio 2 and BBC Radio Five Live), France Musiques (the French version of BBC Radio 3, playing classical music, world music and jazz), France Culture (the nearest equivalent to Radio 4) and France Info (a rolling news and talk station). Radio France also operates 43 local stations, under the banner "France Bleu", a "youth" station, Le Mouv' (similar to BBC Radio 1), which is present in 12 cities in France, and a "free-style" music station for Paris, FIP.

For many years, France had enjoyed commercial radio in the form of stations based across the border in Luxembourg (RTL, launched in 1931), Monaco (RMC, launched in 1945), and Germany (Europe 1, launched in 1955).

However, there was no local commercial radio in France until the early 1980s, when several hundred local stations were licensed. By the late 1980s, however, these had been allowed to consolidate into a number of national or regional networks. There is currently some format regulation (broadcasters need permission from French radio regulator the CSA for major format changes), and there is a law, introduced in 1995, which governs the amount of French-language repertoire and new music that

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stations must air. Some stations are required to provide varying degrees of local programming at certain times, depending upon their category of licence (of which there are five different types - local non commercial, local commercial not part of a network, local commercial part of a network, commercial station part of a thematic network with no local programming; and station part of a national full service network).

Stations relaying entirely national networked output are not allowed access to the local advertising market, while those benefiting from local advertising revenues have to provide at least some local programming.

Apart from the stations of Radio France, the market has consolidated into 18 national or regional networks offering a range of formats (Figure Thirty One). In addition to these, arguably because of regulation, there remain 84 independent commercial local stations around the country, many of which have now grouped together into a federation.

The French experience suggests that, left to itself, the commercial local radio market may be likely to consolidate into national networks. Regulation in France has ensured that some local programming is maintained but, generally, operators have moved to national provision wherever they can. It is worth noting that regulation is in place to prevent purely national stations from accessing local advertising. This is designed to protect local programming. Without this regulation, it would be possible for national stations to broadcast local advertising, using a separate feed to each transmitter or group of transmitters.

It may well be that listeners in France prefer the variety offered by national stations to that offered by local stations. Similarly, UK listeners may prefer more national stations to the existing local provision. However, the purpose of this examination is to consider what the market would provide and it seems likely that, if there was no regulation, much less local programming would be provided.

Figure Thirty One: Commercial Radio networks in France

Name	Format
Beur FM	Ethnic
BFM	Business news
Cherie FM	Soft adult contemporary
Europe 1	News and talk
Europe 2	Hot adult contemporary
Fun Radi	Rhythmic adult contemporary
MFM	Gold
Nostalgie	Soft adult contemporary / Gold
NRJ	Contemporary hit radio
Radio Classique	Classical
RCF	Religious
RFM	Adult contemporary
Rire et Chansons	Adult contemporary and comedy
RMC Info	News and talk
RTL	Full service (music, talk and sport)
RTL 2	Soft adult contemporary
Skyrock	Urban
Sud Radio	Full service regional station for the south west of France

Source: *Telerama Guide Radio 2003-4*

Radio in the United States

In the United States, there are no publicly funded radio services and there are no national analogue radio services (national radio has only recently arrived in the US, courtesy of the XM Radio and Sirius satellite subscription radio providers). All analogue radio is local although there are syndicated programmes, particularly talk shows. Most radio is commercial, although the National Public Radio (NPR) service offers syndicated programming, including news, documentaries and classical music (including programming from the BBC) to 750 independently operated, non-commercial NPR affiliates across the country. Each affiliate carries a mix of national NPR programming and its own local programmes. NPR is funded by donations from the public and business. However, despite the fact that the population of the US is four times that of the UK and that disposable income is higher in the US, the amount of funding raised by NPR is very small and, as a result, the range of NPR programming is generally far smaller than that of the BBC.

As in the UK, the choice available to listeners varies around the country, with those living in the cities having the greatest choice.

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There is no format control on stations, which are free to change their format at will. As a result, they can respond to changes in demand in the market. So, without the presence of publicly funded radio, does the market offer as much choice as the highly regulated system in the UK?

Because US cities are further apart than UK cities, there is less risk of interference between stations in different cities and so each city can theoretically offer a greater number of stations, as it can fill-up the MW and FM wavebands with its own stations. In New York City, for example (Figure Thirty Two), there are 70 stations across FM and MW, (plus 21 small-scale college radio stations) offering a wide variety of choice for listeners. In comparison to London, there is a wider variety of stations. However, there are some obvious omissions, such as an equivalent of the well-funded BBC Radio 4, the volume of live music of BBC Radios 1, 2 and 3, or the specialist programmes of BBC Radio 3. To what extent these public purpose elements of radio are present on the airwaves in New York City is open to debate, but it is hard to argue that the market does not provide a wide variety of stations.

However, as the cities get smaller, so listener choice decreases. Las Vegas (population 478,000) and Mobile, Alabama (population 260,000) each have 44 stations. While there may appear to be a wide range of genres, the majority of the public purpose elements we would recognise in the UK, are provided by NPR. Talk stations tend to rely on phone-ins or rolling news and there is no provision of some of the more challenging speech elements of BBC Radio.

A recent development in the United States has been the launch of pay radio, which is proving popular, as it allows listeners access to a wide range of stations without advertisements (the volume of advertising on commercial stations in the US is much higher than in the UK). At some stage in the future, it is possible that pay radio may develop in the UK. However, at present there does not appear to be great demand, either from listeners, or from potential operators.

Figure Thirty Two: A comparison of radio station choice in selected US cities

Radio stations in New York City <i>Population 19.9 million (metropolitan area)</i>		Radio stations in Las Vegas <i>Population 478,000</i>		Radio stations in Mobile, Alabama <i>Population 260,000 (incl. Pensacola FLA)</i>	
Format	No.	Format	No.	Format	No.
Adult Contemporary	7	80s Hits	1	Adult Alternative	1
Business News	3	Adult Contemporary	1	Adult Contemporary	2
Classic Rock	2	Classic Hits	1	Adult Contemporary/Talk	2
Classical	1	Classic Rock	1	Black Gospel	3
Contemporary Christian/Religious	1	Classical	1	Black Gospel/Religious	1
Contemporary Hit Radio	3	Contemporary Christian	1	Blues	1
Dance	2	Country	2	Classic Country	1
Easy Listening	1	Easy Listening	1	Classic Rock	1
Ethnic	6	Hot Adult Contemporary	2	Classical	1
Hot Adult Contemporary	1	Jazz/Adult Alternative	1	Contemporary Christian	1
Modern Rock	1	Modern Rock	1	Contemporary Hit Radio	2
News	3	News	2	Country	3
News/Talk	1	News/Talk	1	Easy Listening	1
News/Talk/Classical	1	News/Talk/Business News	1	Hot Adult Contemporary	1
News/Talk/Soft Adult Contemp.	1	Oldies	1	News/Talk	1
Oldies	3	Oldies/Talk	1	News/Talk/Sports	1
Pre-teen	1	Regional Mexican	4	Oldies	4
Religious	6	Religious	1	Pre-teen	1
Rhythmic-CHR	1	Rhythmic-CHR	3	Religious	3
Rock	2	Rock	1	Religious/Southern Gospel	1
Romantica	1	Romantica	1	Southern Gospel	2
Smooth Jazz	1	Smooth Jazz	2	Sports	2
Soft Adult Contemp.	1	Soft Adult Contemp.	1	Talk	2
Spanish	1	Spanish CHR	1	Talk/Adult Standards	1
Spanish CHR	3	Spanish Oldies	1	Talk/Sports	2
Spanish News/Talk	1	Spanish Talk	1	Traditional Country	1
Spanish Religion	1	Sports	2	Urban	1
Sports	2	Talk	3	Urban Adult Contemporary	1
Talk	5	Talk/Sports	1		
Talk/Ethnic	1	Urban	1		
Talk/Variety	1	Urban Adult Contemporary	1		
Urban	2	Variety	1		
Urban Adult Contemporary	1				
Variety	2				
	70		44		44
<i>of which 38 are on FM and 32 on AM</i>		<i>of which 32 are on FM and 12 are on AM</i>		<i>of which 24 are on FM and 20 on AM</i>	
Small scale FM university stations	21				

Source: *Inside Radio*

In general, then, the market may be able to provide much (but not all) of what we enjoy in the UK but only if the market is large enough. In practice, due to spectrum limitations in the UK, this would probably mean that, in order to provide anything approaching the choice available in New York City, the UK radio market would need to become a national one. Even then, there would be a failure to provide fully the current range and quality of output.

Unregulated radio in the UK – A counterfactual

Without regulation, the UK radio market would probably look very different to its current state. Let us suppose that there was no BBC and that frequencies had not been allocated to local commercial stations with the aim of increasing local choice. If the market had been totally free, what might have developed?

One extreme possibility is that UK radio would have developed in a similar way to the French market. The available frequencies would allow for perhaps 15 to 20 quasi-national networks on FM, none with truly national coverage, but concentrating on the major population centres, while MW would support perhaps another 5 or 6 quasi-national networks.

Let us assume, in this extreme case, that there were no local stations. The cost of running a national commercial radio station is currently around £10m per annum, so, in this scenario, the total cost of running the UK radio system, across FM and MW, could be around £200 – 250m per annum.

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This compares with the current cost of running UK radio of around £1.05 billion per annum (£590m for the BBC, £460m for the commercial sector).

If we make a further simple assumption that radio revenues would be broadly flat (local advertising would still be possible on national networks, as it is on national television networks), then a very simple calculation would imply that the maximum cost of intervening in the market (the BBC and the commercial sector) is up to £850m per annum (i.e. £1.05 billion less £200m).

What would these networks offer? It is likely that there would be something similar to the French model. There would probably not be the range of choice available in New York City, where, even with a large number of stations the market does not provide many of the public purposes elements of radio we currently enjoy in the UK. A UK version of donation-funded radio may emerge to deliver these public purposes, but this could not be guaranteed and the amount of money raised is likely to be very much smaller than the amount the BBC currently spends on radio.

And what of local output? In practice, even with no regulation there would probably be some local stations, although they would probably only exist in perhaps the largest 20 or so towns and cities. Because there probably would be some local stations, the cost of regulation in the extreme case outlined above is almost certainly over-estimated.

This very simple counterfactual suggests that the citizenship and consumer rationale for intervention, set out at the start of this section, may provide strong reasons to intervene in the radio market, on the grounds of spectrum scarcity and the lack of an effective market mechanism.

The need for this intervention may decrease in a digital world as competition increases, but it will not necessarily go away - there is no equivalent of television digital switchover for radio to drive a completely competitive market. Similarly, the need for intervention may be less in geographical markets where there is a wide range of choice but, even there, some regulation is likely to be necessary.