Channel 4 submission to Ofcom consultation on UK TV advertising

Executive summary

1. Channel 4 welcomes the opportunity to respond to Ofcom's consultation on the possible reference of the UK advertising trading mechanism to the Competition Commission (CC).

2. Channel 4 is a publicly-owned, commercially-funded public service broadcaster, with a statutory remit to deliver high quality, innovative, experimental and distinctive content across a range of platforms. TV advertising, which accounts for over 90% of Channel 4's total revenue, is central to enabling Channel 4 to fulfil its public service remit and functions—financing investment in a diverse range of high-quality UK-originated content. In 2010, Channel 4 invested £362 million in UK-originated content across all its services, supporting over 350 independent production and digital media companies across all parts of the UK. Oxford Economics estimates that Channel 4 contributed £1.1 billion to UK GDP in 2010 and supported 28,000 jobs through its own activities, procurement from its supply chain and increased consumer spending through the payment of wages.

3. Beyond Channel 4, TV advertising supports hundreds of channels and underpins investment in high quality, UK-originated content, in particular from the other commercially funded public service broadcasters which, together with Channel 4, invested over £1.1 billion in UK content in 2010.

4. Given the importance of advertising to the UK creative economy, any decision to subject the market to a long and potentially destabilising investigation by the CC would be proportionate only if Ofcom found evidence of serious anti-competitive practices likely to cause significant detriment to advertisers and/or TV viewers.

5. The UK TV advertising market has evolved to its current state in order to capture the significant benefits of the current trading mechanic. Across the digital landscape, technological change is transforming the opportunities to create, distribute, consume and monetise content. In particular, the proliferation of connected devices will change the relationship between audiences and content. By 2020, Channel 4 forecasts that around two-thirds of all UK television viewing will be via connected devices enabling the collection of rich customer data and the launch of targeted advertising solutions based on analysis of this data. The advertising market is evolving in response to these developments, and should be allowed to continue to advance through a process of self-determined innovation. Channel 4 has played a lead role in driving advertising innovation since the 1990s and is keen to continue this, developing new ideas and commercial strategies and seeking to innovate in the converging media landscape.

6. Channel 4 notes the competition concerns raised by the CC and the Office of Fair Trading, most recently re-stated during the House of Lords Communications Committee's inquiry into the regulation of television advertising. However, Channel 4 also notes that in evidence submitted to the House of Lords inquiry Ofcom confirmed that it had received no evidenced complaint regarding competition issues related to TV advertising trading.

7. Channel 4 acknowledges that the UK TV advertising mechanism may seem complex to those unfamiliar with the market. It is, however, reasonably

straightforward and operates by reference to a limited number of key principles (including the determination of floating prices based on supply and demand). Any perceived complexity is far exceeded by the benefits that the current trading mechanic provides to advertisers, viewers, media buyers and sales houses. Channel 4 does not consider a market referral to be a proportionate remedy.

8. This submission will substantiate the position that a referral is not necessary or proportionate, and may instead both damage confidence and inhibit the ability of the market to evolve organically over time to the detriment of both advertisers and viewers.

The UK TV advertising market remains highly competitive

9. The UK TV advertising market is highly efficient and competitive.

10. Despite recent consolidation, there are four or more players on both the demand side (media buyers/advertisers) and the supply-side (sales houses) of the market, each competing aggressively for market share. The top two sales houses in the UK have a combined market share of 75%, less than in other major European markets, such as Germany (92%) and Italy (89%).

11. A recent report from Enders Analysis suggests that sales house consolidation will make only a limited difference to the advertising market, as there has been countervailing consolidation on the buying side. By way of example, Omnicom acquired MGM (1997) and Rapp (1986), Aegis acquired Feather Brooksbank (1999), Publicis acquired Cordiant (2003), Interpublic acquired Brand Connection (2001), Havas acquired All Response (1997) and BLM (2008), and WPP (Group M) acquired Mindshare (1989), Mediaedge (2001) and Mediacom (2005). The market share of the four largest media buying groups is just over 75% [redacted].

12. That said, Channel 4 believes there is one feature of the market that continues to raise potential competition concerns—the market strength of ITV in the provision of mass audiences. Channel 4 remains of the view that a competition remedy, such as the Contract Rights Renewal (CRR) undertakings, continues to be necessary to constrain ITV1's position of market power.

Large, sophisticated participants understand the market and react to transparent price signals

13. The companies which directly participate in the market for UK TV advertising are large, sophisticated organisations with significant resources dedicated to monitoring, measuring and responding to price signals. For example, the media buyer with the largest share of NAR in the UK, Group M, is part of the WPP group, with over 17,000 staff and total worldwide billings of US$73.5 billion. The media buyer with the second largest share of NAR in the UK, VivaKi, is part of the Publicis Group, the second largest media counsel and buying group in the world. These companies are hugely experienced and able to devote significant resources to interpreting price signals and making informed decisions about the purchasing of TV advertising.

14. TV advertisers themselves are typically highly sophisticated public companies with large marketing departments. Most choose to use media buyers as these

agencies' buyer power and expertise enables advertisers to obtain lower prices and good levels of contract servicing.

15. All major advertisers make extensive use of media auditors to assess the effectiveness of campaigns and the performance of the media buyer. As prices in the UK market are subject to a robust audit process, there is a large degree of transparency and information available. Auditors assess and provide information on a range of areas such as the price paid per impact, coverage, frequency, and other quality elements of the campaign. As a result, they play a key role in enabling advertisers to make well informed decisions about the price and quality of the service they are buying. In very few other industries is there such transparency of information to help buyers make decisions.

16. While Channel 4 is not best placed to comment on the contractual relationship between advertisers and media buyers, there is strong evidence to show that advertisers frequently switch between media buyers. Based on internal analysis, Channel 4 understands that around 30% of the 100 largest spending advertisers have switched media buyer within the last five years—for example, BT moved from Starcom to Maxus in 2010, and Renault moved from Carat to OMD in 2009. Furthermore, there is evidence to suggest that the propensity to switch has increased recently as a result of advertisers being focused on driving improved terms from agencies and formalising the choice of agency via procurement competitions. Analysis from Mediatique states that 141 advertisers (representing £461m of net advertising revenue) switched agency in 2010, compared to 89 in 2009 (representing £340m of net advertising revenue).

17. In addition to these levels of *actual* switching, the *opportunities* to switch also indicate a high degree of open competitiveness in the market. In this regard, Channel 4 understands that a significant number of advertisers put their business out to tender in 2010. These high levels of both competitive tender and actual switching are illustrative of a competitive market process, where advertisers are able and willing to compare the terms and conditions offered by alternative agencies and to act accordingly.

18. Channel 4 also notes that while contracts between advertisers and media buyers generally run for two to four years, there is commonly a right of termination during such period on three to six months' notice, allowing advertisers to switch between media buyers with relative ease. The threat of exit is therefore real for incumbent media buyers, with rival media buyers constantly prospecting clients.

19. In Channel 4's experience, media buyers are also responsive to price signals in the market, and on an annual basis engage in highly competitive negotiations with sales houses. The market responds rapidly to fluctuations in supply as changes in SOCI are reflected in changes to SONAR—for example, this can be seen from ITV1's declining SOCI and corresponding decline in SONAR since 2003 and also in Sky Media's increasing SOCI and SONAR. The expertise of media buyers acting on behalf of advertisers thus ensures a rapid adjustment to changing market conditions.

20. [Redacted]

The current trading mechanic delivers significant benefits to advertisers and viewers

High levels of efficiency lead to lower prices for advertisers

21. The annual process of negotiating a Share of Commercial Impacts (SOCI) in return for a Share of Budget (SoB) is very efficient. The administrative costs would be far higher were, for example, spots traded on a campaign-by-campaign basis. [Redacted]

22. The trading mechanic also allows advertisers to execute campaigns efficiently. For example, it allows advertisers to buy a specific target audience and only pay for those impacts that reach their defined audience, reducing wastage and improving effectiveness.

23. In addition, the current system also allows media buyers to operate efficiently, with low transaction costs, enabling them to offer very competitive "cost of buying" to their advertiser clients. An alternative trading model—for example, trading individual slots against a ratecard—would require media buyers to employ far more staff to deal with the c.2.5m slots that are traded per month in the UK, and the cost of this would be passed on to advertisers and potentially consumers.

24. There is good evidence to suggest that the efficiencies realised by the current trading system have led to reduced prices. As Ofcom notes, the price of TV advertising has fallen steeply over the last ten years and has not been cheaper since 1993. For example, in 2010 the CPT for Adults was just 66% of its 2000 level. International comparisons also suggest that the UK has seen larger falls than any similar market. The UK market model has, therefore, provided significant value to advertisers.

Advertisers benefit from significant flexibility

25. The current trading system provides significant flexibility in that share deals eliminate the need for advertisers to commit to a level of absolute expenditure for the year ahead; reducing their exposure to demand-side risks, which are particularly high in the current economic climate. An additional benefit is that with the existence of both line-by-line trading and umbrella deals, advertisers have a choice of the mechanism that best suits their needs.

26. The Station Average Price (SAP) system also delivers benefits to advertisers. For example, the operation of SAP means the market is never "'full"—new campaigns can always be accommodated giving advertisers considerable flexibility. SAP is also an extremely elastic pricing mechanism, reflecting changes in the demand and supply of audiences, meaning that advertisers directly and transparently benefit from changes in the market, such as the large increase in commercial impacts seen over the past decade.

Efficient allocation of risk allows advertisers to deliver more effective campaigns

27. The current trading mechanism allows sales houses to minimise administration costs and bundle and optimise advertising airtime across the schedule, resulting in lower prices and more effective campaigns for advertisers.

28. For example, the system reduces risk for advertisers in delivering campaigns as it places the responsibility—and risk—for the delivery of commercial impacts with the sales house. This avoids the need for advertisers to speculate on the performance of individual programmes (as they would in a spot trading model).

29. The process of optimisation also means that adverts are shown during programmes which are likely to be seen by the greatest possible proportion of people in the target demographic, rather than from other target demographics. Sales houses therefore maximise the number of impacts traded by delivering a higher number of impacts than would be the case if adverts were shown randomly throughout the day.

30. In recent years, sales houses have invested heavily in ad optimisation technology, which has led to an evolution in how advertising is managed and traded. [Redacted] This investment, which has been enabled by, and in turn improves, the current trading system has consequently delivered benefits to advertisers by increasing the number of usable impacts and providing better predictions and closer targeting.

31. Bundling of airtime by non-dominant suppliers allows buyers and sellers of airtime to work together to achieve efficiencies in the sale of airtime leading to reduced prices for advertisers. If channels and/or dayparts were unbundled, the number of packages would substantially increase, requiring a significant increase in staff costs and systems upgrades; costs which would be passed on to advertisers and potentially consumers.

32. [Redacted]

<u>Viewers benefit from high levels of investment in UK content</u>

33. Viewers clearly benefit from the current system of trading advertising, which ensures efficient levels of investment in UK content—over £1.1 billion from the commercially-funded PSBs in 2010. Broadcasters compete for audiences in order to maximise their SOCI—and consequently SoB—from media buyers. Broadcasters are then able to use these revenues to invest in a wide range of programmes that will appeal to a wide range of audiences, which will drive further viewing and impacts in future. Looking back over the past five years, broadcasters have been able to devote increasing percentages of their advertising revenue to programming, to the benefit of viewers—Channel 4, for example, has increased its programme budget as a percentage of advertising revenue from 70% to 79% over the past five years for the main Channel 4 service.

34. The current trading system also provides broadcasters with a relatively high level of confidence to invest in programming. While upfront volume deals would of course provide a greater degree of certainty, the current system does give broadcasters a reasonable, advanced indication of their budgets for the coming year, facilitating investment in content, including in genres with long lead times such as film and drama.

Viewers benefit from access to new, innovative content

35. Channel 4 has an incentive to attract as large and diverse an audience as possible for a whole range of reasons, not least to effectively fulfil its public service remit and functions. Channel 4's cross-subsidy model means revenue from more profitable programmes is used to support the delivery of content that may not be commercially viable, but which has significant public value.

36. For other commercial broadcasters, content strategy may be more directly influenced by potential advertising revenue. However, it would be mistaken for Ofcom to conclude that this dynamic reduces content innovation. In this scenario, the trading system—which provides incentives for broadcasters to compete for audience share—is actually likely to encourage innovation. UK audiences have an appetite for new, innovative content and so a failure to innovate is actually likely to result in smaller audiences, and consequently a smaller share of media buyers' budgets. The three commercially-funded PSBs broadcast nearly 490 new and one-off programmes during peak in 2010, demonstrating broadcasters' appetite to provide innovative connect.

37. The system of selling impacts also allows broadcasters to manage the inevitable uncertainty associated with high levels of content innovation, in that they can optimise impact delivery from programming hits and diminish the damage of underperforming shows, wherever they arise in the schedule. By contrast, if the market were to evolve to a system of trading spots, advertisers may opt to purchase slots in the most predicable hits shows in order to minimise risk. Accordingly, broadcasters would have the incentive to continue to keep producing safe, returning series which they know will consistently deliver impacts, but at the expense of innovation, and thus viewer satisfaction, and the support of a diverse and vibrant UK content sector.

A referral of the market to the CC is unnecessary and disproportionate

38. Given the above, Channel 4 does not believe there are reasonable grounds for suspecting that features of the TV advertising market prevent, restrict or distort competition in the sector, such that a reference to the CC is warranted. A market referral would be disproportionate and would fail to acknowledge appropriately the significant benefits of the current system.

39. In addition, a full market investigation by the CC could take up to two years to come to any conclusions, resulting in a lengthy period of regulatory uncertainty. Channel 4 is therefore concerned that a review could destabilise an already highly-sensitive TV advertising market, resulting in advertisers taking money out of TV, which would have a detrimental impact on broadcasters' revenues and consequently their ability to invest in UK content. It would also inhibit the ability of Channel 4 and other participants in the market to innovate at what is a key stage in the evolution of the broader TV landscape.

The market should be allowed to continue to evolve through a market-led process of gradual and measured innovation

40. It is important to stress that Channel 4 is not advocating the status quo in its entirety. Channel 4, however, believes the market should be allowed to continue

to evolve through a process of gradual and measured innovation, while maintaining the benefits discussed above.

41. Broadly speaking, some features of the market—for example trading impacts, umbrella deals and the use of discounts against SAP—have been in place since the early 1990s. This fact merely reflects the significant advantages presented by the current trading mechanic, rather than any undue constraint on participants in the marketplace. Far from stagnating, Channel 4 believes that the market has gradually and continually evolved since the 1990s. Examples of innovation include the cap and collar pricing mechanism (introduced in 1993 by Channel 4), enhanced demographic targeting (most notably the innovation regarding age and socio-economic based packages introduced by Channel 4 in 1993), pool value—i.e. value pots (introduced in the mid 1990s) and Per Inquiry (PI) deals—where revenues are shared with advertisers based on results.

42. More recently, Northern & Shell announced plans to include Channel 5 as part of an integrated sales proposition including its newspaper, magazines and online services. BSkyB also continues to work on refining the Sky Ad Smart proposition. Participants in this market, like any other, can and will innovate based on a rational evaluation of the associated risks and rewards. Channel 4 therefore does not believe that the airtime trading model is frozen in time or artificially restrained, or that the industry has lacked innovation.

43. Creatively, Channel 4 has again been at the forefront of advertising innovation, and has undertaken a number of exciting campaigns in recent years to provide advertisers with more value, and generate greater revenues for Channel 4 to invest in content. For example, Channel 4 has sought to innovate by experimenting with the form of advertising slots. In 2008, Channel 4 broadcast the first ever live advert for Honda, and in 2010 and 2011, Jimmy Carr and other comedians 'hijacked' breaks in the Channel 4 Comedy Gala. Channel 4 has also innovated in contextual advertising, advertising special events and narrative campaigns. These strategies proved highly successful in increasing viewer engagement and improving consumer awareness and recognition of brands.

44. Going forward, Channel 4 believes that market developments such as the launch of YouView, the growth in connected devices in the home, the development of next-generation services from Sky and Virgin and the prospect of entry by new players such as Google and Apple are likely to drive significant changes in the market dynamics of TV advertising.

45. All parts of the value chain in TV advertising are responding to these changes. Mainstream broadcasters, for example, are exploring a range of innovations with regard to product placement, VOD distribution, data collection/monetisation and new forms of audience engagement. Similarly, although advertisers may continue to favour mass market traditional advertising, they are exploring a range of different engagements, including direct to consumer (e.g. the Audi Channel), interactive, "viral" marketing, and online/VOD. Media buyers, meanwhile, are exploring a range of ways of increasing service provision to end clients, including investments in ad insertion and co-operation with clients on data collection and monetisation.

46. Channel 4 is keen to continue its lead role in advertising innovation and to develop new ideas and commercial strategies, and always seeks to be the first to

innovate in the market. However, Channel 4 also believes there is a role for the regulator to encourage innovation in the market, removing any undue impediments to such activity. In this regard, Channel 4 believes that access to data—i.e. in-depth insight into the behaviour and tastes of viewers—will be vital to enabling future innovation and investment. Channel 4 is therefore keen to explore options for ensuring that viewer data can be accessed by broadcasters (subject to compliance with a robust data protection framework which protects the interests of consumers)—rather than being restricted by platform operators—to enable broadcasters to develop new business models and consequently sustain investment in UK content.

47. The remainder of this submission addresses the specific questions posed in the consultation.

22 July 2011

Responses to specific consultation questions

Question 1: Do you think we have captured all the relevant market developments which might have had an impact on competition in the sector?

Channel 4 agrees that Ofcom has broadly captured the material market developments, building on its previous analysis in relation to earlier reviews of advertising, such as the Airtime Sales Rules and COSTA. However, Channel 4 believes there have been advances in new advertising initiatives by a wide range of participants in the market, in addition to those identified by Ofcom.

The market has evolved in response to external developments, such as the emergence of digital channel portfolios, the emergence of sponsorship and product placement, and in response to regulatory changes such as amendments to RADA/COSTA and the BCAP Code.

Examples of innovation to date include the cap and collar pricing mechanism (introduced in 1993 by Channel 4), enhanced demographic targeting (most notably the innovation regarding age and socio-economic based packages introduced by Channel 4 in 1993), pool value—i.e. value pots (introduced in the mid 1990s) and Per Inquiry (PI) deals—where revenues are shared between advertisers and broadcasters based on results. Recently, Northern & Shell unveiled plans to include Channel 5 as part of an integrated sales proposition including its newspaper, magazines and online services. BSkyB also continues to work on refining the Sky Ad Smart proposition.

Across the digital landscape, technological change is transforming the opportunities to create, distribute, consume and monetise content. In particular, the proliferation of connected devices will change the relationship between audiences and content. By 2020, Channel 4 forecasts that around two-thirds of all UK television viewing will be via connected devices enabling the collection of rich customer data and the launch of targeted advertising solutions based on analysis of this data. The advertising market is evolving in response to these developments, and should be allowed to continue to advance through a process of self-determined innovation.

Going forward, Channel 4 believes that market developments such as the launch of YouView, the growth in connected devices in the home, the development of next-generation services from Sky and Virgin and the prospect of entry by new players such as Google and Apple are likely to drive significant changes in the market dynamics of TV advertising.

All parts of the value chain in TV advertising are responding to these changes. Mainstream broadcasters, for example, are exploring a range of innovations with regard to product placement, VOD distribution, data collection/monetisation and new forms of audience engagement. Similarly, although advertisers may continue to favour mass market traditional advertising, they are exploring a range of different engagements, including direct to consumer (e.g. the Audi Channel), interactive, "viral" marketing, and online/VOD. Media buyers, meanwhile, are exploring a range of ways of increasing service provision to end clients, including investments in ad insertion and co-operation with clients on data collection and monetisation.

Creatively, Channel 4 has again been at the forefront of advertising innovation, and has undertaken a number of exciting campaigns in recent years to provide advertisers with more value, and generate greater revenues for Channel 4 to invest in content. For example, Channel 4 has sought to innovate by experimenting with the form of advertising slots. In 2008, Channel 4 broadcast the first ever live advert for Honda, and in 2010 and 2011, Jimmy Carr and other comedians 'hijacked' breaks in the Channel 4 Comedy Gala. Channel 4 has also innovated in contextual advertising, advertising special events and narrative campaigns. These strategies proved highly successful in increasing viewer engagement and improving consumer awareness and recognition of brands.

In recent years, sales houses have invested heavily in the development of sophisticated ad optimisation technology and algorithms that increase the quantity of usable advertising, which has led to an evolution in how advertising is managed and traded. [Redacted] This investment, which has been enabled by and in turn improves the current trading system, has consequently delivered benefits to media buyers and advertisers.

Question 2: Are there standard measurement systems being developed for tracking the effectiveness of internet display advertising? If so, are they likely to affect widespread take up of internet display advertising (and over what timescale)?

Channel 4 believes that reporting and the system of metrics for on-demand and online usage is at a stage of rapid development in what is a relatively nascent market. Currently, a range of tools and initiatives are used to track internet display advertising, for example Quantcast, Nielsen NetRatings and Comscore AdMetrix.

Channel 4 believes that new measurement systems will be necessary to improve the effectiveness of internet display advertising—and the emergence of common systems as "currency" for advertising should be expected to increase the appeal of internet display advertising. Channel 4 is confident that the market will find an appropriate solution in the medium term through a process of self-determined innovation.

Question 3: Do you agree with our conclusion that, at present, internet advertising does not constitute a sufficiently strong competitive constraint on TV advertising? Is this likely to change in the foreseeable future?

Channel 4 agrees that at present TV advertising and internet advertising remain materially separate and distinct markets. Channel 4 believes that internet advertising cannot be compared to TV advertising—over 75% of internet advertising spend is on search and classified. In terms of display advertising, internet display advertising remains a small proportion of the total display advertising sector relative to television[1].

For advertisers, TV provides a completely different product to the internet, which cannot deliver the mass market fast build campaigns and shared experience of TV. This was recently recognised by the CC, which found that internet advertising is not substitutable for television advertising (but potentially complementary) and also saw no evidence that internet display advertising will become a substitute for television advertising in the foreseeable future. Channel 4 agrees with this analysis.

[1] In 2010, internet display advertising amounted to 9% of total display advertising, compared to 36% for TV advertising.

Question 4: Do you agree with our market definition? Have we considered the appropriate market developments in forming our view?

Channel 4 accepts for the purposes of this market review the definition of the market proposed by Ofcom—a single UK market for the supply of TV airtime for advertising. Throughout the range of different reviews into the advertising market over the past years Channel 4 has consistently supported this definition, and considers that Ofcom has taken into account the appropriate potential market developments in forming its view—Channel 4 agrees that TV advertising remains a separate and distinct market compared with internet display advertising.

Question 5: Do you agree with our overview of the way TV advertising is traded? Are there any other characteristics of trading that we should consider?

Channel 4 broadly agrees with Ofcom's overview of the way TV advertising is traded, which in general terms captures the main features of the market. In relation to specifics, Channel 4 would suggest the following clarifications to Ofcom's overview.

- Paras 5.4, 5.12, 5.14, 5.22, 5.35: Negotiations are between media buyers and sales houses, rather than broadcasters.
- Para 5.35: Channels are often sold based on a discount to that channel's SAP, but many channels are sold at an index to another (typically larger) channel's SAP. [Redacted]
- Para 5.23: Campaigns are typically simply approved to sales houses without any form of negotiation, the negotiation having been done in the annual deal.
- Para 5.38: A discount to SAP does not imply that someone else must be getting a smaller share of impacts. Typically all prices negotiated are discounts to SAP as optimisation means that it is possible for all buyers to get a discount from SAP.
- Para 5.39: If total revenues committed are higher than anticipated, SAP will be higher, irrespective of the demographic to which the revenue is committed.
- Para 5.43: Power ratios can be misleading for two reasons. Firstly, they reflect only total revenue and inventory and not the prices actually paid by media buyers. Sales houses that optimise well typically sell at prices significantly below their calculated power ratio. Secondly, channels with strong demographic profiles will appear expensive. For example, music channels tend to have a high AD1634 profile and will typically only sell variations of this demographic. A power ratio based on all adults will not capture the significant quantity of AD1634 impacts traded and will falsely imply a higher price.
- Para 5.47: "Specials" are often traded at fixed prices.

Question 6: Do we understand correctly that the market has essentially operated in the same way since the early 1990s? Does our analysis of why the market evolved from a slot traded ratecard model accurately reflect reality?

Broadly speaking, Channel 4 agrees that some features of the market—for example trading impacts, umbrella deals and the use of discounts against SAP—have been in place since the early 1990s.

However, far from stagnating, Channel 4 believes that the market has continually evolved since the 1990s through a process of gradual and measured innovation, beyond the degree recognised by Ofcom in the consultation document. These innovations are set out in response to question 1.

Question 7: Are there any other benefits associated with the current system of trading which we have not factored into our analysis?

While the market has been characterised by ongoing innovation, the core model has remained stable because it works extremely well, delivering significant benefits to advertisers, viewers, media buyers, sales houses and broadcasters. Ofcom has articulated some of these benefits, but in Channel 4's view the advantages of the current system of trading are more widespread, as set out below.

High levels of efficiency lead to lower prices for advertisers

The annual process of negotiating a Share of Commercial Impacts (SOCI) in return for a Share of Budget (SoB) is very efficient. The administrative costs would be far higher were, for example, spots traded on a campaign-by-campaign basis. [Redacted]

The trading mechanic also allows advertisers to execute campaigns efficiently. For example, it allows advertisers to buy a specific target audience and only pay for those impacts that reach their defined audience, reducing wastage and improving effectiveness.

In addition, the current system also allows media buyers to operate efficiently, with low transaction costs, enabling them to offer very competitive "cost of buying" to their advertiser clients. An alternative trading model—for example, trading individual slots against a ratecard—would require media buyers to employ far more staff to deal with the c.2.5m slots that are traded per month in the UK, and the cost of this would be passed on to advertisers and potentially consumers.

There is good evidence to suggest that the efficiencies realised by the current trading system have led to reduced prices. As Ofcom notes, the price of TV advertising has fallen steeply over the last ten years and has not been cheaper since 1993. For example, in 2010 the CPT for Adults was just 66% of its 2000 level. International comparisons also suggest that the UK has seen larger falls than any similar market. The UK market model has, therefore, provided significant value to advertisers.

Advertisers benefit from significant flexibility

The current trading system provides significant flexibility in that share deals eliminate the need for advertisers to commit to a level of absolute expenditure for the year ahead; reducing their exposure to demand-side risks, which are particularly high in the current economic climate. An additional benefit is that with the existence of both line-by-line trading and umbrella deals, advertisers have a choice of the mechanism that best suits their needs.

The Station Average Price (SAP) system also delivers benefits to advertisers. For example, the operation of SAP means the market is never "'full"—new campaigns can always be accommodated giving advertisers considerable flexibility. SAP is also an extremely elastic pricing mechanism, reflecting changes in the demand and supply of audiences, meaning that advertisers directly and transparently benefit from changes in the market, such as the large increase in commercial impacts seen over the past decade.

Efficient allocation of risk allows advertisers to deliver more effective campaigns

The current trading mechanism allows sales houses to minimise administration costs and bundle and optimise advertising airtime across the schedule, resulting in lower prices and more effective campaigns for advertisers.

For example, the system reduces risk for advertisers in delivering campaigns as it places the responsibility—and risk—for the delivery of commercial impacts with the sales house. This avoids the need for advertisers to speculate on the performance of individual programmes (as they would in a spot trading model).

The process of optimisation also means that adverts are shown during programmes which are likely to be seen by the greatest possible proportion of people in the target demographic, rather than from other target demographics. Sales houses therefore maximise the number of impacts traded by delivering a higher number of impacts than would be the case if adverts were shown randomly throughout the day.

In recent years, sales houses have invested heavily in ad optimisation technology, which has led to an evolution in how advertising is managed and traded. [Redacted] This investment, which has been enabled by, and in turn improves, the current trading system has consequently delivered benefits to advertisers by increasing the number of usable impacts and providing better predictions and closer targeting.

Bundling of airtime by non-dominant suppliers allows buyers and sellers of airtime to work together to achieve efficiencies in the sale of airtime leading to reduced prices for advertisers. If channels and/or dayparts were unbundled, the number of packages would substantially increase, requiring a significant increase in staff costs and systems upgrades; costs which would be passed on to advertisers and potentially consumers.

[Redacted]

Viewers benefit from high levels of investment in UK content

Viewers clearly benefit from the current system of trading advertising, which ensures efficient levels of investment in UK content—over £1.1 billion from the commercially-funded PSBs in 2010. Broadcasters compete for audiences in order to maximise their SOCI—and consequently SoB—from media buyers. Broadcasters are then able to use these revenues to invest in a wide range of programmes that will appeal to a wide range of audiences, which will drive further viewing and impacts in future. Looking back over the past five years, broadcasters have been able to devote increasing percentages of their advertising revenue to programming, to the benefit of viewers—Channel 4, for example, has increased its programme budget as a percentage of advertising revenue from 70% to 79% over the past five years for the main Channel 4 service.

The current trading system also provides broadcasters with a relatively high level of confidence to invest in programming. While upfront volume deals would of course provide a greater degree of certainty, the current system does give broadcasters a reasonable, advanced indication of their budgets for the coming year, facilitating investment in content, including in genres with long lead times such as film and drama.

Viewers benefit from access to new, innovative content

Channel 4 has an incentive to attract as large and diverse an audience as possible for a whole range of reasons, not least to effectively fulfil its public service remit and functions. Channel 4's cross-subsidy model means revenue from more profitable programmes is used to support the delivery of content that may not be commercially viable, but which has significant public value.

For other commercial broadcasters, content strategy may be more directly influenced by potential advertising revenue. However, it would be mistaken for Ofcom to conclude that this dynamic reduces content innovation. In this scenario, the trading system—which provides incentives for broadcasters to compete for audience share—is actually likely to encourage innovation. UK audiences have an appetite for new, innovative content, so a failure to innovate is actually likely to result in smaller audiences, and consequently a smaller share of media buyers' budgets. The three commercially funded PSBs broadcast nearly 490 new and one-off programmes during peak in 2010, demonstrating broadcasters' appetite to provide innovative content.

The system of selling impacts also allows broadcasters to manage the inevitable uncertainty associated with high levels of content innovation, in that they can optimise impact delivery from programming hits and diminish the damage of underperforming shows, wherever they arise in the schedule. By contrast, if the market were to evolve to a system of trading spots, advertisers may opt to purchase slots in the most predicable hits shows in order to minimise risk. Accordingly, broadcasters would have the incentive to continue to keep producing safe, returning series which they know will consistently deliver impacts, but at the expense of innovation, and thus viewer satisfaction, and the support of a diverse and vibrant UK content sector.

Question 8: Can we draw any conclusions from features of TV advertising trading models in other countries about whether features in the UK market prevent, restrict or distort competition?

Channel 4 believes that it is difficult to draw meaningful insights from international comparisons as each market is considerably different, characterised by its own particular features.

However, Channel 4 notes that many major media markets operate on the basis of fixed rate card prices. Channel 4 further notes that these rate cards are typically only used as the starting point of negotiations between media buyer and sales house. In France, for example, we understand that discounts to ratecard are in the region of 45% to 50%. The extensive process of negotiation means that the actual prices agreed are far from transparent. In several markets, this effect is compounded by the absence of media auditors, which are used extensively by all major advertisers in the UK market.

Furthermore, Channel 4 also notes that the UK sales houses are less consolidated than in some other European countries, such as Germany and Italy.

Question 9: How transparent is the pricing of TV airtime? Does it enable advertisers and media buyers to make informed decisions about the purchasing of TV advertising on different broadcasters?

Channel 4 notes Ofcom's concerns that the combination of annual share deals and the role of Station Average Pricing (SAP) may mean that that there are not clear price signals in the market, and that this might reduce the amount of switching expected in a well-functioning market.

In Channel 4's view, the market does provide clear price signals for media buyers and advertisers. In addition, Channel 4 believes that the price signals enable these groups to make informed decisions about the purchasing of TV advertising on different broadcasters, and also facilitate switching between different broadcasters and media buyers.

The companies which directly participate in the market for UK TV advertising are large, sophisticated organisations with significant resources dedicated to monitoring, measuring and responding to price signals. For example, the media buyer with the largest share of NAR in the UK, Group M, is part of the WPP group, with over 17,000 staff and total worldwide billings of US$73.5 billion. The media buyer with the second largest share of NAR in the UK, VivaKi, is part of the Publicis Group, the second largest media counsel and buying group in the world. These companies are hugely experienced and able to devote significant resources to interpreting price signals and making informed decisions about the purchasing of TV advertising.

TV advertisers themselves are typically highly sophisticated public companies with large marketing departments. Most choose to use media buyers as these agencies' buyer power and expertise enables advertisers to obtain lower prices.

All major advertisers make extensive use of media auditors to assess the effectiveness of campaigns and the performance of the media buyer. As prices in the UK market are subject to a robust audit process, there is a large degree of transparency and information available. Auditors assess and provide information on a range of areas such as the price paid per impact, coverage, frequency, and other quality elements of the campaign. As a result, they play a key role in enabling advertisers to make well informed decisions about the price and quality of the service they are buying. In very few other industries is there such transparency of information to help buyers make decisions.

In Channel 4's experience, media buyers and advertisers are highly responsive to price signals in the market, and on an annual basis engage in highly competitive negotiations with sales houses. The strong countervailing buyer power of the agencies is a significant constraint on any sales house which does not have the market power of ITV.

[Redacted]

In addition, prices are predictable—while exact prices are not known, they can be predicted with a relatively high degree of certainty. Channel 4's analysis over the last decade shows that, in any given year, SAP for each of the major channels follows a relatively stable and predictable trend. This means that buyers can forecast prices without difficulty and make meaningful comparisons between key prices being offered by different sellers.

Ofcom notes that ratecards were previously used as the basis of the UK airtime trading mechanic. While at first glance it may appear more transparent to use a ratecard as a basis for trading, the final price agreed will almost certainly be "off-ratecard" following a lengthy and non-transparent negotiation process. As Ofcom notes, in comparable international markets, the final price agreed will "often include an element of commission or unaccounted-for incentive payments". On the basis of the international evidence, Channel 4's does not believe that the introduction of a ratecard in the UK will increase transparency.

In conclusion on transparency, Channel 4 believes that the market provides price signals to media buyers and advertisers, who are sophisticated and experienced in interpreting this information and use it to switch suppliers. There are also substantial efficiency benefits associated with the current trading system, which in Channel 4's view offset any residual concerns about price transparency. As a result, Channel 4 does not believe that a lack of transparency is a feature of the market that necessitates a referral.

Question 10: To what extent do advertisers switch between media buyers? What factors influence the decision and how easy is it to switch media buyers?

While Channel 4 is not best placed to comment on the contractual relationship between advertisers and media buyers, there is strong evidence to show that advertisers frequently switch between media buyers. Channel 4 understands that around 30% of the 100 largest spending advertisers have switched media buyer within the last five years—for example, BT moved from Starcom to Maxus in 2010, and Renault moved from Carat to OMD in 2009. Furthermore, there is evidence to suggest the propensity to switch has recently increased as shown in the table below.

Table 1: Advertisers switching agency

	2009	**2010**
Number of advertisers switching agencies	89	141
Nominal NAR value of switched agency accounts	£340m	£461m

Source: Mediatique.

In addition to these levels of *actual* switching, the *opportunities* to switch also indicate a high degree of open competitiveness in the market. In this regard, Channel 4 understands that a significant number of advertisers put their business out to tender in 2010. These high levels of both competitive tender and actual switching are illustrative of a competitive market process, where advertisers are able and willing to compare the terms and conditions offered by alternative agencies and to act accordingly.

Channel 4 also notes that while contracts between advertisers and media buyers generally run for two to four years, there is commonly a right of termination during such period on three to six months' notice, allowing advertisers to switch between media buyers with relative ease. The threat of exit is therefore real for incumbent media buyers, with rival media buyers constantly prospecting clients.

Question 11: To what extent do any benefits associated with these features of the market offset or even outweigh the potential detriment?

Channel 4 believes that there are substantial benefits associated with the current trading mechanism, as outlined in response to question 7, which offset any concerns about transparency.

Question 12: How has the recent consolidation in the market altered the relative bargaining relationships between sales houses and media buyers?

Channel 4 has not observed any lessening of competition between sales houses since the recent consolidation. Consolidation between sales houses has had a very small impact on the structure of the market with Channel 4's market share increasing by 7 percentage points (sales agreement with UKTV) and BSkyB's by 5 percentage points (purchase of VMTV). Channel 4 continues to operate in a competitive environment, facing a much larger rival ITV and strong smaller rivals such as Channel 5 and BSkyB, and has not felt any opportunity to lessen the degree to which it competes.

Consolidation between media buyers has had a material impact on market structure.

[Redacted]

Question 13: To what extent has consolidation resulted in sales houses having a strong market position in relation to particular audience demographics?

Channel 4 notes Ofcom's comment that "the level of the power ratio for Channel 4 means that it is not possible to rule out the possibility that it too has a position of market strength, at least in the delivery of certain types of audiences". Channel 4 does not believe it has a strong market position in relation to any demographic.

[Redacted]

Question 14: What might be the implications of consolidation for competition e.g. in terms of media buyers switching between broadcasters?

[Redacted]

Question 15: To what extent does the bundling of commercial impacts across channel schedules and between channels constrain the ability of media buyers/advertisers to switch expenditure between broadcasters?

Channel 4 notes Ofcom's view that the combination of bundled airtime and possible market strength of broadcasters in the delivery of particular audiences might have a detrimental effect on the amount of switching by media buyers.

Channel 4 believes that bundling delivers significant benefits to advertisers, media buyers and sales houses, allowing them to operate more efficiently and flexibly in the market.

More broadly, Channel 4 supports Ofcom's conclusions on this issue from its Airtime Sales Review, which found that "bundling is unlikely to be a problem unless it is undertaken by a player with market power".

[Redacted]

Question 16: How important are the possible benefits to advertisers, media buyers and sales houses from the bundled sale of airtime across a schedule? Are there other benefits that we have not considered?

The issue of bundling airtime was considered in detail by Ofcom during 2010 in the context of its consultation to remove the conditional selling rule.

Channel 4 supported this proposal (except in relation to ITV given the concerns raised above), as some bundling can benefit both advertisers and broadcasters. For example, the bundling of deals can release efficiency and scale benefits for both parties, such as cost savings on legal and administrative expenses. Bundling can also allow buyers and sellers to operate more flexibly in the market and come to an effective deal that benefits both parties. As a result, it can also lead to lower prices for advertisers.

Channel 4 continues to believe that bundling delivers significant benefits for advertisers, media buyers and sales houses.

Importantly, bundling places responsibility—and risk—for the optimisation of the delivery of commercial impacts with the broadcaster. For broadcasters, this supports investment in a wider range of more innovative, riskier content. The system of selling impacts also allows broadcasters to manage the inevitable uncertainty associated with high levels of content innovation, in that they can optimise impact delivery from programming hits and diminish the damage of underperforming shows. By contrast, if the market were to evolve to a system of trading spots, broadcasters would have the incentive to continue to keep producing safe, returning series which they know will consistently deliver impacts, but at the expense of innovation, and thus viewer satisfaction, and the support of a diverse and vibrant UK content sector.

The process of bundling and optimisation also means that adverts are shown during programmes which are likely to be seen by the greatest possible proportion of people in the target demographic, rather than from other target demographics. Sales houses therefore maximise the number of impacts traded by delivering a higher number of useful impacts, benefiting advertisers, media buyers and sales houses, leading to a reduction in price.

Bundling also allows media buyers and advertisers to deliver far more effective and efficient campaigns than if deals were not bundled. For example, campaigns have various targets, such as weekly targets, daypart targets, delivery by day or delivery by time length. In many cases, these targets are not required at a specific channel level—without bundling far more campaigns would exist, with duplicative targets, and buyers and sellers would have to monitor and correct unnecessary targets in order to meet the higher level target, resulting in higher transaction costs.

As the evidence suggests that bundling is currently benefitting broadcasters and media buyers, and there remains a statutory power for Ofcom to deal with any concerns about anti-competitive bundling in the market, Channel 4 does not believe this feature of the market suggests a referral is necessary.

Question 17: To what extent does the interaction of umbrella deals and annual SoB deals act to prevent, restrict or distort competition in the market for TV advertising?

AND

Question 18: To what extent does the ability of advertisers to switch between media buyers serve to impose an effective constraint on media buyers' behaviour?

AND

Question 19: To what extent does the way in which media buyers are remunerated help to align incentives between advertisers and media buyers? Does it have any adverse effects?

AND

Question 20: To what extent do the benefits of umbrella deals and annual SoB deals outweigh any concerns?

Channel 4 hopes it is more helpful to take questions 17 to 20 together.

While Channel 4 is not best placed to comment on the contractual relationship between advertisers and media buyers, Channel 4 has no evidence to suggest that agency deals generate material distortive effects. By contrast, there is strong evidence to show that advertisers frequently switch or threaten to switch between media buyers, as set out in response to question 10.

In relation to the specific impact of umbrella deals, Channel 4 believes these confer a range of benefits on sales houses, media buyers and advertisers. For example, umbrella deals deliver economies of scale, provide security and place less of an administrative burden on all parties in the market. [Redacted]

Channel 4 operates a mixed economy of umbrella deals and line-by-line deals, and will continue to work alongside media buyers to deliver optimal outcomes for advertisers.

Question 21: Do respondents agree that CRR has had an effect on contract negotiations and/or innovation in the way airtime is traded?

Channel 4 believes there is one feature of the market that continues to raise competition concerns—the market strength of ITV in the provision of mass audiences. Channel 4 remains of the view that a competition remedy, such as the Contract Rights Renewal (CRR) undertakings, continues to be necessary to constrain ITV1's position of market power.

Ofcom identifies that the CRR undertakings effectively constrain any changes in the way ITV1 airtime is traded, which may limit evolution across the whole sector. Whilst Channel 4 does not consider CRR to have materially constrained evolution to date, it is acknowledged that this mechanism may become more of a material restraint on full-scale innovation going forward. Consequently, Channel 4 would be willing to engage in a very specific review of alternative competition remedies which continue to protect against ITV1's market strength. However, it is important to stress that the trading mechanism is evolving and will continue to evolve whether or not CRR remains in place. The issues associated with the CRR remedy are not in themselves sufficient to merit a full market referral to the CC.

Question 22: To what extent do the new methods of distributing and consuming content require the development of alternative trading arrangements? Can the market adapt and develop under the current trading mechanism? Is the current trading model likely to prevent other possible developments in the sector?

Channel 4 notes Ofcom's view that the distribution and consumption of content has changed over time, but the way in which TV airtime is traded remains the same as when ITV1 had a monopoly on the supply of airtime.

By contrast, as set out in response to question 1, TV advertising has gradually and continually evolved under the current trading mechanism to deal with changes in the market. Channel 4 does not believe that this innovation has been unduly constrained to date by the current trading model, and does not believe that the current trading model prevents other possible developments in the market.

Going forward, Channel 4 believes that market developments such as the launch of YouView, the growth in connected devices in the home, the development of next-generation services from Sky and Virgin and the prospect of entry by new players such as Google and Apple are likely to drive significant changes in the market dynamics of TV advertising.

All parts of the value chain in TV advertising responding to these changes. Mainstream broadcasters, for example, are exploring a range of innovations with regard to product placement, VOD distribution, data collection/monetisation and new forms of audience engagement. Similarly, although advertisers may continue to favour mass market traditional advertising, they are exploring a range of different engagements, including direct to consumer (e.g. the Audi Channel), interactive, "viral" marketing, and online/VOD. Media buyers, meanwhile, are exploring a range of ways of increasing service provision to end clients, including investments in ad insertion and co-operation with clients on data collection and monetisation.

Channel 4 is keen to continue its lead role in advertising innovation and develop new ideas and commercial strategies, and always seeks to be the first to innovate in the market. Channel 4 has therefore established a new Audience Technologies and Insight Department to develop and innovate ad models in all areas, focusing particularly on viewer relationship management and cross-media measurement. These developments are taking place under the current trading system and Channel 4 believes that these initiatives can continue to adapt and evolve under the current trading regime.

However, Channel 4 also believes there is a role for the regulator to encourage innovation in the market, removing any undue impediments to such activity. In this regard, Channel 4 believes that access to data—i.e. in-depth insight into the behaviour and tastes of viewers—will be vital to enabling future innovation and investment. Channel 4 is therefore keen to explore options for ensuring that viewer data can be accessed by broadcasters (subject to compliance with a robust data protection framework which protects the interests of consumers)—rather than restricted by platform operators—to enable broadcasters to develop new business models and consequently sustain investment in UK content.

Question 23: To what extent have broadcasters become more risk averse when considering acquiring or commissioning new programming? Is this the result of the operation of the current airtime trading mechanism?

Channel 4 does not believe there is any evidence to support Ofcom's hypotheses that broadcasters have been deterred from investing in content by the current trading mechanism or that broadcasters are faced with the incentive to stick to programming that is known to deliver predictable audiences, thereby limiting advertisers' ability to experiment.

By contrast, as set out in response to question 7, Channel 4 believes the current trading mechanism secures significant benefits for viewers, including high levels of content investment and innovation.

Channel 4 has been able to engage in a wide range of content innovation under the current trading system. For example in 2010, this included new approaches to traditional genres such as history (*Blitz Street*) and science (*Inside Nature's Giants*). *One Born Every Minute* explored the potential of fixed rig cameras to provide unprecedented intimacy, and in *Seven Days* Channel 4 sought to push the boundaries of reality television, allowing viewers to influence real life events. In addition, in 2010 Channel 4 broke new ground in combining television and online experiences with *Million Pound Drop*, which included a live television element with an accompanying online game.

Question 24: To what extent have media buyers/advertisers been restricted or prevented from experimenting with new marketing approaches as a result of the current airtime trading mechanism?

While Channel 4 is not best placed to comment on how media buyers and advertisers have experimented, the rapid growth of total advertising expenditure—for example on the internet and on mobile—suggest that there are few constraints on the use of new marketing methods as a whole.

With regard to TV advertising, the wide range of innovation and changes in the market seen since the 1990s—set out in response to question 1—have allowed advertisers to experiment with marketing approaches and generate greater value. Many of Channel 4's innovations have been conducted in partnership with advertisers and media buyers, for example the break hijack in Channel 4's Comedy Gala was developed in close conjunction with the individual advertisers involved.

Question 25: Are there any offsetting benefits of the current trading mechanism for viewers?

Channel 4 believes the current trading mechanism delivers significant benefits for viewers, as set out in response to question 7.

Question 26: In light of the OFT's guidance on factors to take into account in considering a market reference, what is your view about the proportionality of a reference?

AND

Question 27: What are your views of the availability of possible remedies to address concerns?

Channel 4 hopes it is more helpful to take questions 26 and 27 together.

As set out in this response, Channel 4 does not believe there are reasonable grounds for suspecting that features of the TV advertising market prevent, restrict or distort competition in the sector, such that a reference to the CC is warranted, or that the use of any undertakings needs to be considered in lieu of a reference, or that the imposition of any remedy is required. A market referral would be disproportionate and would fail to acknowledge appropriately the significant benefits of the current system.

Given the importance of advertising to the UK creative economy, any decision to subject the market to a long and potentially destabilising investigation by the CC would (in accordance with the OFT's Guidance as applied by Ofcom in this review) be proportionate only if Ofcom found evidence of serious anti-competitive practices likely to cause significant detriment to advertisers and/or TV viewers.

Channel 4 notes the competition concern raised by the CC and the Office of Fair Trading, most recently re-stated during the House of Lords Communications Committee's inquiry into the regulation of television advertising. However, Channel 4 also notes that in evidence submitted to the House of Lords inquiry Ofcom confirmed that it had received no evidenced complaint regarding competition issues related to TV advertising trading.

It is important to stress that Channel 4 is not advocating the status quo in its entirety. Channel 4, however, believes the market should be allowed to continue to evolve through a process of gradual and measured innovation.

Channel 4 considers a market referral to be neither necessary nor proportionate, and may instead both damage confidence and inhibit the ability of the market to evolve organically over time.

22 July 2011