Competition issues in the UK TV advertising trading mechanism

Consultation on the potential reference to the Competition Commission

Consultation

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Section 1

Summary

1.1 In this document we are consulting on whether or not to refer the UK market for TV advertising to the Competition Commission (CC) for market investigation.

1.2 We are making this decision within the framework of the Enterprise Act 2002 (EA02); that is, Ofcom can make a reference to the CC if there are “reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom”[1].

1.3 If we identify features which we believe may prevent, restrict or distort competition then the next step would be for Ofcom to consider whether to exercise our discretion to refer the market to the CC for investigation. We will be applying the OFT market investigation guidelines[2] for making a market reference, which include assessing whether referral is a proportionate response to the problems identified and the likely availability of appropriate remedies.

1.4 The focus of the consultation is the operation of the trading model. Hence, the document reviews the key features of the way in which airtime is sold by broadcasting sales houses and purchased by media buyers and advertisers, what we have termed the ‘airtime trading mechanism’, and covers the commercial relationships between stakeholders at the various levels of the supply chain.

1.5 When viewers watch programmes on a commercial channel, they also watch advertising (thereby providing the advertising airtime for broadcasters to sell to advertisers). Around £4bn is currently spent on TV advertising annually. It is critical for financing TV content for many broadcasters and is the main source of revenue for commercial Public Service Broadcasters (PSBs). TV advertising is also an important feature of many consumer-focused markets, used to communicate information about products to potential purchasers, and there is likely to be a relationship between the price of advertising and the prices final consumers will pay.

1.6 Therefore, any competition concerns will potentially affect both advertisers and television viewers, both in terms of prices, consumption patterns and the nature and quality of content. For this reason we believe it is important to consider the possible effects on these two sets of consumers – advertisers and TV viewers.

1.7 Given our current understanding of the way in which the sector operates, we believe that there may be competition concerns associated with specific features of the TV advertising market. However we also note that there are likely to be offsetting efficiency benefits. The aim of this consultation is to encourage stakeholder views on the nature and scale of the competition concerns and any offsetting benefits in order to help us conclude whether a market reference is appropriate.

[1] Section 131 EA02.

[2] OFT 511: Market investigation references – Guidance about the making of references under part 4 of the Enterprise Act (OFT) March 2006.
http://www.oft.gov.uk/shared_oft/business_leaflets/enterprise_act/oft511.pdf

1.8 Since 2000 there have been a number of reviews which have involved analysis of aspects of the way UK TV advertising is bought and sold, most recently in the House of Lords Communications Select Committee Review of TV advertising regulation. As part of these reviews, a number of concerns have been raised about possible anti-competitive effects associated with the airtime trading mechanism and in several instances it has been suggested that it may be appropriate to undertake a more complete and thorough review of the trading mechanism. In particular, the CC has identified concerns about the potentially anti-competitive effects of characteristics of the trading model, including Share of Broadcast (SoB) deals, media agency umbrella deals and Station Average Pricing (SAP) [3].

1.9 These reviews have also taken place against a background of significant wider sector developments such as changes in viewing patterns, the growth of the internet as an advertising medium, volatility in advertising revenues following the economic downturn and changes in ownership on both sides of the sector. In addition, there have been a number of technological developments within the sector (e.g. video on demand, IPTV, targeted advertising) which, while currently in their infancy, have the potential to influence the way in which TV advertising (and advertising more generally) is traded in the future.

1.10 Given these developments and following the conclusion of the reviews, we think it is now appropriate to assess whether the underlying trading mechanism gives rise to competition concerns and whether the features of the market are having an adverse effect on sector evolution.

1.11 In the consultation we set out our understanding of the key features of the way TV advertising airtime is traded. In broad terms, the sector is characterised by:

- The sale and purchase of impacts, rather than slots, although some slots, ‘specials’ are sold individually;
- Annual bespoke SoB deals, in which media buyers commit to spend a proportion of their total TV advertising expenditure with a specific broadcaster, in return for specific terms and conditions and discounts off the prices for different demographic audiences;
- A very high proportion of umbrella agency deals, in which media buyers negotiate annual terms on behalf of a portfolio of clients. We note that advertisers rarely deal with broadcasters directly and enter contracts with media buyers which typically last for several years;
- A relatively high level of concentration in terms of both broadcasters’ sales houses and media buyers;
- Product differentiation which may be combined with market strength in specific areas, such as demographic groups. In particular we note the strength of ITV in relation to the delivery of mass audiences;
- Bundling of impacts across a channel schedule and across channels.

1.12 We also note that the trading mechanism appears to be unique to the UK, having evolved from one in which prices for slots were negotiated off published ratecard

[3] Carlton Communications Plc and Granada Plc: A report on the proposed merger’ Competition Commission, 2003, paragraphs 2.180 – 2.183.

prices. We believe this evolution may, in part, reflect a desire to reduce transactions costs and manage risks on both sides of the sector. However we note that there does not appear to have been much significant change to the way airtime is traded since the early 1990s, despite substantial wider changes in the sector.

1.13 We believe that there may be justifiable concerns that the combination of these features may prevent, restrict or distort competition in the sector. However, we also note that under each of these issues there may be offsetting efficiency benefits associated with the features identified. In particular, we have identify potential concerns around:

Transparency of pricing signals

- We consider that the combination of annual share deals and the role of SAP may mean that there are not clear price signals for media buyers and advertisers.

- In addition, we believe the combination of these annual share deals and the nature of umbrella deals could mean that what advertisers pay is determined by media buyers rather than underlying supply and demand features facing broadcasters and this may limit advertisers' ability to respond effectively to price incentives.

- The effect of poor transparency of pricing signals might be to reduce the amount of switching we might expect to see in a well-functioning market.

- At the same time we are aware that the players in this market include large, sophisticated organisations and they may consider that there are sufficient price signals. We also recognise that umbrella deals are likely to reduce transactions costs for both broadcasters and advertisers and provide a degree of flexibility for advertisers to adjust their marketing plans over the course of the year.

Bundling of airtime

- We consider that the combination of bundled airtime and possible market strength of broadcasters in the delivery of particular audiences may have a detrimental effect on the amount of switching by media buyers.

- In the context of a differentiated product market, we believe it is likely that different types of impacts are valued differently by media buyers and advertisers. It may be that some broadcasters have a particular strength in the delivery of specific types of impact (whether by time of day or in particular programmes etc). Given that impacts are bundled across the schedule it is possible that broadcasters are able to use market strength to leverage from less competitively supplied impacts to more competitively supplied impacts.

- The effect of this could be that switching of advertising revenues across broadcasters is inhibited.

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

Limited evolution of the trading model

- It is possible that the limited evolution of the trading model has resulted in a lack of innovation in the way airtime is bought and sold. This could have an adverse effect on the nature of deals available to advertisers and on the choice of programmes available to viewers.
- We also consider that this could create a problem in identifying the most effective way of tackling ITV's market strength in the delivery of mass audiences. In the context of the current trading model, and particularly given the bundling of impacts, the Contract Rights Renewal (CRR) remedy is applied to ITV1's entire schedule, despite the fact that the CC has identified the source of ITV's market strength as being its unique ability to deliver mass audiences. It appears likely that the structure of the trading model may make it difficult to design a more targeted remedy. Moreover, CRR effectively constrains any changes in the way ITV1 airtime is traded, which may limit evolution across the whole sector.
- As a result we are concerned that the trading model appears to be effectively frozen in time and may not be able to evolve in response to commercial pressures and sector-wide developments.
- On the other hand, it could also be the case that the trading model has not evolved because the current airtime trading system was already reasonably efficient, delivered what advertisers want and is sufficiently flexible to accommodate changes going forward.
- The current trading model also provides media buyers, advertisers and broadcasters with the ability to reduce the uncertainty surrounding the performance of a particular programme or campaign. For example, a slot trading model may increase uncertainty for advertisers, about the performance of individual slots, in contrast to the 'insurance' offered by a deal which provides them with a share of commercial impacts.

1.14 We believe it is important to establish where the balance of costs and benefits lies and would welcome stakeholders' assessment of this.

1.15 The analysis we set out suggests that any possible prevention, restriction or distortion of competition may in turn have an adverse effect on two sets of consumers: advertisers and TV viewers. This is due to the two-sided nature of TV advertising; television channels offer programming to attract viewers on one side of the market while on the other side of the market they sell access to those audiences to advertisers. Prevention, restriction or distortion of competition may adversely affect the efficient allocation of advertising revenues across broadcasters, innovation by broadcasters and the consumer experience, both in terms of higher prices and access to content.

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

1.17 If we conclude that, on balance, we believe there is a reasonable suspicion that there are features of the market which will interact to prevent, restrict or distort competition, we will decide whether to exercise our discretion to refer the market to the CC for a market investigation. In making this decision we will consider whether the referral is a proportionate response to the problems identified. We will also consider whether the referral is the appropriate route to addressing potential concerns and whether the CC would have appropriate powers to address possible competition concerns.

1.18 We invite responses to our consultation questions outlined in Annex 5 by **22 July 2011**. In addition, in the event that, in light of the consultation responses, we decide that a market investigation reference to the CC is appropriate we have set out the draft terms we are minded to use when making a reference in Annex 1. We also welcome stakeholder views on this.

Section 2

Introduction and background

2.1 In this document we are consulting on whether there are reasonable grounds to suspect that features of the TV advertising market might prevent, restrict and distort competition and meet the legal threshold for a market investigation reference to the Competition Commission (CC) under the Enterprise Act 2002 (EA02).

2.2 This reflects potential concerns that features of this market may be restricting, preventing and distorting competition, leading to adverse effects for advertisers and consumers in the related downstream markets.

2.3 If we believe there are features which act to limit competition in the market then the next step would be for Ofcom to consider whether to exercise our discretion to refer the market to the CC for investigation. In assessing potential competition concerns, we will be applying the OFT guidelines for making a market reference, which include assessing whether referral is a proportionate response to the problems identified.

Legal powers

2.4 We have a concurrent power with the Office of Fair Trading (OFT), relating to commercial activities connected with communications matters, to make market investigation references to the CC under s131 EA02.

2.5 Section 131 provides:

> "(1) [Ofcom] may…make a reference to the Commission if [Ofcom] has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.
>
> (2) For the purposes of this Part any reference to a feature of a market in the United Kingdom for goods or services shall be construed as a reference to:
>
>> (a) the structure of the market concerned or any aspect of that structure;
>>
>> (b) any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or
>>
>> (c) any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.
>
> (3) In subsection (2) "conduct" includes any failure to act (whether or not intentional) and any other unintentional conduct."

2.6 A 'feature' of a market for the purposes of EA02 has a broad meaning. In cases where the s131 EA02 test has been met, we have discretion on whether to make a reference. We exercise that discretion having regard to the OFT's guidance on market investigation references (the 'OFT's Guidance').[4]

2.7 Amongst the factors we consider in deciding whether or not to make a reference are our competition and sectoral powers. We have concurrent Competition Act 1998 (CA98) powers under s371 Communications Act 2003 (CA03) in relation to activities connected with communications matters. We also have powers under s316 CA03. However, these powers exist only in relation to licensed and connected services, which means that we would have limited ability to address competition concerns involving media buyers and advertisers under these powers.

2.8 This consultation is published in accordance with s169 EA02, which requires us to consult, so far as is practicable, any person on whose interests a proposed reference is likely to have a substantial impact and give reasons for the proposed decision.

Background

2.9 Since 2000 there have been a number of reviews which have involved analysis of aspects the way UK TV advertising is bought and sold:

- in 2000 the CC examined the proposed merger between Carlton Communications plc (Carlton) and United News and Media plc (UNM) and the proposal by Granada Group plc (Granada) to make an offer to acquire either Carlton or UNM (2000 CC Report)[5];
- in 2003 the CC investigated the proposed merger between Carlton and Granada, which resulted the merger being approved subject to the Contract Rights Renewal (CRR) undertakings (2003 CC Report)[6];
- in 2010 the CC completed a review of the CRR undertakings (2010 CC Report)[7];
- In 2010 Ofcom reviewed and subsequently removed the Airtime Sales Rules (ASR)[8]; and
- In 2010/11 the House of Lords House of Lords Communications Select Committee conducted a review of advertising regulation (HoL Report)[9].

2.10 During these reviews a number of concerns have been raised about possible anti-competitive effects associated with the way airtime is bought and sold, or the 'airtime trading mechanism'.

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[4] OFT 511: Market investigation references – Guidance about the making of references under part 4 of the Enterprise Act (OFT) March 2006.
[5] Carlton Communication Plc and Granada Group Plc and United News and Media Plc: A report on the three proposed mergers, Competition Commission, 2000 http://www.competition-commission.org.uk/rep_pub/reports/2000/441carlton.htm#summary
[6] Carlton Communications Plc and Granada Plc: A report on the proposed merger' Competition Commission, 2003 http://www.competition-commission.org.uk/rep_pub/reports/2003/482carlton.htm#summary
[7] Review of ITV's contract rights renewal undertakings, Competition Commission, 2010 http://www.competition-commission.org.uk/rep_pub/reports/2010/557ITV.htm
[8] Airtime Sales Rules Review – Statement, Ofcom, 28 July 2010 http://stakeholders.ofcom.org.uk/consultations/asr/
[9] House of Lords Communications Committee - First Report, Regulation of Television Advertising, 8 February 2011 http://www.publications.parliament.uk/pa/ld201011/ldselect/ldcomuni/99/9902.htm

2.11 In the 2010 CC Report, the CC noted that, during the course of the review, "a number of third parties" suggested that a wider market review was required to address a number of characteristics in the market which "prevent, distort or restrict competition". In particular, it noted: "CRR operates in a complex and opaque environment conditioned by the existence of SoB deals, media agency umbrella deals and the SAP trading mechanism. These characteristics of the market continue to have potentially anti-competitive effects"[10].

2.12 The CC highlighted that these characteristics were similar to those identified in its 2003 investigation, in which the CC indicated that there were features relating to the sale of airtime (which were outside the scope of its investigation) that had caused it 'disquiet'. The CC suggested that the market should be reviewed in order to assess "whether the nature of the deals struck, the trading mechanisms, and the overall market structure substantially lessen competition in the sale of airtime on commercial television, and how the system might be changed to enable it to operate more effectively and competitively"[11].

2.13 The main areas of concern highlighted by the CC were:

- The system of annual share-for-discount deals coupled with the Station Average Price (SAP) mechanism;
- The potential effects if a broadcaster was able to use market power to increase its share of advertisers' budgets, for a given level of discount;
- Lack of transparency of agreements resulting from the annual television advertising deal round; and
- The bundling of airtime, including peak and off-peak airtime[12].

2.14 In July 2010 Ofcom published a Statement concluding the review of ASR[13]. As part of this, we considered the need to undertake a broad review of the trading model. We supported the view of the CC that the trading model is complex and there appears to be limited transparency of prices. We proposed that this reflects in part the bespoke nature of deals between media buyers and advertisers and also the way airtime is negotiated in terms of share commitments.

2.15 In the Statement we concluded that, if combined with market power, it is possible that the features identified by the CC could interact in such a way that prevents, reduces or distorts competition in the TV advertising sector. However we also noted that it is also plausible that the characteristics of the trading model are efficient responses to the specific features of the TV advertising market and the uncertainty and transaction costs that key players face.

2.16 We also explained that we have not to date received any evidenced complaints from the industry in relation to the issues raised by the CC. As a result, there is a lack of clarity about the nature and scale of any broader competition problems arising from the way airtime is traded or in relation to consumer harm which might arise as a result. Given this and the implications for the sector in terms of the uncertainty that a review would be likely to impose on the sector, we concluded that we would not

[10] 2010 CC Report, paragraphs 9.4 – 9.5.
[11] 2003 CC Report, paragraph 1.26.
[12] 2003 CC Report, paragraphs 2.180 – 2.181.
[13] Airtime Sales Rules Review – Statement, Ofcom, 28 July 2010,

launch a review of the issues raised by the CC at that time. However we committed to keep this decision under review[14].

2.17 Since then, the House of Lords Communications Select Committee (HoL Committee) has undertaken a review of the TV advertising regulation. This was concluded in February 2011 with a number of recommendations, including “a wholesale review into the television advertising trading market”, given the need for “a transparent trading system which enables fairness, flexibility and certainty”[15]. The HoL Committee proposed that a review should consider:

- The efficacy of current television advertising regulations;
- How the advertising trading system might be made more open and transparent, including the possibility of an online auction as a trading mechanism;
- Whether any best practice can be transferred from television advertising trading systems in other countries; and
- The appeals process for television advertising airtime trading to ensure that all players in the market have a remedy if they believe they have been unfairly treated[16].

2.18 Moreover, since we last considered the question of a market review we note that the sector appears to have stabilised following a period of substantial declines in revenue and changes in ownership. In light of this, and wider developments, such as changes in viewing patterns and developments in content delivery (e.g. video on demand), we think it is now appropriate to assess whether the structure of the trading mechanism is having an adverse impact on competition and sector evolution.

Regulatory context

2.19 Ofcom has a number of powers in the area of TV advertising, and regulation has evolved over time to address a number of different objectives, some set by Parliament, others determined at the EU level. Some of these rules relate to the way TV advertising is sold and others relate to the content of advertising, the amount of advertising and the distribution and scheduling of advertising. In some cases regulation is designed to promote competition in the sector and in other areas we have rules to protect consumers, for example, from over-exposure to advertising. In addition, Ofcom has the duty to secure the availability throughout the UK of a wide range of TV and radio services which (taken as a whole) are both of high quality and calculated to appeal to a variety of tastes and interests. Linked to this, Ofcom is also required to have regard to the desirability of promoting the fulfilment of the purposes of public service television broadcasting in the UK[17].

2.20 Ofcom has a co-regulatory partnership with the Advertising Standards Authority (ASA) to determine which products and services can be advertised and the manner in which advertising is scheduled and promoted. The ASA is responsible for managing complaints about broadcast advertising, with the exception of complaints about political advertising, ‘participation’ television (long-form advertising predicated on Premium Rate Services such as chat, quiz, psychic, and gambling) which are

[14] Airtime Sales Rules Review – Statement, Ofcom, 28 July 2010, paragraphs- 2.25 – 2.26.
[15] HoL Report, paragraph 194.
[16] HoL Report, paragraph 195.
[17] Section 3(4)(a) CA03.

Ofcom's responsibility. Programme sponsorship and product placement also fall within Ofcom's remit, although it is important to note that, within the Audiovisual Media Services (AVMS) Directive, sponsorship and product placement are both defined separately to television advertising[18],with all three presented as different types of 'audiovisual commercial communication'[19].

2.21 The ASA's Broadcasting Committee of Advertising Practice (BCAP) undertakes Ofcom's functions with respect to setting, reviewing and revising of advertising standards codes. The BCAP Code is designed to inform advertisers and broadcasters of the standards expected in the content and scheduling of broadcast advertisements and to protect consumers.

2.22 In order to fulfil our duties, we aim to research and review markets regularly, and in this capacity we continue to monitor developments in relevant advertising markets.

Contract Rights Renewal (CRR)

2.23 The CRR remedy is part of the undertakings intended to address competition concerns arising from the Carlton and Granada merger in 2003. At the time the CC found that the proposed merger would have an adverse effect on future competition for the sale of TV advertising which might manifest itself in a number of ways, in particular, the parties ability post-merger to: insisted on terms that were generally less attractive to advertisers or media buyers (e.g. by demanding a greater level of commitment for a given discount, or offering worse terms); enhance the degree of price discrimination; and/or change the system under which TV advertising is sold to the advantage of the merged entity[20]. The CRR remedy[21] was designed to address this.

2.24 A key part of the undertakings is a mechanism designed, for the duration of the remedy, to give all advertisers and media buyers who had a contract with Carlton or Granada at the time of the 2003 merger the fall back option of renewing the terms of their 2003 contracts. Where that contract includes a specified share of broadcast (SoB), the CRR remedy provides that this share would vary in direct proportion to ITV's share of commercial impacts (SOCI), subject to a cap at the initial share. The main features of the CRR remedy can be summarised as follows:

- ITV is obliged to offer advertisers and media buyers the right to renew their contract on the same terms and conditions as that contained in their 2003 'protected' contracts. Thus, there would be no increase in the SoB advertiser's or media buyer's commitment to ITV1 and no reduction in the discounts they receive;

[18]'Television advertising' "means any form of announcement broadcast whether in return for payment or for similar consideration, or broadcast for self-promotional purposes, by a public or private undertaking or natural person in connection with in connection with a trade, business, craft or profession in order to promote the supply of goods or services, including immovable property, rights and obligations, in return for payment." (AVMS Directive – Article 1, 1(i) and replicated in COSTA).
[19]'Audiovisual commercial communication' "means images with or without sound which are designed to promote, directly or indirectly, the goods, services or image of a natural or legal entity pursuing an economic activity. Such images are included in a programme in return for payment or for similar consideration or for self-promotional purposes. Forms of audiovisual communication include, inter alia, television advertising, sponsorship, teleshopping and product placement." (AVMS Directive - Article 1, 1(h)).
[20] 2003 CC Report, paragraph 2.132.
[21] Full details of the undertakings as they currently stand can be found at: http://www.competition-commission.org.uk/inquiries/ref2009/itv/pdf/itv_crr_undertakings_160710.pdf

- While advertisers are able to use their protected contract terms, they are not obliged to do so. If they so choose, advertisers can instead negotiate changes with ITV. Where new terms and conditions are negotiated, CRR obliges ITV to offer fair and reasonable terms;

- Advertisers and media buyers have the right to reduce automatically the proportion of their spending on ITV1 (SoB commitment) if ITV1's SOCI falls. The way in which spend will vary with performance is determined by the Audience Ratchet Mechanism (ARM). Conversely, if ITV1's SOCI increases, advertisers can also increase their SoB commitment on the same protected contract terms[22]; and

- ITV is prohibited from changing the existing airtime sales system and the way in which they offer commercial airtime for sale; and

- Advertisers and media buyers have the right to bring disputes over the fairness and reasonableness of terms offered by ITV plc to an independent adjudicator, (the Office of the Adjudicator).

2.25 Ofcom has a role, along with the Office of the Adjudicator, in the administration of the CRR undertakings, although ultimate responsibility for these lies with the CC.

2.26 A review of the CRR undertakings was launched by the OFT in January 2008 and referred to the CC for consideration in May 2009[23]. The CC concluded its review in May 2010 finding that, despite a number of sector changes since the remedy was introduced, there is still an ongoing need for the CRR remedy to provide protection to advertisers and media buyers. However, some changes were made to the undertakings to extend the definition of ITV1 to allow impacts from ITV+1 and ITV1HD to be included in the ARM.

2.27 This conclusion was based on the CC's analysis of the market strength of ITV and the extent to which this has eroded since the introduction of the undertakings. The CC concluded that ITV1 still retained an enhanced market position, primarily due to its unique ability to deliver large audiences and that, absent an effective remedy, ITV would be able to worsen terms to advertisers overall through seeking higher SOB commitments, reducing discounts or worsening terms and conditions[24].

Code on the Scheduling of TV Advertising (COSTA)

2.28 COSTA rules determine the amount and frequency of advertising that broadcasters are permitted to show. Their origin can be found in the Television without Frontiers (TWF) Directive agreed in 1989. This aimed to foster a single market in television broadcasting across the EU by setting minimum common standards, amongst other things, for the amount and scheduling of television advertising.

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[22] The undertakings require ITV to offer the same ITV1 contract terms (including duration) to advertisers each year. Where a protected contract contains any SOB provisions, such shares will be revised annually in direct proportion to changes in ITV1's SOCI since 2002 (or the relevant base year). As noted above, advertisers are not required to accept this contract and can choose to negotiate a different contract under fair and reasonable terms.

[23] Review of the Contract Rights Renewal Undertakings – OFT Advice to the Competition Commission, OFT, May 2009. http://www.oft.gov.uk/shared_oft/register_of_orders_and_undertaki/CRR-review/CRR_Review.pdf

[24] 2010 CC Report, paragraph 26.

2.29 The TWF Directive provided a framework for Member States to develop their own more detailed rules. In the early 1990s a distinction was made between public service channels and non-PSB channels with the public service channels being subject to stricter regulation, explicitly to protect the quality of the viewer experience. The main public service channels are allowed an average of seven minutes an hour across the day (subject to a maximum of 12 minutes in any one hour). In addition, peak-time restrictions limit advertising between 6pm and 11pm to an average of 8 minutes an hour, subject to a maximum of 12 minutes in any one hour. The non-public service channels are permitted nine minutes of advertising an hour on average (subject to a maximum of 12 minutes in any one hour) which was the maximum average per hour allowed under the TWF.

2.30 In the UK, the Independent Television Commission (ITC) developed the initial Rules on the Amount and Distribution of Advertising (RADA) which Ofcom inherited. Following major changes to the TWF Directive, which became the AVMS Directive in December 2007, we undertook a comprehensive review of the advertising rules. In early 2008, we removed the old ITC rules, and introduced a much shorter and simpler code: COSTA. This removed outdated or unnecessary rules that had little or no beneficial impact, either on viewers or broadcasters.

2.31 We also prepared for a more fundamental review of whether the amount of advertising on public service channels should continue to be regulated more strictly than other channels, or whether a new common set of rules should be adopted. However, in the light of the economic downturn, both broadcasters and advertisers expressed concern that changes could be destabilising to all broadcasters, and we decided to delay this review.

2.32 We have now resumed preparations for this review. As part of this, we are considering whether the original rationale for stricter regulation of public service channels still holds, although it has become clear that we face a challenge in balancing our duties in this area. These include:

- The need to foster a wide range of high quality services appealing to a variety of tastes and interests;
- The desirability of a strong public broadcasting system; and
- The promotion of competition as a means of furthering the interests of consumers.

2.33 Therefore, before making a decision about the appropriate limits on advertising minutage we need to consider the principles for regulation in this area and ensure we have a clear understanding of how our different public interest objectives should be balanced. With this in mind we are now conducting further work on whether there is a case for a move away from the status quo in relation to the current minutage rules within the wider context of our duties in this area.

Product placement

2.34 In February 2011 TV broadcasters regulated by Ofcom were, for the first time, allowed to include product placement in television programmes[25].The historical

[25] Product placement is “the inclusion in the programme of, or a reference to, a product, service or trade mark where the inclusion – a) is for a commercial purpose; b) is in return for the making of any

prohibition on product placement on TV was based on the principle that there should be a clear separation between editorial content (programmes) and advertising. The purpose of this prohibition was to protect consumers from surreptitious advertising (as prohibited by the TWF Directive). Although the AVMS Directive confirmed the prohibition of product placement, it did introduce a derogation which permits Member States to allow product placement in specific programme genres, subject to certain restrictions. The UK's Audiovisual Media Services (Product Placement) Regulations 2010 (the Regulations) amended the CA03 to enable product placement in certain genres of programming on UK television[26]. The CA03 requires Ofcom to set rules for product placement, which must implement a range of detailed requirements set out in the legislation[27].

2.35 The Regulations came into force on 16 April 2010, but the UK Government made clear that product placement would not be permitted until Ofcom had consulted on, and made the necessary changes to the Ofcom Broadcasting Code. Following a consultation process, in December 2010, we issued a regulatory statement[28] and revised rules in relation to Commercial references in television programming, including product placement. These rules were incorporated into a revised Section Nine of the Ofcom Broadcasting Code which came into force on 28 February 2011[29].

Structure of this document

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

- In Section 3 we provide an overview of the advertising and broadcasting sectors and outline key sector developments over recent years;
- In Section 4 we outline our proposed market definition;
- In Section 5 we describe the key features which characterise the sale and purchase of TV airtime in the UK;
- In section 6 we consider how key features of the market may potentially prevent, restrict or distort competition; and
- In Section 7 we outline the factors we will consider in deciding whether to exercise our discretion to refer the market to the CC (in the event that we conclude there is a reasonable suspicion to believe that there are features of the market which prevent, restrict or distort competition in the market).

payment, or the giving of other valuable consideration, to any relevant provider or any person connected with a relevant provider; and c) is not prop placement." (CA03, Schedule 11A).

[26] Under the amended CA03, product placement is prohibited except in films, series made for TV, light entertainment and sports programmes. Product placement is prohibited in all news and children's programmes and in UK-produced current affairs, consumer advice and religious programmes.

[27] In summary, the CA03 prohibits the product placement of cigarettes and other tobacco products and prescription-only medicines in all programmes. In UK-produced programmes, it also prohibits the product placement of alcoholic drinks, gambling, food or drinks that are high in fat, salt and sugar, all medicinal products, electronic or smokeless cigarettes and other tobacco products and baby milk. Permitted placed products must not affect the editorial independence of the broadcaster, be promoted or given undue prominence. UK-produced programmes containing product placement must be clearly signalled at the beginning and end of the programme and when after commercial breaks.

[28] http://stakeholders.ofcom.org.uk/binaries/consultations/724242/statement/statement.pdf

[29] http://stakeholders.ofcom.org.uk/binaries/broadcast/831190/broadcastingcode2011.pdf

Our consultation process

2.37 In order to gather sufficient information to conclude whether a market investigation reference is appropriate, we have outlined a number of questions in this document. We invite responses to these questions by **22 July 2011.** In addition, in the event that, in light of the consultation responses, we decide that a market investigation reference to the CC is appropriate we have set out the draft terms we are minded to use when making a reference in Annex 1. We welcome stakeholder views on this.

2.38 Given the potential length of time a market investigation by the CC would take, we are aiming to conclude our process in the Autumn of this year.

Section 3

TV sector overview

Introduction

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

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

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

The UK advertising sector

3.3 It is clear from the large sums of money spent on advertising in the UK (Table 3.1) that it is seen as an effective way of marketing goods and services.

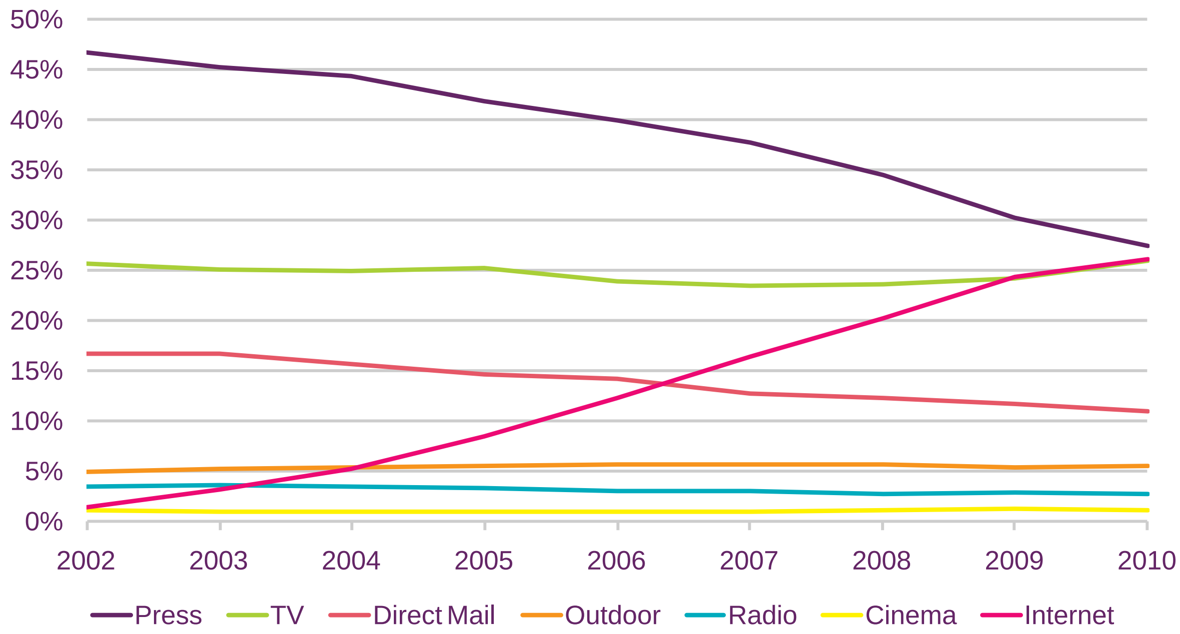
Table 3.1: Total UK Advertising Expenditure 2001 – 2010

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

Source: Advertising Association/Warc Expenditure Report

3.4 Chart 3.1 provides an overview of the proportion of total advertising spend accounted for by each medium in both 2002 and 2010. This comparison shows direct mail and radio advertising expenditure has declined during the period, with spend on outdoor and cinema advertising remaining fairly constant. Spending on television advertising also experienced a decline between 2002 and 2009, but recovered slightly in 2010. There has been significant growth in advertising on the internet, while press advertising (which includes all forms of advertising in newspapers, magazines, business & professional publications and directories) has fallen significantly. Even so, in 2010 press advertising still continues to account for the largest share with 27.5% of total UK advertising spend. Internet advertising accounted for the second largest share (26.1%), followed closely by TV advertising (26.0%) and direct mail (10.9%). The smallest proportions were accounted for by outdoor (5.6%), radio (2.7%) and cinema advertising (1.2%).

Chart 3.1: Percentage of UK advertising spend across different media



Source: Advertising Association/Warc Expenditure Report

3.5 Advertising can be split into display and classified advertising. Classified advertisements are generally grouped within a publication or featured on the internet under headings classifying the product or service being offered. These adverts are usually text-based and may just consist of the type of item being sold and contact details. Generally no pictures or other graphics are featured, though a logo may be included. Press (64.3%) and internet (30.5%) advertising account for a significant proportion of all classified advertising.[30]

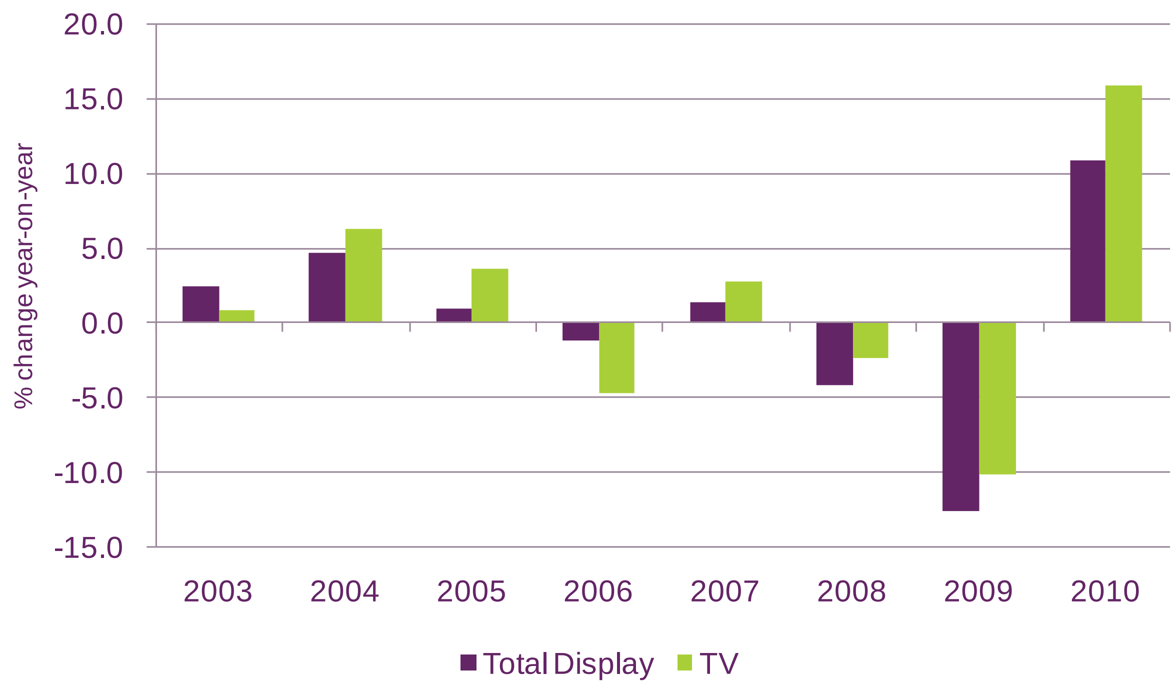
3.6 A sub-category of classified advertising is found on the internet: search-driven advertising, delivered by means of a keyword search. This accounts for the bulk of internet advertising (57.3%).[31] Search engines identify key words and use these as the basis for directing an advertising message to the 'searcher' or potential customer.

3.7 Display advertising is advertising that combines text with other graphical information, such as logos, photographs, diagrams, moving images, location maps etc and may include audio elements. Over one third of display advertising revenues are accounted for by TV advertising and slightly less than a third (26.2%) of revenues arise from spending on press advertising. The remaining revenues can be attributed to other forms of advertising including direct mail (15.3%), Outdoor (7.8%), internet (8.9%), radio (3.7%), and cinema (1.6%)[32].

3.8 With the exception of 2006, year-on-year growth for TV advertising has been faster (or the decline slower) than overall display advertising as Chart 3.2 demonstrates. Spend on TV advertising did not contract as significantly, following the economic downturn in 2009, and made stronger recovery, relative to total display advertising. TV advertising accounted for 36.4% of all display advertising in 2010, up from 34.8% in 2009. Internet display advertising also grew significantly over this period, however, it continues to represent a relatively small proportion of display advertising.

[30] Advertising Association/Warc Expenditure Report
[31] Advertising Association/Warc Expenditure Report
[32] Advertising Association/Warc Expenditure Report

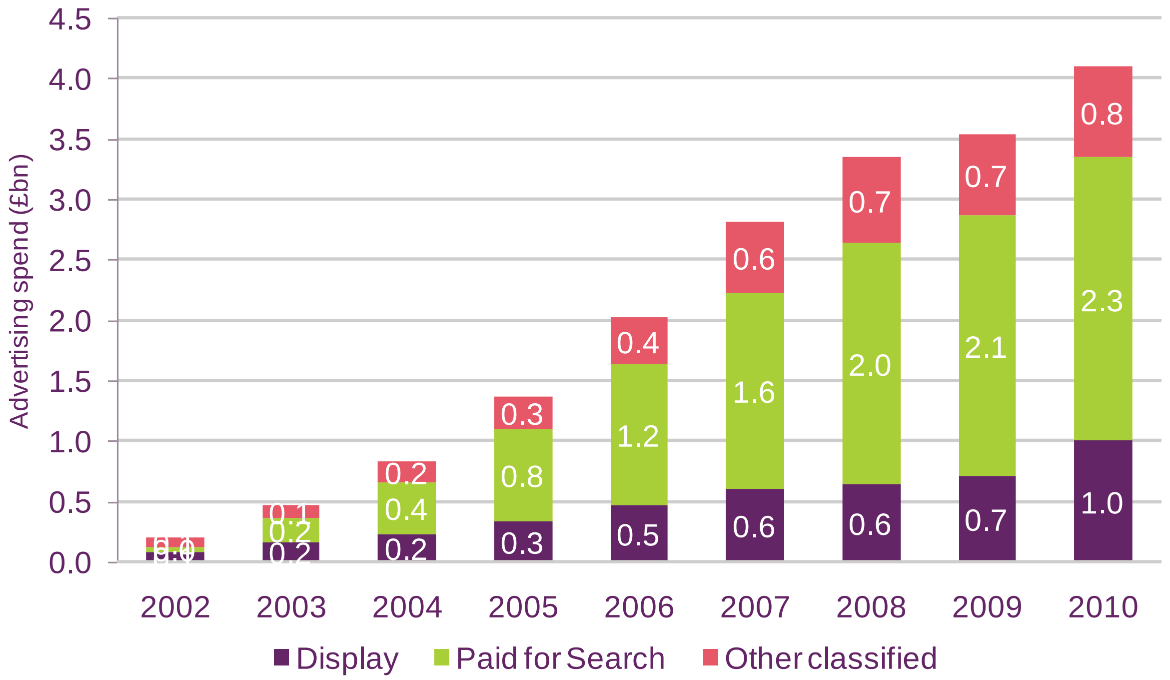
Chart 3.2: Year-on-year change in spend (%) – TV vs total display advertising



Source: Advertising Association/Warc Expenditure Report

3.9 One of the key market developments over the last decade has been the growth of internet advertising. As demonstrated by Chart 3.1 above, internet advertising as a proportion of all advertising has risen rapidly from 1.2% in 2002 to 26.1% by 2010, and now attracts similar levels of revenue to that of TV and press advertising.

Chart 3.3: Distribution and growth of internet advertising spend



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

3.10 This growth has predominantly been driven by the growth in search-based advertising. Chart 3.3 shows that the paid for search internet advertising comprises by far the largest share of internet advertising. In 2010, internet display advertising accounted for approximately 23.1% of total internet advertising[33]. The extent to which internet advertising might be substitutable for TV advertising is discussed further in Section 4.

TV advertising sector

The importance of TV advertising to advertisers

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

3.12 TV is a powerful and important medium for advertisers, both because it combines visual imagery, sound and movement and because television viewing is an extremely popular leisure activity[34]. As noted above, TV advertising accounts for a substantial portion of all UK advertising (26%), and represents the single largest category of display advertising. In 2010, approximately £4bn was spent on TV advertising in the UK (see Table 3.2 below).

Table 3.2: TV Advertising expenditure 2002 – 2010

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

Source: Advertising Association/Warc Expenditure Report

3.13 During the course of the OFT and CC's review of CRR, media buyers and advertisers re-iterated the importance of TV advertising in achieving brand awareness, sales uplift and reaching large proportions of the public. TV enables advertisers to combine moving images and sound to maximise audience engagement, with research suggesting that an engaged viewer is more likely to have a positive emotional association with the brand and is more likely to consider purchasing it in the future[35]. TV viewers also considered to have a higher level of emotional engagement with TV than any other media[36].

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

- near universal reach, which is important for manufacturers of Fast Moving Consumer Goods (FMCG)[37], such as detergent, toiletries, paper products;

[33] PwC / Internet Advertising Bureau / Advertising Association / Warc
[34] CC 2003 Report, paragraph 3.12.
[35] http://www.thinkbox.tv/server/show/nav.752
[36] http://www.thinkbox.tv/server/show/nav.762#2
[37] FMCG is a term generally used to describe frequently purchased consumer goods which are relatively low cost. They are often common items used daily for which there is a high demand. FMCG

- the ability to reach a large number of consumers rapidly, which is important for goods that have a limited duration (e.g. newspapers, promotions and sales); and
- the ability to multiply and prolong the effect of TV advertising by using creative techniques and complementary media (such as the internet) to engage public interest; and
- allowing mass marketing to target demographics.

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

Two-sided nature of the TV advertising market

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

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

Advertising and the consumer

3.18 The costs and revenues associated with TV advertising affect consumers in two main ways:

i) as viewers of commercial programming; and

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

3.19 With the obvious exception of the BBC, most channels get some or all of their income from advertising. Chart 3.4 below provides an overview of the different sources of income used to fund television content. TV advertising revenues therefore have the potential to make a major contribution both to the choice and quality of the programmes available to viewers.

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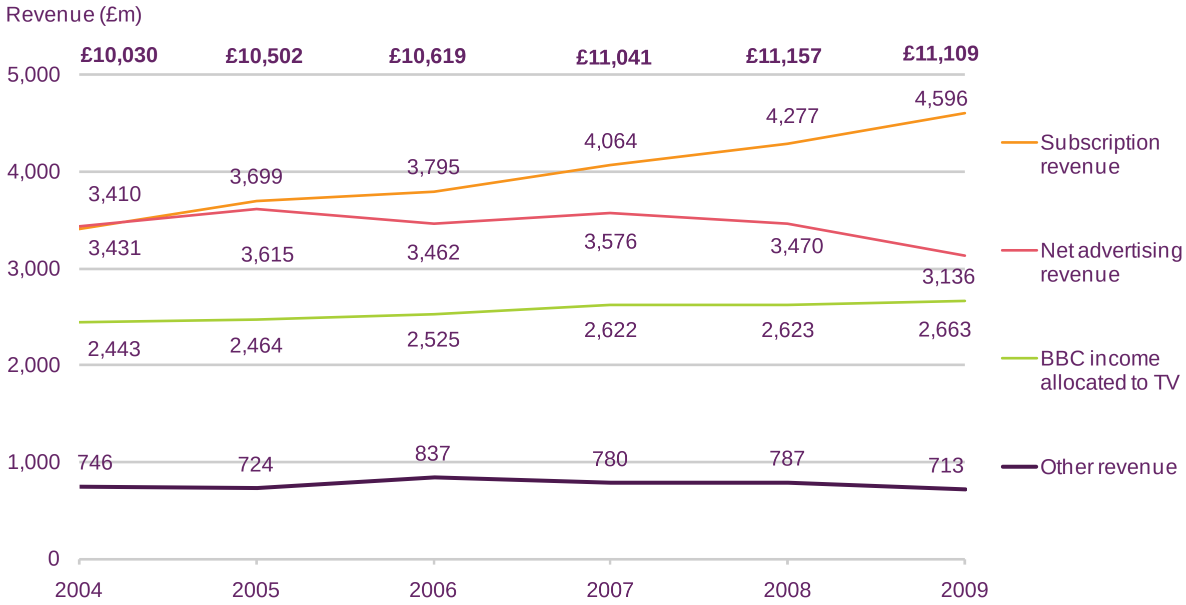
products contrast with durable goods or major appliances such as kitchen appliances, which are generally replaced less than once a year.

Chart 3.4: Total TV industry revenue, by source



Source: Ofcom/broadcasters
Note: Figures expressed in nominal terms and replace previous Ofcom revenue data for TV industry, owing to restatements and improvements in methodologies. 'Subscription revenue' includes Ofcom's estimates of BSkyB, Virgin Media, BT Vision, TalkTalkTV, Setanta Sports (until its closure), ESPN and Top Up TV television subscriber revenue in the UK (Republic of Ireland revenue is excluded). It also excludes revenue generated by broadband and telephony. 'Other' includes TV shopping,

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

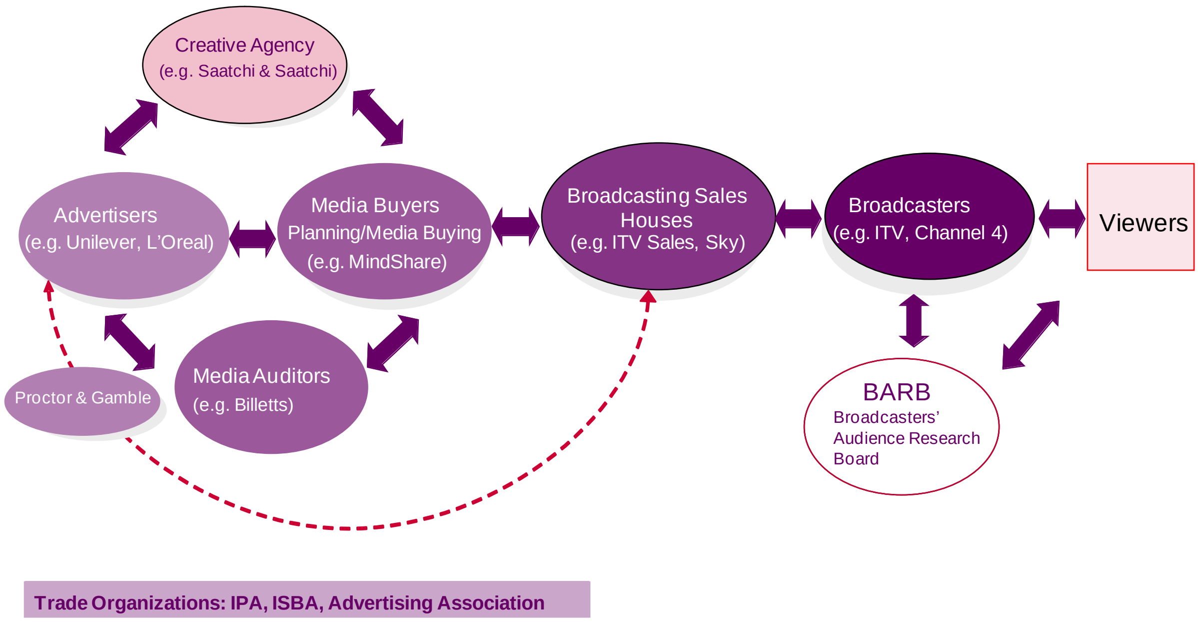
3.21 It is worth noting that given commercial broadcasters also compete with the BBC for audiences; investment in quality programming will also be influenced by the degree of competition faced from the BBC for viewers. In other words, the greater the quality of programming on the BBC, the more commercial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

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

Overview of the TV advertising supply chain

3.23 Figure 3.1 below provides an overview of the various players and their roles in the TV advertising supply chain. The role of each of these different players is also described briefly below. The commercial relationships and how TV advertising is bought and sold is covered in greater detail in Section 5.

Figure 3.1: The TV Advertising Supply Chain



Source: Ofcom

Advertisers

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

Creative Agencies

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

Media Buyers

3.26 Media buyers (or media agencies) are engaged by advertisers to act as a central point for negotiating the terms on which advertising is purchased from broadcasters.

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

Broadcasting Sales Houses

3.28 TV advertising airtime is generally sold on behalf of broadcasters by broadcasting sales houses. Sales houses are responsible for managing the media buyer relationship, negotiating contracts and terms and conditions. The larger broadcasters have their own sales houses i.e. ITV, Channel 4, Five and Sky. Smaller broadcasters often contract to sell airtime through larger sales houses.

Broadcasters

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

Media auditors

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

BARB

3.31 BARB (Broadcasters' Audience Research Board) is the primary provider of television audience measurement in the UK. It covers all channels broadcasting across all platforms - terrestrial, satellite and cable in both analogue and digital[38].

Targeting and measurement of TV audiences

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

3.33 Television audiences typically comprise a range of different demographic groups which can be differentiated according to three main characteristics i.e. age, sex, and

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

socio-economic status[39]. Demographic groupings are overlapping e.g. the 16-34 Men demographic is a subset of Adult Men and also a subset of 16-34 Adults and so on.

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

3.35 The exposure of a particular demographic to an advertisement is measured in terms of 'commercial impacts' (or impacts). Each occasion an advert is seen by a viewer counts as one impact. The effectiveness of advertising in reaching a target demographic group is measured in television ratings (TVRs). For a particular campaign, one TVR equates to reaching 1% of the target group with one 30 second advert[40]. Thus, an advert in a programme that reaches 25% of a particular demographic group delivers 25 TVRs. These commercial impacts or TVRs provide the 'currency' in which broadcasters and advertisers deal i.e. broadcasters and advertisers contract with one another for the delivery of a given volume of TVRs from a particular demographic group.

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

TV sector developments

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

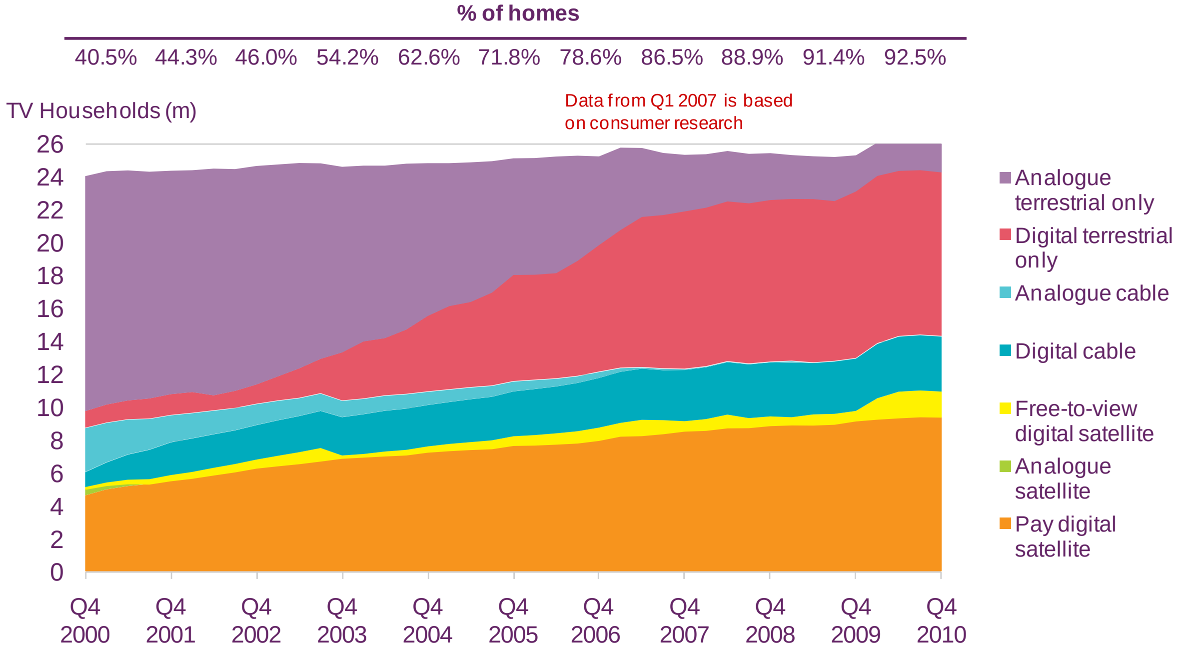
[39] Audiences are conventionally divided into some 15 different demographic groups which form the basis for the trading of advertising airtime. These different demographic groups are set out below (based on descriptions used in the 2000 CC 's Report):
Broad Demographic Groups: Adults, Housewives, Women,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

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

Digital platform take-up has grown significantly

3.38 The introduction of digital broadcasting has significantly increased the number and range of different channels available to TV viewers. Since 2002, the number of channels broadcasting in the UK has more than doubled, increasing from 236 to 490 in 2010. At the same time, there has been significant growth in the penetration of digital TV. As Chart 3.5 shows, by the end of 2010, 24 million UK households (92.5%) had digital TV, compared to only 9 million (40.5%) in 2000.

Chart 3.5: Multi-channel television take-up by platform



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

3.39 The proportion of homes with digital television will continue to increase until Digital Switch Over (DSO) is completed in 2012. It is estimated that by the end of June 2011, 40% of total UK households will be in areas 'switched' to digital terrestrial transmission (i.e. where there is now no analogue TV signal)[41] and this figure will reach around 98.5% of the population once DSO is completed. As the remaining 7.5% of UK households, who currently only access analogue TV services, take up digital television during this period, they are likely (as we explain below) to follow previous digital TV adopters and shift some of their viewing to non-PSB channels.

Fragmentation of TV viewing

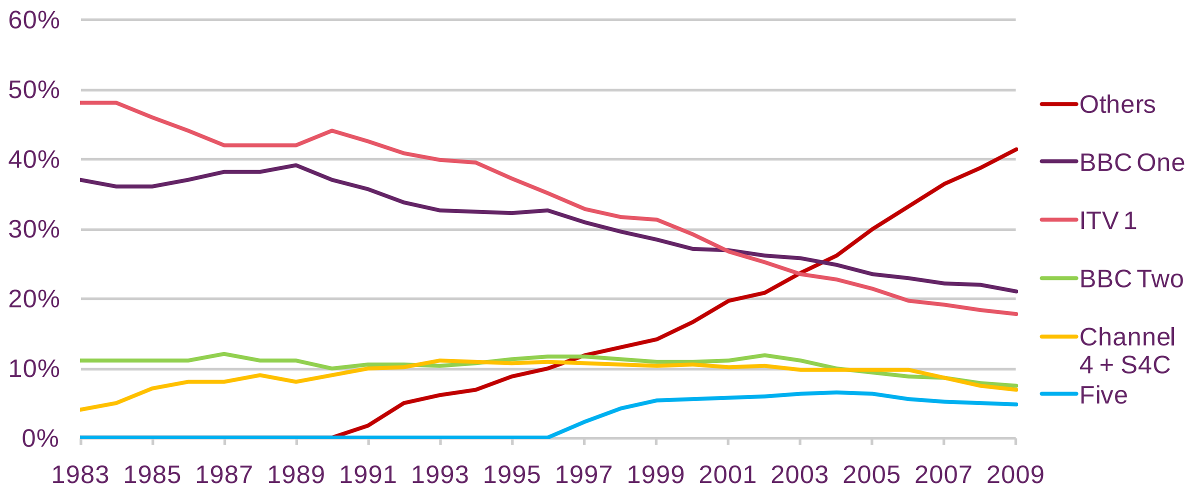
3.40 The growth in the number of digital TV channels and the increasing take-up of multichannel TV has resulted in increasingly fragmented viewing. More viewers watch content delivered over a wider range of digital channels and viewing of analogue channels and their simulcast digital versions has declined.

3.41 Multichannel viewing as a proportion of television viewing in all homes, all day, has grown to 43.7% in 2010[42], almost double its level in 2003. As a result, the five main

[41] Ofcom Communications Market Report 2010
[42] BARB/Kantar Infosys (based on all individuals)

PSB channels (BBC1, BBC2, ITV1, Channel 4/S4C and Five) all experienced reductions in viewing share over the same period. The collective share of these channels has fallen by a quarter since 2003 to 56.3% in 2010[43]. Chart 3.6 below demonstrates the changing shares in viewing during the period 1982 to 2009.

Chart 3.6: Audience shares in all homes, 1982 to 2009



Source: BARB, TAM JICTAR and Ofcom estimates

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

3.43 However, since 2003, the key difference is that all five main PSB channels have shown a decline in their respective audience shares. As noted above, both the individual as well as collective percentage audience share of the five main networks in all UK homes has fallen since 2003. The combined share of the commercial analogue channels - ITV1, Channel 4 and Five – fell over a quarter from 39.8% in 2003 to 28.6% in 2010[44].

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

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

Increase in the volume of commercial impacts

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

[43] BARB/Kantar Infosys (based on all individuals)
[44] BARB/Kantar Infosys (based on all individuals)
[45] BARB/Kantar Infosys (based on all individuals)

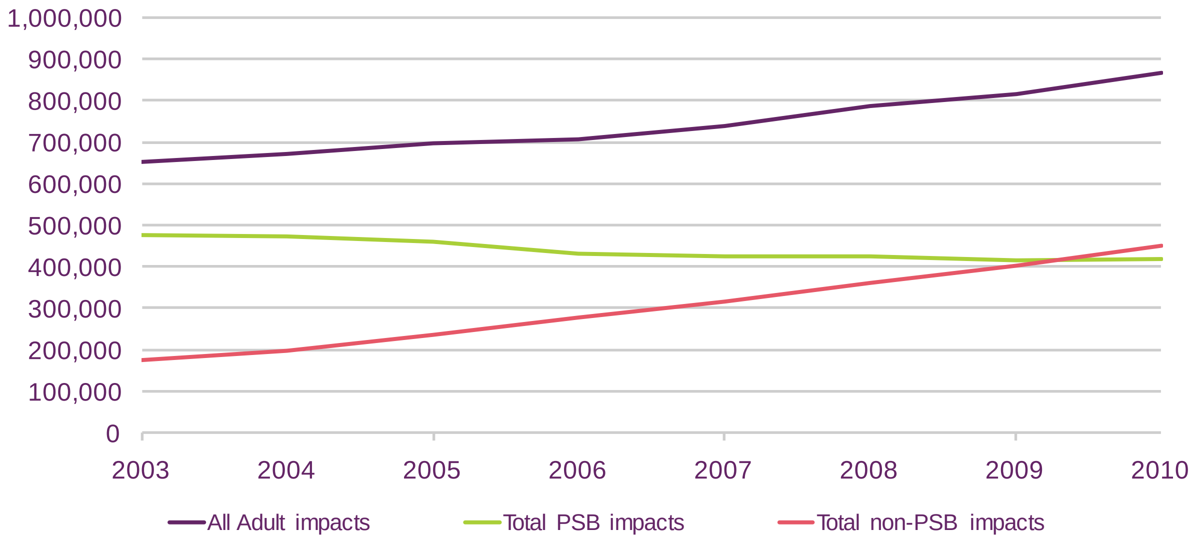
3.47 Shifts in viewing from the BBC to non-PSB channels will increase the total number of impacts in the market substantially since viewers will be substituting from a channel with zero adverts to one with adverts.

3.48 In addition, current advertising minutage regulations allow the commercial non-PSB channels to broadcast more advertising minutes than commercial PSB channels[46]. Therefore any shift in viewing from the commercial PSB to non-PSB channels may also increase the overall viewing of TV adverts (and, hence, increase the number of impacts available).

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

3.50 In aggregate terms, the overall volume of Adult commercial impacts increased by 32.7% from 654 million to 868 million between 2003 and 2010. This is shown in Chart 3.7 below. This overall growth is essentially attributable to the significant increase in commercial impacts from non-PSB channels whilst the total number of commercial PSB impacts has fallen relative to the 2003 level. As can be seen in the figure below, the proportion of Adult commercial impacts delivered by non-PSBs is now greater than that delivered by PSBs, although, as noted, some of these impacts will be delivered by channels which are owned by PSB broadcasters.

Chart 3.7: Total adult commercial impacts over time 2003 – 2010



Source: BARB/Kantar Infosys

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

Changes in the market position of the main sales houses

3.52 The market shares and respective positions of the sales houses can be measured both in terms of volume, via their SOCI and value, via their share of net advertising revenues (NAR). Below we examine the changes in SOCI and NAR for the major

[46] See paragraph 2.29 for details

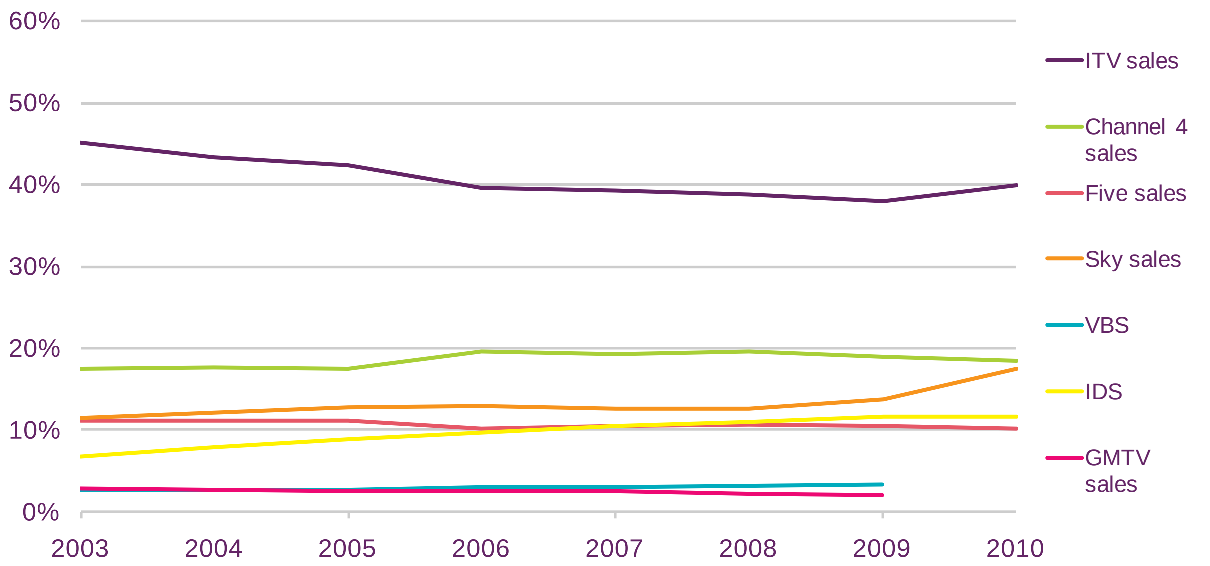
sales houses and the effect of the fragmentation of viewing and increases in the number of commercial impacts over recent years.

<u>Changes in SOCI</u>

3.53 The growth in commercial impacts supplied by non-PSBs has also led to a shift in the distribution of SOCI between the channels and sales houses. Chart 3.8 below shows changes in SOCI in the Adult demographic for each of the major sales houses. It shows that the SOCI of ITV's sales house has declined from 45% in 2003 to 39.8% in 2010[47].

3.54 Over the same period, there have been some increases in the SOCI delivered by other sales houses, such as IDS and Sky[48]. Furthermore, Sky and Channel 4's relative share of SOCI is likely to increase further given recent consolidation in the sector (discussed further in Section 5).

Chart 3.8: Adult SOCI by sales house from 2003 – 2010



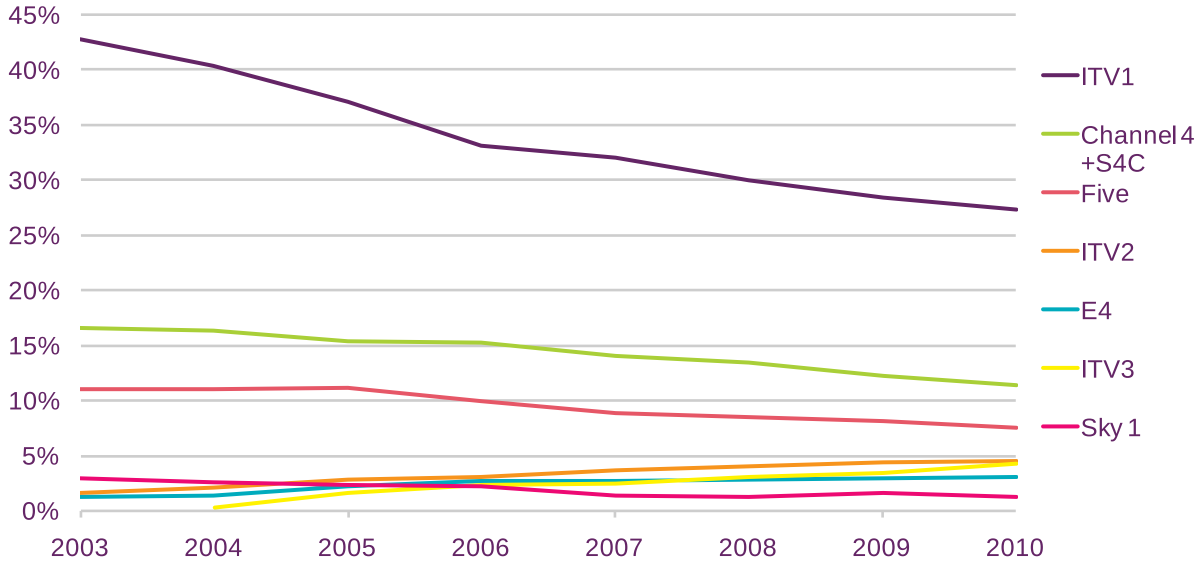
Source: BARB/Kantar Infosys

3.55 It is also informative to examine SOCI in terms of the position of individual channels and how this has changed over time. Chart 3.9 below illustrates how the share of Adult SOCI for each of the main commercial analogue channels has fallen.

[47] The chart also shows historical figures for GMTV's and VBS sales houses. ITV assumed full control of GMTV in November 2009. Therefore GMTV's SOCI has been included within ITV's from 2010 onwards. Similarly, in November 2009 Sky acquired the contract to sell the Viacom portfolio of channels, and the VBS sales house was closed at the end of 2009.

[48] Shifts in sales houses' SOCI will reflect the changes in viewing and in commercial impacts achieved by the channels the sales house represents. This representation is not static however and some channels have been represented by different sales houses over recent years. A sales house can also increase its SOCI by selling advertising on behalf of a greater number of channels.

Chart 3.9: Adult SOCI by channel 2003 – 2010



Source: BARB/Kantar Infosys

3.56 The lower shares of Adult SOCI for commercial analogue channels reflect the shift in viewing to non-PSB channels. Between 2003 and 2010, ITV1, Channel 4 and Five's combined share of Adult SOCI fell from circa 70% to 46%[49] – with the gains going to the non-PSB channels. The non-PSB channels increased their combined share of Adult SOCI from around 27% to 52% over the same period[50].

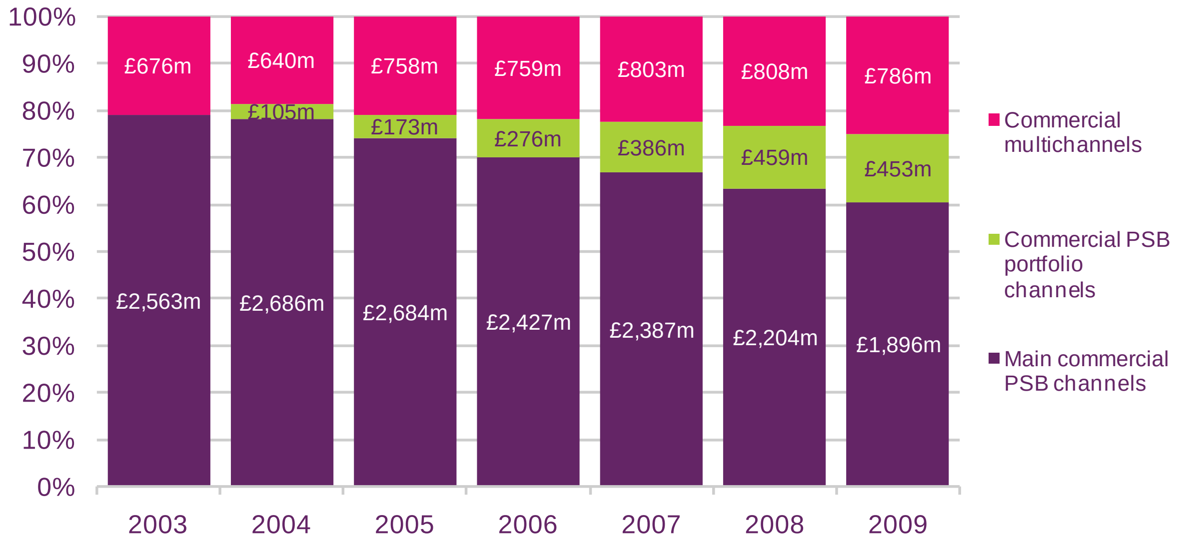
3.57 Whilst ITV1, Channel 4 and Five have lost SOCI, it is important to recognise that the ITV and Five sales houses have not experienced as large a decline in SOCI as their main channels – and in the case of the Channel 4 sales house, there has actually been a slight increase relative to 2003. This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

Changes in NAR

3.58 The shifts in viewing and SOCI noted above may have impacted the revenues of broadcasters. Chart 3.10 shows the breakdown of NAR by type of channel between 2003 and 2009[51]. Non-PSB channels experienced a growth in advertising revenues at the expense of the commercial analogue channels. In 2003, ITV1, Channel 4 and Five accounted for 79% of net advertising revenues compared to 60% in 2009, representing a decline of approximately 26% (although, some care needs to be taken when interpreting changes in NAR for ITV1 as it is influenced in part by the CRR remedy[52]).

[49] These figures do not include GMTV or S4C – however both of these channels also experienced significant declines in their channel SOCI over the same period.
[50] However, as already noted, the increase in non-PSBs' SOCI includes gains achieved in SOCI by PSBs' digital 'family' channels.
[51] 2010 NAR data is not currently available as it was still in the process of being compiled at the time of publication.
[52] The CRR ratchet allows media buyers to withdraw revenue from ITV1 in proportion to the fall in ITV1's SOCI so part of ITV's decline in share of NAR can be attributed to the CRR remedy itself.

Chart 3.10: NAR by channel type 2004-2009



Source: Ofcom/broadcasters. Note: Figures expressed are in nominal terms and replace previous data published by Ofcom. Main commercial PSB channels comprise ITV1, STV, UTV, Channel Television, GMTV1, Channel 4, Five and S4C; Commercial PSB portfolio channels include ITV2, 3, 4, Men & Motors, CiTV, E4, More 4, Film 4, 4Music, Five USA and Fiver (plus their '+1' channels). For previous years closed channels have also been included. Sponsorship revenues are not included

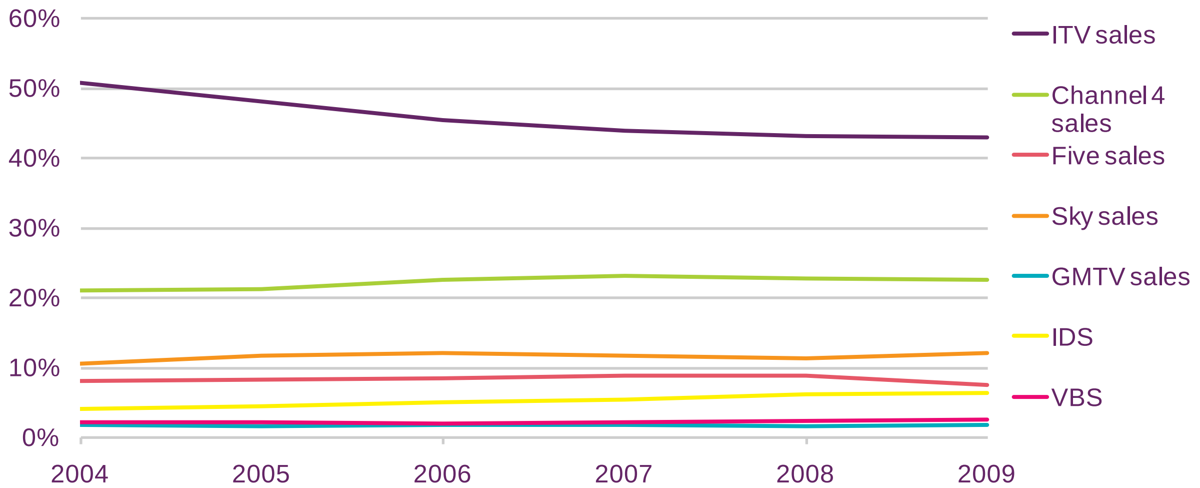
3.59 However, while digital channels have increased their combined share of advertising revenues since 2004, the majority of the recent revenue gains to digital channels as a whole have actually gone to the commercial PSB portfolio channels, (shown in green in the diagram above) – these channels had negligible revenues in 2003 but by 2009 comprised over 14% of total sector NAR.

3.60 This reflects the fact that PSBs launched additional channels after 2003[53] and these portfolios of channels have been successful in attracting an increasing share of viewing, commercial impacts and advertising revenues. This may indicate that PSBs have been able to broaden their overall offering to advertisers and possibly deliver a more targeted product to advertisers, even of this has contributed to a decline in revenues from their main channels. .

3.61 For ITV, the growth of its family channels has only partially offset the decline in ITV1's share of TV advertising revenues; whilst for Channel 4, it has actually helped to deliver a slight increase in its sales house's share of revenue relative to its position six to seven years ago – this is illustrated in Chart 3.11 below.

[53] For example, ITV3 was launched in 2004, ITV4 in 2005, More4 in 2005 and Five USA in 2006.

Chart 3.11: Share of NAR over 2004-2009 by sales house

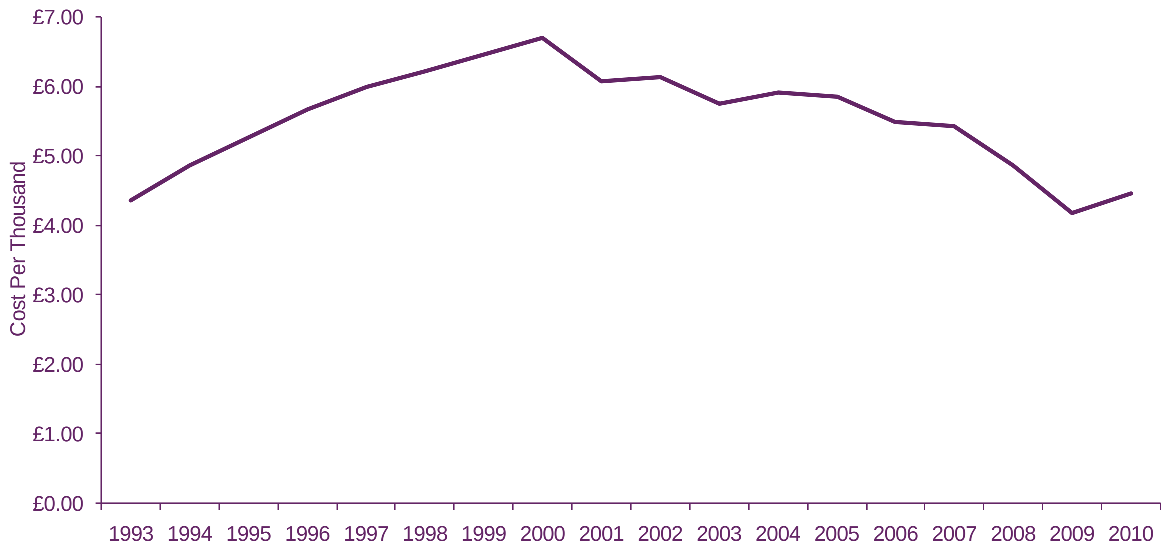


Source: Ofcom/broadcasters

Advertising prices have fallen

3.62 In response to previous reviews, a number of stakeholders have told us that there has been a widespread fall in the price of commercial impacts in recent years. The large growth in the number of commercial impacts, as well as the stronger negotiating position of media buyers, may have contributed to this. Chart 3.12 below provides an indication of the changes in the average cost of commercial impacts over time (as measured by cost per thousand impacts or 'CPT').

Chart 3.12: Television advertising cost per thousand over time



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

Advertising revenue forecasts

3.63 Historically, advertising spend has broadly reflected the general performance of the economy. While TV advertising has recovered reasonably well from the fall in revenues in 2008, the sector is currently predicted to see relatively low levels of growth in real terms over the next few years. In March 2011, Enders Analysis forecast that TV advertising expenditure will grow by approximately 5% in 2011 and remain flat to marginally positive in real terms beyond 2011[54]. However, in June 2011, Enders Analysis revised down their 2011 growth forecast to 1% as they considered that the advertising outlook had progressively worsened since mid April[55]. The Advertising Association/Warc also predicts that TV advertising will see limited real growth in 2011 and 2012 of 0.4% and 2.8% respectively. Nonetheless, concerns still remain about the wider economy and the likely impact any potential downturn in consumer spending might have on advertising revenues.

Future developments in TV viewing and advertising

3.64 There are several technological developments which may have an impact on how viewers consume television and other audio-visual content in the future – Digital Video Recorders (DVRs[56]), Video on Demand (VOD) and VOD delivered over the internet.

3.65 Non-linear viewing of audio-visual content is a small but growing component of all viewing[57]. Ofcom research indicates that DVR viewing is driving consumption of on-demand content, and is the most popular way for consumers to view non-linear broadcast content. The average time per week spent viewing content on a DVR is nearly 2.5 hours (145 minutes), more than half (57%) of total average non-linear viewing. On-demand viewing (on the TV or via the internet on a PC) accounts for an average of 33 minutes each week, with this split fairly evenly between TV-based (18%) and PC-based (15%) on-demand content[58].

3.66 DVR adoption has steadily risen over the past five years, rising from more than threefold from 11% in 2005 to 37% of homes in 2010[59]. There are concerns that if an increasing number of viewers begin to use DVRs to time-shift their television consumption, the impact of TV advertising may be reduced as viewers fast-forward through commercial breaks. However, thus far, the impact of DVRs in this regard has not been overly significant. The proportion of time shifted viewing time shifted via DVR usage within different types of DVR enabled homes has remained relatively stable over the last few years, with increases in overall DVR time shifting driven by increased rollout of DVRs, rather than growing usage within DVR homes. On this basis, total DVR time shifting across all TV homes and is predicted to grow to around 10-11% of all TV viewing by 2020[60]. According to the latest Skyview panel data (which accurately measures viewing patterns in Sky homes), 83% of viewing in a DVR household is to 'live' TV and viewing increases by 15% when homes acquire a DVR. In addition, of the 17% of viewing that is time-shifted, viewers with a DVR still watch 30% of advertising breaks at normal speed[61]. Research also suggests that viewers still continue to engage with ads, even when they fast-forward through

[54] TV NAR in 2011 and medium term outlook, Enders Analysis, 1 March 2011.
[55] Sunshine to showers: TV 2011 advertising update, Enders Analysis, 3 June 2011.
[56] Also referred to as Personal Video Recorders (PVRs)
[57] Ofcom Communications Market Report 2010, section 2.1.5.
[58] Ofcom Communications Market Report 2010.
[59] Ofcom Communications Market Report 2010.
[60] The UK Multichannel TV landscape, 3 Reasons Ltd, Spring 2011. This forecast is based on the assumption that as DVR penetration increases, the average proportion of time shifted viewing amongst DVR users will fall given that future DVR growth will be more focused on cable and DTT homes, where levels of DVR time shifting are lower than in Sky+ homes.
[61] http://www.thinkbox.tv/server/show/nav.898

them[62] and some advertisers/broadcasters. Therefore, it appears that the effects of DVRs on TV advertising may not be as great as once feared.

3.67 VOD content can be consumed in several ways (e.g. catch-up, movies, short clips) via a range of different platforms (e.g. over the internet on a computer, IPTV, on a TV set via a cable connection, on a mobile device). Ofcom research indicates that on demand viewing (on the TV or via the internet) accounts for an average of 33 minutes of viewing per week[63]. As the popularity of VOD increases there is the potential for viewing to move away from 'traditional' linear broadcasts, which may have a resulting effect on the number of commercial impacts available to TV advertisers. Similarly, advertising around, or in, VOD content may begin to attract advertising revenues away from TV and other advertising mediums. At present the VOD sector is still in its infancy and the degree to which it may impact on liner viewing, and thus TV advertising revenues, is not clear. In addition, the existing linear broadcasters are likely to be prominent suppliers of VOD in the future, benefiting from access to content and viewer loyalty.

3.68 Widespread adoption of DVR and VOD will also allow for new forms of TV advertising such as targeted advertising (ad insertion), product placement and click through from content to product sale. For example, Sky AdSmart allows the advertising shown to be tailored the viewer and their interests, therefore, households with children may receive one type of advert, dual income/childless families can receive another and singles could get a third. In addition, Channel 4 has forecast that around two thirds of all TV audiovisual content viewing time (on TV, PC and mobile) will be tracked intelligently in some way by 2020[64].

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

3.70 The recent acquisition by Northern & Shell of Five, and proposed acquisition by New Corp of Sky could also signal the potential for advertising to be sold on a cross-media basis (e.g. bundling TV and print advertising). Negotiating across a wider portfolio of products has the potential to change the dynamics of the negotiating strength exercised by media owners and media buyers, and may ultimately influence how TV advertising is traded in the future (e.g. may be a trend towards a common 'currency' for cross-media advertising bundles).

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

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62 http://www.thinkbox.tv/server/show/nav.898

63 Ofcom Communications Market Report 2010.

64 David Abraham speech to the Royal Television Society, 23 May 2011. http://www.rts.org.uk/sites/default/files/David-Abraham-2011.pdf

Section 4

Market Definition

Introduction

4.1 The test for making market investigation references to the CC under s131 EA02 requires the consideration of reference markets for the goods or services involved. In making a reference to the CC, the OFT's Guidance says that it is necessary to give 'some consideration for the definition of the relevant market', although noting that 'the effects on competition of some features may be clear enough that firm conclusions on the definition of the relevant market… are unnecessary'[65]. Market definition thus has a role to play in identifying the competition constraints that individual firms face, although it is not an end in itself.

4.2 In May 2010 the CC concluded its review of the CRR Undertakings in which it considered the relevant market to be the UK TV advertising market. In this Section we consider whether, and to what extent, any market development since then might require us to depart from that market definition.

4.3 We consider market definitions used in previous competition investigations in order to build up a picture of the factors that have been taken into account in determining the scope of the relevant economic market. This also provides a sense of how the definition of the relevant market has changed over time. We then outline our approach to market definition as well as setting out some of key economic features of TV advertising and what impact they might have on the process of market definition.

4.4 The discussion is structured as follows:

- Approach to market definition
- Market definitions used in previous competition investigations
- Economic features of TV advertising
- Product and geographic market definition analysis
- Conclusions

Approach to market definition

4.5 Ofcom's approach to market definition is in line with OFT guidance on market definition[66]. The aim of market definition is to establish the products and services which are subject to a competitive price constraint. It entails an analysis of the short run competitive constraints faced by suppliers of a particular product or service and provides a framework for analysing whether a particular firm has market power.

4.6 There are two dimensions to market definition – the relevant products to be included in the market and the geographic coverage of the market. An investigation of the relevant product market involves considering the constraints on the pricing of a

[65] OFT's Guidance, paragraph 4.8.
[66] Competition Law Guideline – Market Definition, OFT 2004.

particular good or service by examining substitutability from the perspective of customers and competing suppliers. Once the relevant product market has been defined, the geographic scope of a market is examined by considering whether customers can substitute goods or services from other nearby geographical areas or whether producers from other areas could supply the product in the geographic area in question, in response to a change in competitive conditions.

Market definition in previous competition investigations

4.7 Over the last 11 years there have been four investigations by UK competition authorities which have considered the issue of the definition of the relevant market in the context of TV advertising. We summarise the key findings of those reports in respect of the definition of the relevant product market and note some of the factors which the CC took into account in reaching its conclusion.

4.8 In 2000, in the Carlton Communication Plc/Granada Group Plc/United News and Media Plc investigations[67] (2000 CC Report) the CC found that ITV1 constituted a 'market segment in economic terms'[68], referring specifically to the fact that for 'major advertising campaigns advertisers have limited options about whether to use ITV'. However, it concluded that there was a single market for TV advertising market on the basis that "some advertisers are likely to regard various combinations of Channel 4, Channel 5 and the pay-TV channels as offering comparable national coverage and reach to that of ITV"[69].

4.9 In terms of the factors which the CC took into account in reaching its market definition, it noted that TV was the only mass advertising medium with daily availability in virtually all UK homes and that it could build mass awareness more rapidly than any other media. It also noted that TV offered scope for combining colour, sound and moving images to create a 'high' impact with potential customers and that - given the range of channels and programmes available – TV offered advertiser the ability to target (and monitor in some detail) particular audiences and demographic/socio-economic groups.

4.10 In 2003, as part of the Carlton Communications plc/Granada plc merger, the CC adopted a similar approach and concluded that the relevant market was no wider than TV advertising[70]. This conclusion was reiterated in 2007, when the CC investigated the BSkyB plc/ITV plc[71].

4.11 The most recent investigation of issues around the definition of the relevant product market in this area took place in the context of the CC's review of ITV's contract rights renewal undertaking in 2010.

Review of ITV's contracts rights renewal undertakings[72]

4.12 As part of our input[73] to the 2010 CC Report we explored the possibility of other market definitions, including different individual demographic and intertemporal

[67] Carlton Communication Plc and Granada Group Plc and United News and Media Plc: A report on the three proposed mergers, Competition Commission, 2000.
[68] 2000 CC Report, paragraph 4.29.
[69] 2000 CC Report, paragraph 4.35.
[70] 2003 CC Report, paragraph 5.31.
[71] Acquisition by British Sky Broadcasting plc of 17.9 per cent of the shares in ITV plc – Final report, Competition Commission, December 2007, paragraphs 4.141 – 4.143.
[72] 2010 CC Report.

markets (e.g. peak versus off-peak). However, in respect of different demographic audiences, we concluded that chains of substitution would be likely to exist which would link most different demographic groups together into a broader market. On potential intertemporal markets, we recognised that some times of day might be regarded as being more valuable to advertisers than others, but that there was insufficient evidence to suggest that we should adopt a narrow market definition. We therefore concluded that the appropriate relevant market was the supply of TV advertising at an aggregated level.

4.13 Our findings were endorsed by the CC. It acknowledged various changes in the television industry since its 2003 Report (such as the progress of DSO and the increase in the number of channels available, leading to increased fragmentation of audiences across channels; as well as the increased availability of VOD services and DVRs) and in advertising expenditure by media (in particular the rapid growth of internet advertising expenditure since 2003). However, the CC concluded that the relevant market for the purpose of the review remained television advertising in the UK.

4.14 In terms of considering whether the relevant market might be narrower than TV advertising, the CC maintained that neither segmentation of the market by platform nor segmentation by demographic was appropriate (although the CC considered that a degree of substitutability between the airtime bought under at least some different demographics remained a relevant consideration when assessing ITV1's market position).

4.15 In terms of considering whether the relevant market might be broader than TV advertising, the CC considered the potential role played by internet advertising. The CC noted that, despite the rapid growth of *total* internet advertising expenditure since 2003, internet *display* advertising, which is the closest in nature to TV advertising, accounted for a significantly smaller share of total advertising expenditure (4.6% in 2009) than TV advertising (22.7%). The CC concluded that, although internet display advertising was likely to grow further in the future, there was no evidence "that the sale of television advertising was constrained by internet display advertising or would be likely to become constrained in the near future"[74]. The CC also added that it was not clear whether internet display advertising could be regarded as a substitute or a complement to television advertising.

Conclusion

4.16 We consider that these four reports provide a useful starting point in our analysis of market definition in this area and also help to inform our understanding of what factors have historically been considered to be important for market definition. There appears to be a clear pattern in the way the market definition adopted by the CC has changed over time. That is, the CC has gradually widened the definition of the relevant market from an ITV-centric perspective to encompass all TV advertising, but suggested that market should not be broader than TV advertising.

4.17 In the next section we note particular economic factors in relation to TV advertising that could be relevant to the issue of market definition.

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[73] Review of the Contract Rights Renewal Undertakings – Evidence to the OFT and the CC, Ofcom, 2 June 2009.
[74] 2010 CC Report, Paragraph 11.

Economic features of TV advertising

4.18 The broadcasting and advertising sectors are characterised by a number of economic features which need to be taken into account when conducting a market definition exercise and/or when conducting an assessment of competition. These include: the different business models used by broadcasters; the impact of two sided markets on the 'price' of TV advertising; and product differentiation. These features, and any potential implications for market definition are discussed below.

4.19 We can observe different business models, e.g. an advertising-funded model for commercial, free to air broadcasters and a subscription-funded business model for pay-TV broadcasters (which may also offer advertising airtime in and around their programming).

4.20 However, for the purposes of defining advertising markets, we do not consider that it is appropriate to make a distinction between channels with different business models. Media buyers/advertisers do not appear interested in the business model of a channel per se when it comes to decisions about purchasing advertising airtime: rather they are more interested in the ability of the channel to deliver reach and coverage for different types of audiences.

4.21 As noted in Section 3, TV advertising is part of a two-sided market, which means that in principle there is a need to take into account the inter-dependencies between the different sides of the market. Normally, failure to take into account the "two-sidedness" of a market runs the risk of defining a product market too narrowly e.g. the constraints on pricing imposed by the other side of the market are not taken into account. In the case of TV advertising, the situation is reversed i.e. without taking into account the other side of the market, there is a risk of defining a market too broadly. For example, it is possible that if a firm reduced the amount of advertising in order to increase the price to advertisers then there could be a reduction in the firm's advertising revenue which would tend to suggest that a price increase would not be profitable if we focused just on the advertising side of the market and the tendency would be to broaden the definition of the relevant market.

4.22 However, on the other side of the market, a reduction in the volume of advertising could serve to make a channel more attractive to viewers (assuming that viewers prefer less advertising) and audiences would increase. If this was the case then there could be an offsetting increase in the demand for advertising from advertisers at the new higher price. As a result the broadcaster would gain an offsetting increase in revenue/profitability and thus definition of the relevant product market definition would properly be narrower than if only the advertising side of the market were taken into account. .

4.23 However, Ofcom believes that the interdependence between the two sides of the market does not change the market definition analysis substantially[75] and therefore can be examined at the competition assessment stage.

4.24 For the purpose of market definition we focus our analysis on the 'advertising' side of the market rather than the 'viewer' side of the market, but we recognise the need to take into account any potential knock-on effects on the viewer side.

[75] Since we would not expect significant changes in viewing as a result of small changes in the quantity and frequency of adverts.

4.25 Finally, advertising airtime is not a homogeneous product. The pricing data, which are examined in more detail in Section 5, demonstrates that prices vary between different broadcasters indicating that there is an important element of product differentiation[76]. Negotiations between media buyers and broadcasters' sales houses do not simply focus on 'price' but also cover a broad range of non-price factors relating to the delivery of airtime and which will have a bearing on the perceived 'value' of the airtime. These factors include the proportion of commercial impacts to be delivered across different day-parts (peak versus off-peak); the actual positioning of advertisements in breaks; access to 'special' event programming (such as World Cup finals) etc. The data on pricing suggests that channels with certain characteristics (e.g. mass audience programmes, highly valued demographics) are able to command a premium over other channels.

4.26 Prices for goods/services do not need to be the same for those products to exercise a competitive pricing constraint on one another. In a differentiated product market we might expect to see a range of prices for the product in question rather than a single standard 'market price'. Those products which are of higher quality, or are perceived to be of higher quality, will be able to command a premium relative to the market. However, they might be subject to competitive pricing pressure from the other products in the market if attempted price increases were undermined by consumers switching to cheaper, lower quality products.

TV Advertising – Product Market Definition

4.27 In this section we consider whether there have been any market developments which would lead us to conclude that the market is broader or narrower than the UK market for TV advertising.

Demand-side substitution

4.28 As discussed in Section 3 there is a wide variety of media that can be used to advertise to end consumers, and for market definition purposes it is necessary to consider whether there is any scope for demand-side substitution between TV and these other advertising media.

4.29 TV is considered to be a form of display advertising. As discussed in the 2000 CC Report, a clear feature of TV advertising was that it was able to combine sound and moving pictures in a way that other media for the most part could not or could not in a way that was considered to exert a competitive constraint on the pricing of advertising.

4.30 In previous investigations, television advertising has always been considered to be a separate product market from other advertising media. For instance, in terms of product characteristics, press advertising would appear to have limited similarity to television advertising – it can obviously offer display advertising in the form of still pictures but it cannot offer the combination of sound and moving pictures. Similarly radio advertising can offer a sound element but not the visual imagery. Cinema advertisements may be the closest in nature to television adverts, and in some cases identical adverts can feature in both cinema and on the TV, but cinema lacks the reach and coverage of TV and also lacks the audience monitoring associated with TV advertising. Finally, TV typically generates an emotional attachment in viewers that is difficult to replicate with other media. All these features imply that there is no close

[76] See paragraph 5.4.4.

substitution relationship between TV advertising and other advertising categories here mentioned.

4.31 However, as set out in Section 3 and considered in the 2010 CC Report, the main development in recent years has been the exponential growth of internet advertising. The internet is also a medium which can combine audio and visual imagery (particularly, for instance, advertising appearing alongside online VOD content), and has the potential to deliver mass reach. Hence internet advertising could have come to exert a competitive constraint on TV advertising. ITV has made this argument in its submissions to the the HoL's Report.

4.32 In terms of considering the extent to which internet advertising may now represent a close demand-side substitute it is important to recognise that internet advertising includes not just display advertising but also classified and 'search' advertising. As set out in Section 3, internet display advertising accounts for a relatively small proportion of the expenditure on all display advertising and of all internet advertising, suggesting that internet's growing share of overall advertising expenditure was mainly driven by 'search' advertising[77]. Market studies also indicate that 'online display advertising has to compete with search as a direct response tool, which offers self-selecting audiences and […] a more attractive pricing model'[78].

4.33 The fact that internet display advertising accounts for a much smaller proportion of total advertising expenditure than TV advertising suggests that there is still little direct substitution between the two. This is also acknowledged in various submissions to the HoL's Report[79]. The HoL Committee recognised that internet advertising might come to exert an indirect impact on television advertising revenue, namely a 'budget stealing' effect on television and other display advertising media. In particular, the HoL's Report points to the effectiveness of internet advertising in targeting individual needs to suggest that, "as internet advertising has become increasingly sophisticated, advertisers have been shifting away from display towards more targeted consumer initiated advertising, such as search and classified" [80]. We recognise that there might be movements of spend at the margins, nonetheless there is no clear sense at present that internet advertising can be regarded as a sufficiently close substitute to TV advertising to constrain TV advertising pricing.

4.34 Furthermore, in terms of product characteristics, there are a number of reasons for thinking that the scope for demand-side substitution between TV advertising and internet advertising may be limited at present. The internet does not yet offer the mass, broad demographic appeal of television. Whilst television is in virtually every home in the UK, internet penetration, albeit growing, was in around 74% of homes by the end of 2010[81]. Those with an internet connection are increasingly more representative of the UK population as a whole; although "the internet is no longer the domain of young men ... it is still predominantly upmarket. ABC1 users comprise 63% of the internet population compared to 59% of the population as a whole"[82]. At this point in time the internet does not offer the reach and coverage that TV can although this will change over time as penetration of broadband increases.

[77] See paragraph 3.10.
[78] UK internet advertising: 5 year forecast, Enders Analysis, 28 September 2010, page 4.
[79] For example, representatives for the IPA argued that "although there had been a transfer of business from TV to online advertising, 'certain media have been more vulnerable' and other media, particularly radio and regional press, had been more affected by the growth in online internet advertising than television." HoL Report, Appendix 5 .
[80] HoL Report, Appendix 5.
[81] Ofcom's Technology Tracker, Q4 2010
[82] The UK Media Yearbook 2010, ZenithOptimedia, page 130.

4.35 In terms of audience measurement systems, BARB is a well-understood system that provides detailed information on the audiences for particular TV advertisements and forms the basis for advertisers to plan their campaign objectives. On the internet, improved tracking technology can provide very detailed measurement of direct responses and advertisers can track ‘click throughs’, monitor results and react to them almost in real time. However, there may be less certainty as to who is actually accessing the advert, hence it is not clear to what extent advertisers and media buyers could rely on this tracking technology to plan their campaigns.

4.36 We note that ZenithOptimedia has commented that the ”lack of standard reporting in the internet market continues to be a topic of much discussion” and that ”brand advertisers in particular, used to offline accountability, have struggled to understand the value of on-line advertising without the ability to measure reach and frequency.”[83]

Question 2: Are there standard measure 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)?

4.37 Discussions with stakeholders during previous reviews have tended to suggest that internet advertising is currently regarded more as a complement to TV advertising than as a close substitute and that decisions about expenditure in one medium or the other were not driven by relative price differences.

4.38 In the 2007 CC Report on the Sky/ITV merger, the IPA stated that “while large FMCG companies advertised extensively on television, they had yet to do so on the internet. The internet was more often used for gaining product and pricing information and for making transactions and had not been used successfully to date to build a non-internet brand in the same way as television”[84]. This is also acknowledged in the HoL’s Report[85].

4.39 Table 4.1 and Table 4.2 below show the top 20 advertisers for both of these categories. In addition to the significant difference in the amount spent on TV advertising compared to online advertising, there does not appear to be any close correlation between the largest purchasers of internet advertising and the largest purchasers of television advertising - there are only a limited number of companies that appear on both lists. Given that firms will typically tend to use a broad range of media in their marketing campaigns – firms rarely focus solely on one medium - this would tend to suggest that those firms are likely to be placing significantly more weight on the importance of TV over internet or vice versa.

[83] The UK Media Yearbook 2010, ZenithOptimedia, page 151.
[84] Acquisition by British Sky Broadcasting plc of 17.9 per cent of the shares in ITV plc – Final report, Competition Commission, December 2007, paragraph 4.142.
[85] For example, witnesses from Enders Analysis noted financial services (one of the sectors where spend on online display advertising has increased most, whereas spend on TV advertising has shown little growth) as an example, claiming that operators in this sector would not cut spend on TV advertising completely because “they know that if they want people to go on the internet and look at them, they need to get the fame and branding from television”. HoL Report, Examination of Witnesses - Question 13.

Table 4.1: Top 20 Internet Advertisers Feb 2011

Advertiser	Total Ad Spend £
Ebay	3,088,000
O2 Uk	1,851,724
Virgin Media	1,651,150
British Sky Broadcasting Ltd	1,607,424
Hutchison 3G Uk Ltd	1,261,566
Procter & Gamble Ltd	1,198,947
Gamesys	1,070,712
Microsoft Ltd	1,053,900
Totally Money	940,350
Talktalk Grp	919,000
Kelloggs Co Of Gb Ltd	906,680
Amazon (Uk) Ltd	837,827
Tesco Plc	731,408
First Direct	704,537
Experian Ltd	685,567
Lloyds Tsb Plc	662,333
British Gas Plc	629,568
BT Ltd	578,384
Marks & Spencer	574,418
Volkswagen Uk Ltd	571,294
Total Top 20 Advertisers	21,524,789

Source: The Nielsen Company

Table 4.2: Top 20 TV Advertisers Feb 2011

Advertiser	Total Ad Spend £
Procter & Gamble Ltd	8,866,594
Nestle	6,920,541
Unilever Uk Ltd	6,743,724
Bt Ltd	4,325,950
Reckitt Benckiser (Uk) Ltd	4,233,448
Glaxosmithkline Plc	4,176,096
L'Oreal Paris	4,157,773
British Sky Broadcasting Ltd	3,902,034
Virgin Media	3,719,946
Direct Line Ins Plc	3,419,051
Associated Newspapers Ltd	3,194,798
Tesco Plc	3,054,986
Danone Holdings Uk Ltd	2,982,092
Mcdonalds Restrs Ltd	2,936,329
Vauxhall Motors Ltd	2,871,942
Dfs Furniture Co Ltd	2,702,428
Kelloggs Co Of Gb Ltd	2,647,550
Apple Computer Uk Ltd	2,513,442
Mars Uk Ltd	2,451,755
Johnson & Johnson Ltd	2,450,172
Total Top 20 Advertisers	78,270,651

Source: The Nielsen Company

4.40 Taking into account the limited evidence on switching behaviour and reviewing the different product characteristics, we consider that – at this point in time – the scope for demand-side substitution between TV and internet display advertising is not sufficiently close to suggest that the two form part of the same product market.

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?

Supply-side Substitution

4.41 We do not consider that there is currently much scope for supply-side substitution by other media at this point in time. As discussed above, the characteristics of most other advertising media are not well suited to offering the combination of sound and visual imagery together with the monitoring and evaluation systems that TV advertising provides.

Forward Look

4.42 As set out above, we consider that at this point in time the product characteristics of internet display advertising are not sufficiently close to indicate that the two represent close demand-side substitutes.

4.43 However, we do recognise that the there could well be important developments in relation to internet advertising which could mean that the scope for demand-side substitution will increase over time. We would expect measurement systems to become more sophisticated so that the effectiveness of internet advertising can be tracked more effectively. We also expect the penetration of broadband internet to grow, albeit at an increasingly slower pace as broadband penetration approaches maturity, so that a wider range of audiences will have access to internet display advertising.

4.44 Market studies suggest that major impulse to the growth of online display advertising is expected to come from the rise of social media, and specifically Facebook and Twitter; also, there is anecdotal evidence that FMCG companies, historically reliant on TV advertising, are committing to spend increasing shares of their advertising budget on digital advertising (e.g. ITV in its submission to the HoL Committee claimed that Procter & Gamble announced in 2009 that it would increase its spend on internet advertising from 2% to 20% of its total advertising budget)[86]. This trend is attributed to ‘the success of social media sites in attracting large audiences and driving growth in online consumption’[87], and is expected to accelerate over the next five years. Nonetheless, it is worth noting that market sources forecast internet search advertising to remain the main growth engine of overall internet advertising expenditure, at least over the next 5 years[88].

4.45 The streaming of TV content over the internet will increase over time and could well increase with the take-up of higher speed broadband networks. With the growth in on-demand and IPTV services, an increase in the scope for downloading TV and film content etc, consumers are likely to regard television content delivered by different

[86] UK internet advertising: 5 year forecast, Enders Analysis, 28 September 2010; ITV’s submission to the House of Lords
[87] UK internet advertising: 5 year forecast, Enders Analysis, 28 September 2010, page 5.
[88] UK internet advertising: 5 year forecast, Enders Analysis, 28 September 2010, page 1.

delivery platforms as increasing interchangeable. We thus anticipate that the scope for supply-side substitution could increase in the future.

4.46 It is also possible that other technologies – e.g. mobile telecommunications – will also become effective platforms for delivering audio-visual entertainment and with that could come the ability to impose a competitive constraint on TV advertising.

4.47 Furthermore, as noted in Section 3, changes or developments in the direction of cross-media selling might create, through the establishment of chains of substitution between different media, competitive constraints on TV advertising and therefore impact on the definition of the relevant market. There is also the potential for developments in the measurement of TV, VOD and online viewing to lead to a more common 'currency' across these mediums, which may therefore influence substitution between media.

TV Advertising – relevant geographical market

4.48 ITV licences are regional in nature and the respective sales houses do sell some advertising on a regional basis. Channel 4 and Five also have an ability to sell advertising on a sub-national base using various 'macro-regions'. However, virtually all other channels broadcast a single national service and sell airtime on a national basis. We understand that the overwhelming majority of TV advertising is sold on a national basis.

4.49 For the purposes of this investigation, we take as our starting point the position adopted in previous competition investigations, namely that the relevant geographical market is national in scope.

4.50 In terms of whether the relevant geographical market could be broader than the UK, we do not consider that advertising on channels broadcasting to other countries would represent a realistic substitute for advertisers seeking to address UK-based audiences. We therefore assume that the relevant geographical market is national in scope.

4.51 In terms of whether the relevant geographical market could have a regional scope, a number of submissions to the OFT's consultation[89] did argue that the ability to advertise on a regional basis was an important factor which made advertising on ITV1 attractive and that there was a 'reasonably significant' market for regional advertising. We recognise that a regional dimension to advertising can be important to some advertisers. However, it is possible to secure a regional element to advertising using other channels: e.g. Channel 4 and Five offer regional macros, and it is possible to purchase regional TV advertising in Wales, Scotland and Northern Ireland independently of the ITV sales house i.e. through S4C, stv and utv. In addition, as noted above, the market for genuinely local TV advertising appears has been relatively small.

4.52 The 2010 CC Report concluded that "there continues to be sufficient substitutability between regions to support the finding of a national market despite some advertisers having specific regional advertising requirements"[90].We are not aware of any development which would alter the conclusion of the CC, therefore we consider that it is appropriate for the purposes of this analysis to define a UK-wide market for TV

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[89] Review of the Contract Rights Renewal Undertakings - OFT Advice to the Competition Commission, OFT, 29 May 2009.
[90] 2010 CC Report, paragraph 5.17.

advertising. However, we do accept that this regional facility is a factor which could be relevant to the assessment of ITV1's market position.

Conclusions

4.53 In 2010 the CC found that there was a single UK market for the supply of TV airtime for advertising. We have considered, taking into account recent market developments as well as foreseeable trends, whether the appropriate market definition has changed since then and concluded that it has not.

4.54 Taking into account the above discussion about the scope for demand- and supply-side substitution and the discussion of the characteristics of TV as an advertising medium, we do not consider that internet display advertising is currently a close demand-side substitute for advertising on television. We also consider that the relevant market for this investigation is the market for TV advertising in the UK.

4.55 However, we acknowledge that this market may evolve and that over time internet display advertising could come to exercise a more significant competitive constraint on TV advertising. In terms of characteristics, internet display advertising is probably the closest substitute for TV advertising and it is likely that, as measurement systems become more sophisticated and as the penetration of internet and the use of social media increase, internet advertising has the potential to become more credible alternative to TV advertising in the future. Equally, over time other media may also emerge as new sources of competition to TV advertising, e.g. mobile advertising or VOD. As a result the characteristics that represent the unique nature of TV advertising may become less significant if other forms of advertising allow advertisers to reach potential purchasers in a more targeted way. Finally, we acknowledge that also potential changes or developments in the way different media are sold together may influence how TV advertising is traded in the future and may therefore impact on the definition of the relevant market.

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

Section 5

TV advertising: features of the trading mechanism

Introduction

5.1 Section 3 previously outlined the key players in the sector and the way in which the sector has evolved over the last 10 years or so. In this section we explain in more detail our understanding of the underlying mechanics of the way TV advertising is traded.

5.2 We describe the key features of the trading mechanism and how the mechanism has evolved over time. In the next section we consider whether these features might prevent, restrict or distort competition in the market for TV advertising in the UK.

The buying and selling of TV airtime

5.3 Below we discuss the process which underlies the negotiations between media buyers and sales houses. This is largely based on our understanding of how ITV negotiates with advertisers and media buyers, developed over the course of our projects reviewing the CRR undertakings and the ASR[91], and our understanding is that other sales houses have tended to adopt a similar approach.

5.4 In simple terms, sales houses sell, not minutes of advertising airtime, but commercial impacts associated with viewing on commercial TV channels to advertisers and media buyers, who represent advertisers. During contract negotiations, broadcasters and media buyers will typically negotiate the share of the buyer's total expenditure on TV advertising for the forthcoming year (SoB) which will be given to that broadcaster, in return for discounts off that broadcaster's price and a number of terms and conditions relating to how their advertising will be scheduled.

5.5 We also understand that some fixed price deals based, for example, on cost per thousand impacts of the target audience reached, are negotiated, although we believe the number of SoB deals far outweigh these.

Negotiation of annual contracts

5.6 Contracts for the sale of television advertising are typically negotiated between sales houses and media buyers on an annual basis. Historically, negotiations have generally taken place between October to December (the 'deal season') prior to the start of the new advertising year in January. Core terms are normally agreed by December, however, negotiations over other terms may continue throughout January and February.

5.7 At the negotiation stage, both the media buyers and sales houses will only have an indicative idea of the number of commercial impacts likely to be delivered on each channel and the amount of TV advertising which will be demanded by advertisers. For media buyers, this means that they do not know in detail what campaigns

[91] Review of the Contract Rights Renewal Undertakings – Evidence to the OFT and the CC, Ofcom, 2 June 2009 & Airtime Sales Rules Review – Statement, Ofcom, 28 July 2010.

advertisers will wish to run or how much advertisers will choose to spend on campaigns in the coming year. As a result, media buyers need to negotiate aggregate terms which can accommodate their (potentially variable) portfolio of clients. Similarly, broadcasters cannot precisely predict the number and types of impacts they will deliver over the coming year.

5.8 We believe that it may be due to this uncertainty on both sides that negotiations have traditionally tended to focus on a given SoB commitment, rather than a specific 'price' for advertising.

Types of deals

5.9 The vast majority of advertisers use media buyers to negotiate airtime deals. The main types of annual deals agreed during the deal season in order to satisfy the requirements of advertisers are:

- 'Agency Deal': an umbrella deal between sales houses and media buyers that encompasses their expected portfolio of advertisers: media buyers do not negotiate separate contracts for each of their clients.

- 'Line-by-Line Deal': In these deals advertisers, or media buyers on advertisers' behalf, negotiate their own specific terms directly with broadcasters. Some media buyers offer line-by-line deals to all of their clients.

5.10 In some instances, media buyers' agency deals may also include an element of line-by-line deals for particular advertisers, and this will be negotiated under the overall umbrella of the agency deal.

Annual negotiation of SoB and discounts

5.11 The annual negotiations between buyers and sales houses focus on the proportion of SoB media buyers will commit to a sales house in return for a discount from SAP and quality of service terms, such as position in break, daypart guarantees, regional shares, programme guarantees and programme access.

5.12 In return for a share of future spend on airtime from a broadcaster, buyers are essentially negotiating access to that broadcaster's schedule, and an agreed process by which they will receive a share of that broadcasters' impacts. The terms of individual campaigns and prices paid for these are determined over the course of the year, discussed further in paragraphs 5.22 to 5.40.

5.13 In some cases, broadcasters also offer 'pool value' arrangements to media buyers. Under these deals, media buyers are given access to additional airtime which they may distribute between their clients at their discretion or as otherwise specified in line-by-line agreements, in return for a given SoB commitment. Pool value can be thought of as additional discount.

5.14 The amount of SoB that a media buyer is willing to commit to an individual broadcaster is likely to depend on a number of factors, including the broadcaster's SOCI in previous years and expectations about:

- volumes of commercial impacts;

- broadcasters' audience profile;

- coverage of target demographics;
- advertiser needs; and
- quality of programming.

5.15 From our discussions with stakeholders during previous reviews we understand that sales houses and media buyers tend to put considerable emphasis on a broadcaster's SOCI performance both in the previous year and what is expected for the upcoming year. If broadcasters have been able to increase their SOCI over the previous year, then they will use that to try to get media buyers to commit a greater share of broadcast to them for the following year.

5.16 The size of discounts offered to media buyers and advertisers will depend on a number of factors, including:

- the size of the SoB committed by the media buyer or individual advertiser;
- advertisers' (and thus media buyers') demand for each target demographic and the ability of that sales house to optimise those demographics;
- the relative negotiating strength of media buyers and sales houses, which may include, whether the media buyer/advertiser is sensitive to the size of discount offered (price sensitivity), the history of the relationship between the media buyer and the sales house and the importance of the media buyers' business to the sales house; and
- the terms required such as: the proportion of impacts to be delivered across different day-parts; non-pre-emption clauses which prevent the broadcaster from moving an advert from a pre-determined slot; the costs associated with late bookings and cancellations; and the positioning of advertisements in breaks, access to 'special' event programming etc.

5.17 In general, the balance of negotiations will depend on factors such as the importance of media buyers to broadcasters (and vice versa) and the relative negotiating skills of media buyers and advertisers.

5.18 We understand that a key part of the negotiation is around the terms and conditions and, in particular, access to different dayparts. This may have a significant impact on the ability of broadcasters to optimise their schedule and we understand that many advertisers and media buyers set a high value on different dayparts, with peak time being considered particularly valuable.

5.19 Media buyers and sales houses may agree a range of different discounts, including:

- a single discount which applies to all demographics for a media buyers' whole portfolio of advertisers;
- different discounts for each demographic for the whole portfolio of advertisers;
- a single discount which applies to all demographics for some of the portfolio of advertisers;
- individual discounts for specific advertisers across all demographics; and

- individual discounts for specific advertisers for each demographic.

Calculation of discounts to individual advertisers

5.20 If a media buyer operates an 'agency deal', once the overall discounts are negotiated with the sales house, the media buyer will need to consider how these are distributed across its advertising clients[92]. This distribution may be influenced by the contracts agreed between the media buyers and their advertisers and other factors such as: the size of the advertiser's contract with the media buyer, whether they are likely to commit a larger budget in the future; if the client is high profile and likely to bring more business to the media buyer in the future; whether the contract with the media buyer is up for renewal in the near future etc.

5.21 Media buyers cannot grant discounts to clients individually which, when calculated as a whole, are greater than the blanket discount offered by the sales house. For example, the media buyer may be offered a discount of 10% off the Housewives demographic – it may then choose to offer 12% discount to a large advertiser and 8% discount to a smaller advertiser. However, it is important that the aggregate discount offered to clients does not exceed 10%, otherwise, the media buyer will not be able to meet the terms that it has agreed with the sales house.

Individual campaigns

5.22 When a media buyer commits to a campaign with a broadcaster it actually commits a level of expenditure with the broadcaster in the expectation that it will achieve a certain level of impacts for that expenditure and meet certain campaign parameters. It is not until the end of the campaign that the actual price, SAP[93], is calculated and the volume of impacts actually delivered at that price can be determined.

5.23 Throughout the year media buyers and sales houses negotiate the terms of individual campaigns. These terms fall within the parameters of the overarching annual deal negotiated up-front and, from what we understand, a key focus of media buyers during the year will be their need to meet their overarching SoB commitment.

5.24 Prior to booking each individual campaign, media buyers and their clients will agree the specific advertising objectives of that campaign. These objectives will generally include targets for cover and frequency in a given month or over the campaign. For example: an advertiser may estimate that a typical viewer will need to see the advertisement three times before responding and may structure its campaign accordingly. In addition, objectives will generally include a desired budget and timing.

5.25 A media buyer will estimate and monitor the cost of the TVRs across different months of the year. These estimates will take into account information from broadcasters about expected price and the likely demand for impacts among all other advertisers that month. This will help inform the planning of how a campaign should be aired across a mix of channels.

[92] This is in contrast to a 'line by line' deal whereby media buyers agree specific terms with sales houses in relation to specific clients.

[93] Note: SAP is the relevant calculation used by ITV. We understand that other sales houses generally use pricing mechanisms that are loosely based on the SAP mode, with sales house revenue and audience performance figures still forming the basis of the various pricing models to a lesser or greater extent.

5.26 Once a media buyer has determined the precise needs and requirements of an advertiser, the media buyer will develop a detailed media plan to be approved by the advertiser. These plans set out the number of TVRs that each channel must provide in order to meet the advertisers' coverage and frequency objectives, and are based on estimated future costs of impacts across the channels. The resulting budget estimate for the campaign may lead advertisers to increase, decrease or maintain their original budgets for the particular campaign so that they can ensure the delivery of the required number of impacts for the campaign; or to amend coverage, frequency and impact delivery plans.

5.27 Once the media plans are agreed, media buyers book the campaign with the sales houses by the 'advance booking deadline' to avoid a late booking penalty, which would be a specified number of weeks before the date of broadcast[94].

5.28 The sales houses, for their part, use an airtime booking system to aggregate the demands and requirements of the advertisers and then optimise their airtime accordingly. Sales houses optimise their allocation of advertising airtime so that adverts are shown during programmes that they expect will be seen by the greatest possible proportion of people in that target demographic, rather than from other target demographics. For example, a higher number of impacts for ABC1 Men can be achieved against programmes which are popular among this demographic.

5.29 Through optimisation sales houses can 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. That said, we note that, although campaign objectives are defined in terms of target audience demographics, a broader range of demographic groups will actually view the campaign. As a result advertisements attract more impacts than are paid for by advertisers. In addition, advertisements may be shown in programmes that would not necessarily be selected by advertisers if they had control over scheduling of their airtime.

5.30 During the advertising year it is also possible for media buyers and advertisers to separately negotiate a 'burst deal' outside the annual deal. This is a short term or one-off agreement between a single advertiser (usually negotiated by the media buyer on their behalf) and a sales house. A burst deal is typically used in regional advertising by some seasonal advertisers and for some retailers for 'one-off' advertising campaigns. We understand that they represent a very small proportion of total deals negotiated.

Ongoing reconciliation

5.31 Sales houses and media buyers must ensure that the impacts traded throughout the year, via the individual campaigns, are consistent with the overall deal agreed during the deal season and that the overall discount agreed at that time has been delivered.

5.32 If, in a particular month, the sales house fails to deliver the expected number of impacts, then it is considered to have overtraded (or under-delivered) and must give the advertiser extra impacts in a future month. In contrast, if more impacts were achieved for the advertiser than agreed, the sales house will have undersold (over-delivered), and will have to achieve fewer impacts for the advertiser in a future month.

[94] For example we understand that the advance booking deadline for the ITV sales house is normally 8 weeks in advance of the advertisement broadcast date.

5.33 Overtrading essentially means that individual advertisers are receiving less than their 'agreed share of impacts' in that month. This means that the sales house owes a 'deal debt' to advertisers/media buyers. If this is carried over into the following month, the sales house will face increased difficulty in delivering on all its discount commitments in that month. Sales houses therefore seek to ensure that this deal debt does not escalate.

The pricing of advertising

5.34 As described, media buyers and sales houses do not set an absolute price per impact during the deal stage as neither party can be sure of the future demand and supply of impacts. Media buyers, therefore, do not know precisely how many impacts they will receive in return for their SoB commitment.

5.35 Although broadcasters will, in some cases, offer fixed price deals or sell specific spots, the most common pricing concept is the broadcaster's SAP. SAP is an average price per impact across a channel (or sometimes a range of channels). There will be different prices for different demographic groups. A key feature of SAP is that it is calculated ex-post i.e. the SAP is determined by the level of advertising expenditure and the volume of impacts actually achieved by a broadcaster.

5.36 The SAP for ABC1 Men, for example, is calculated monthly as:

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

5.37 SAP is an average measure based on the total distribution of impacts. Rather than entitling media buyers to a given number of impacts, the SAP mechanism entitles media buyers to a share of the impacts actually delivered. In a simple world with one type of impact (and no discounts), the number of impacts delivered to a media buyer is determined both by the share of ITV1 revenue that the media buyer's spend accounts for and the total number of impacts actually delivered. For example, if a media buyer spends £10,000 and total ITV1 revenue for the month is £100,000, the media buyer receives 10% of total impacts delivered. Therefore, if the total number of impacts delivered is 1000, the media buyer receives 100 impacts; or if the number of impacts delivered is 900, the media buyer receives 90.

5.38 A discount from SAP equates to a bigger proportion of impacts than the proportion of spend. However, given there are a fixed number of impacts, this must be offset by someone else getting a smaller share.

5.39 There are two main reasons why the SAP achieved may be lower or higher than planned. First, programmes may achieve different ratings than expected e.g. if they achieved higher than expected ratings this would increase the number of impacts delivered and reduce SAP compared to forecast. Second, media buyers may incorrectly forecast the total expenditure committed by all buyers. For instance, total revenues committed to a particular demographic may be higher than anticipated, raising the SAP for that target demographic. An increase in committed revenues raises the overall revenue of the sales house for the period relative to achieved impacts, thereby raising the SAP and actual price paid by each media buyer. Thus, the increase in expenditure effectively increases the price of TVRs.

5.40 In most instances, the price paid by an advertiser on an individual campaign will be determined by the media buyer rather than the broadcaster: it will be up to the media buyer to determine how to share the discount from SAP it receives across its different clients[95]. The use of auditors is a way for advertisers to compare the price they have been charged with 'the market rate'. However, the auditing of advertising campaigns tends to focus on the relative rather than the absolute level of price for the delivery of commercial impacts against particular demographic groups.

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?

Product differentiation

5.41 In Sections 3 and 4 we have indicated that advertising airtime is not a homogeneous product. Television audiences are made up of impacts from a range of demographic groups[96]. Depending on the product being advertised these different demographic groups are likely to be valued differently.

5.42 Impacts may also be differentiated by characteristics which may all be valued differently by advertisers. For example there may be different valuations for impacts delivered at different times of day, in different programmes or regions and indeed on different channels.

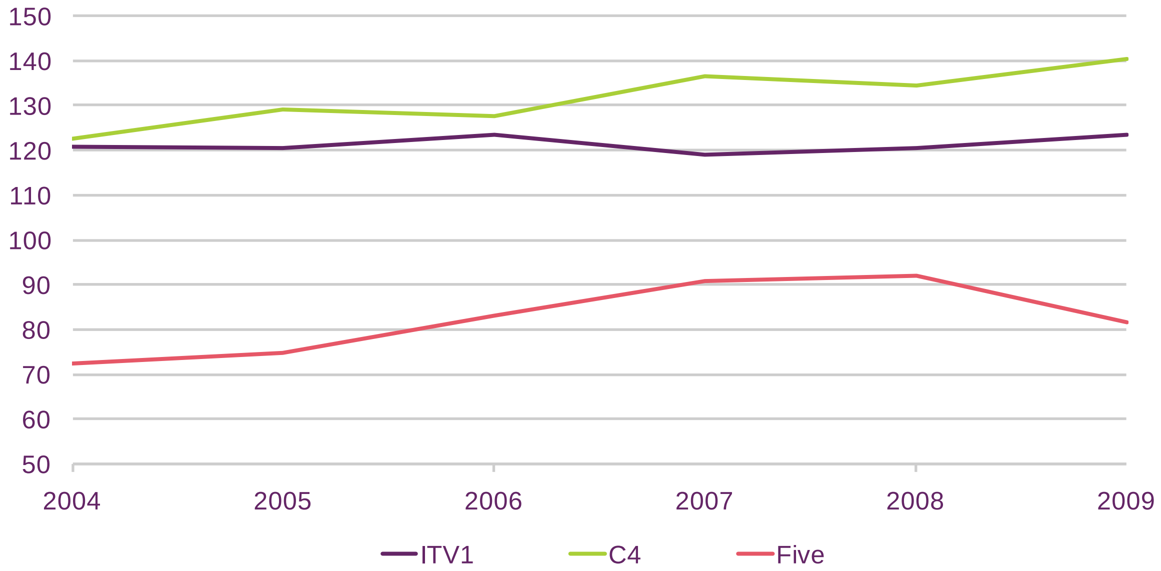
5.43 The implication of this is that we would expect the prices of different impacts across channels to vary. Chart 5.1 below provides an overview of the different price premiums (often referred to as the 'power ratio') of the major channels. Power ratios reflect the weight of revenues allocated to a particular channel, relative to its ability to deliver impacts for a particular demographic and are commonly defined as:

$$\frac{\text{Share of Broadcast (SoB)}}{\text{SOCI for demographic.}} \times 100$$

5.44 A channel with a share of NAR greater than its SOCI will have a power ratio above 100, suggesting that a relatively greater weight of revenues is attracted to the channel than its SOCI would imply, all things being equal. For example it is likely that ITV1's ability to deliver fast mass audiences accounts, at least in part, for the price premium over other channels that ITV1 is able to achieve[97]. Similarly we believe that Channel 4 is particularly valued for its ability to deliver relatively young, affluent audiences.

[95] The exception being where the media buyer has negotiated a line by line deal with the broadcaster, on behalf of its client. In this case, the advertiser will have an individual price set for access to advertising on that channel(s).
[96] See paragraph 3.33
[97] Although, in many respects this price premium has also been influenced by the presence of CRR and its constraint on prices.

Chart 5.1: Adult power ratios



Source: BARB/Kantar Infosys, Ofcom license returns

Bundling of airtime

5.45 As noted, a key feature of the trading model is that broad contract terms are negotiated up-front on an annual basis. When individual campaigns are arranged during the year advertisers contract to buy a certain number of impacts from a particular demographic group. While in some circumstances deals are further characterised by time-of-day terms, programme slot terms etc, advertisers do not generally purchase specific slots.

5.46 The effect of this is that airtime is essentially bundled together across a channel's schedule. This enables sales houses to deliver these impacts how they want, giving it the flexibility to schedule advertisements in such a way that optimises traded impact delivery – as long as campaign objectives are met. Advertisers will receive impacts from a mixture of programme slots and dayparts. As a result ,mass audience impacts are bundled with other impacts, peak-time impacts are bundled with off-peak impacts, weekend impacts may be bundled with weekday impacts and so on. This means that all impacts (for a particular demographic) within a given channel are essentially treated as identical, i.e. one adult impact is considered identical in terms of meeting an advertisers' campaign objective regardless of when viewing takes place.

5.47 The exception to this is that a certain proportion of the (expected) highest-rating programmes, classed as 'specials' are traded on a spot-by-spot basis. The cost of advertising in these programmes is generally set at a premium and may be sold on the open market, effectively by auction. In practice, the number of specials a media buyer can access is generally negotiated as part of the share deal process.

5.48 In addition to the benefits of schedule optimisation, bundling allows advertisers flexible access to the schedule and avoids the transactions costs that would be associated with planning campaigns on a slot by slot basis.

Concentration

5.49 Another feature of the market is the high degree of concentration on both the buyer and sales sides of the market. We also note that the sector has become increasingly concentrated in the last few years.

Sales houses

5.50 There has been significant consolidation amongst the sales houses in recent years, with two sales houses (VBS and IDS) closing down and the responsibility for selling airtime on the associated channels redistributed to the remaining major sales houses. In particular:

- In November 2009, ITV acquired full control of GMTV[98] and merged the operations of the two sales houses.
- In November 2009, the Sky sales house won a five year contract to sell the advertising airtime on Viacom's portfolio of channels[99]. Sky commenced selling this additional airtime at the beginning of 2011 and the Viacom Brand Solutions (VBS) sales house was closed.
- In June 2010, Channel 4 won a 10 year contract to sell the advertising airtime on UKTV portfolio of channels[100], and formally took over the responsibility of selling UKTV advertising airtime from IDS at the beginning of 2011.
- In June 2010, Sky bought Virgin Media Television (VMTV) and assumed control of the Virgin portfolio[101] of channels. It took over the selling of advertising airtime on the VMTV's channels from Virgin's sales house, IDS, in January 2011.
- Following the loss of the UKTV sales contract and the VMTV channels, the IDS sales house was closed.

5.51 As a result of this consolidation, the number of sales houses accounting for the vast majority (96%) of advertising revenues has reduced from seven to four. Of the remaining major sales houses, ITV continues to be the largest accounting for 42.9% of NAR, while Channel 4 and Sky now account for approximately 26% and 17.4% of NAR respectively (up from 22.5% and 12.1% prior to consolidation). Five continues to account for 7.5%.[102]

5.52 Sector developments such as the acquisition of Five by Northern & Shell, and the proposed acquisition of Sky by New Corp, also provide examples of cross media mergers which create the potential for advertising to be bundled and sold across different types of media (e.g. TV and print).

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[98] ITV plc previously held a 75% ownership stake in GMTV. It acquired the remaining 25% from The Walt Disney Company Limited and its subsidiary on 26 November 2009.
[99] Including MTV, Viva, Nickelodeon, VH1 and Comedy Central.
[100] Including Dave, Watch and GOLD
[101] Including Virgin 1, Living TV and Bravo.
[102] All post-consolidation estimates of share of NAR are based on 2009 data. 2010 NAR data is currently unavailable as it was still in the process of being compiled at the time of publication.

Media buyers

5.53 There has also been a trend towards consolidation amongst media buyers, with many media buying points now owned by larger groups or negotiating on a group basis compared with 10 years ago. This has led to the development of more powerful media buyers (e.g. WPP/GroupM), which purchase advertising across a wide range of media and on behalf of a number of advertisers[103].

5.54 Between 2003 to 2010, the share of TV advertising expenditure from media buyers provided by the largest six buying groups rose from 69.1% to 83.2% (see Table 5.1), with the largest media buyer, Group M, accounting for just under one third of TV advertising spend. Given this increased concentration, we might expect buyer power to have increased since 2003.

Table 5.1: Largest 6 media buyers - by % of TV expenditure from all buyers

2003		2010	
Top 6 Media buyers	Share of TV expenditure	Top 6 Media buyers	Share of TV expenditure
Magna	13.6%	Group M	30.2%
Starcom	12.9%	Vivaki	19.4%
Group M	12.0%	Aegis	13.1%
Aegis	11.8%	Opera	12.8%
OMD	10.1%	Magna	3.9%
Zenith Optimedia	8.8%	Walker Media	3.8%
Total for top 6	69.1%	Total for top 6	83.2%

Source: Ofcom, calculated from Nielsen data

5.55 Media buyer consolidation has meant that some individual media buyers may now account for a larger proportion of broadcasters' revenues than in 2003 – in other words, the largest buying 'points' have become larger. For individual broadcasters this may mean they have become more reliant on a smaller group of buyers.

Barriers to entry and expansion

5.56 This concentration may be combined with barriers to entry on both sides of the market. For example sales houses tend to predominately sell their own portfolio of channels, with the exception of Sky which sells airtime on behalf of a large number of cable and satellite channels. We believe that it is unlikely that the large broadcasters will give up control of the link between programming and advertising. As a result, there may be some opportunities for a new sales house to attract smaller (or new) channels, however they are unlikely to be able to achieve significant scale.

[103] Most advertisers use media buyers to buy advertising on TV. Only a very limited number of companies with large advertising budgets purchase airtime directly.

5.57 On the buyer side, we understand that there has been very little new entry in recent years. Moreover, given the considerable focus on discounts by media buyers and advertisers it seems unlikely that a new entrant would be able to achieve sufficient scale to negotiate discounts which might compete with existing media buyers.

ITV's market strength

5.58 We also believe that ITV's position is a relevant feature to consider when analysing the TV advertising market. ITV's market strength is likely, in part, to be a reflection of the way the market has evolved. For example, over the 1950s-1980s ITV had a complete monopoly over sale of TV advertising. Over time the number of broadcasters has increased, first with the introduction of Channel 4, to today where digital broadcasting has led to a large number of channels and increased audience fragmentation. However, as indicated in Section 3 it seems that ITV retains an incumbency advantage. It is still the most viewed commercial channel, across all demographic groups, although the gap between it and the nearest competitor is declining.

5.59 ITV1 continues to deliver the highest proportion of programmes which deliver large audiences. Table 5.2 sets out the top 1000 programmes, showing that ITV1's strength in delivering mass audience programmes is significant.

Table 5.2: Top 1000 programmes for all Adults

	ITV1	Channel 4	Five
2003	995	5	0
2004	985	15	0
2005	991	9	0
2006	968	32	0
2007	979	21	0
2008	988	12	0
2009	988	8	4
2010	994	6	0

Source: BARB/Kantar Infosys

5.60 ITV's market position also seems to influence the way airtime is traded. From our discussions with stakeholders during the CRR and ASR reviews we understand that the way ITV trades airtime has a significant influence on the way airtime is traded throughout the sector. For example, as noted, broadcasters have tended to adopt a similar pricing metric (i.e. SAP) to that of ITV. In addition, we understand that annual media buyer negotiations often start with ITV in order to get that deal settled before concluding negotiations with other broadcasters.

5.61 As noted in Section 2, the CRR undertakings were introduced to address concerns arising from the Carlton and Granada merger in 2003. Of particular concern was that the merged Carlton and Granada sales houses would be able to force media buyers to commit more of their TV advertising budget to ITV1 and/or accept a higher price.

5.62 This conclusion was based on the CC's analysis of the market strength of ITV and the extent to which this has eroded since the introduction of the undertakings. The CC concluded that ITV1 has a unique ability to deliver mass audiences quickly to advertisers, which would enable ITV to raise advertising prices in the absence of any safeguards. .

5.63 Over the course of the CRR review advertisers and media buyers stressed the importance of building rapid coverage of impacts, particularly in the first few weeks of a campaign, as essential to their campaign objectives. Moreover, it was argued that ITV1 is uniquely placed in this regard as it is the only channel capable of consistently delivering audiences large enough to achieve fast mass cover.

Evolution of the trading mechanism

5.64 The model for trading TV advertising evolved over a number of years and when commercial airtime was first traded, in the 1950s, a very different system operated. Over the period 1950s-1980s, when there was just one commercial channel operated by regional monopolies, the ITV regional companies sold slots against a ratecard and advertisers chose the slots they wanted. Ratecards set prices for slots by time of day, with higher prices for peak.

5.65 Over time, ratecard prices became the starting point for negotiations and adjustments to core prices were introduced. For example, in order to attract advertisers, discounts were offered (for volume commitments by advertisers, by time of day and so on). In addition surcharges were introduced to enable advertisers guaranteed access to slots. From what we understand it is also clear that fairly early on in the sector evolution, broadcasters made attempts to adjust prices for slot performance, in terms of impact delivery. Slots could also be pre-empted relatively close to transmission of adverts which could add to uncertainty around planning for advertisers.

5.66 We believe there are likely to be a variety of reasons why there was a shift from a system based on slot trading against a rate card to the current system based on share deals and discounts from SAP, an ex-post pricing system. In many cases we believe these are likely to reflect a desire to reduce transactions costs and manage risks on both the buyer and sales side of the sector.

5.67 Advertisers and broadcasters face a number of risks in negotiating airtime contracts. For example, broadcasters do not know what impacts they will achieve before a programme is aired. If trading was based on slots, this may make it more difficult for advertisers to plan a campaign which achieves a certain amount of frequency and coverage. Hence, it seems reasonable to conclude that the move to trading impacts may have been at least in part driven by advertiser desire for greater certainty about achieving campaign goals.

5.68 In addition this focus on impacts, rather than slots, is likely to mean lower transactions costs for advertisers, media buyers and broadcasters since they do not need to estimate impact delivery over a series of slots.

5.69 Broadcasters would also have faced uncertainty under a trading model characterised by slot trading against a rate card. For example broadcasters, like advertisers, could not be certain of how particular slots would perform[104]. By bundling airtime and trading impacts, rather than slots, a broadcaster is given maximum scope to optimise the delivery of impacts across its schedule; it has flexibility to deliver impacts from whichever slot is most efficient, taking into account the, potentially competing, needs of different advertisers.

5.70 Agency deals may have developed to give greater flexibility to buyers to allocate impacts across their fluctuating or uncertain portfolio of clients with uncertain budgets and campaign requirements. Umbrella deals are also likely to reduce transactions costs for advertisers as the overarching terms of the annual deal are negotiated by a small number of buying points. Moreover this may be expected to allow buyers to develop a degree of negotiating power with respect to large broadcasters, although as we have noted this has been disputed by media buyers.

5.71 However, we do not believe that the way airtime is traded has changed since the early 1990s, despite broader sector developments. This may in part be due to the existence of the CRR undertakings, both because of the extent to which trading across the market is influenced by the remedy, but also because the terms of the remedy limit ITV's ability to change the way they trade airtime.

5.72 During the CRR review we were told that the existence of the CRR remedy has created a 'new currency for negotiation', with each sales house outside ITV focusing their sales efforts on winning a proportion of the amount of money which is expected to move out of ITV1 in line with the ratchet mechanism. Even for the ITV digital channels, media buyers told us that the starting point for negotiation was usually the proportion of spend coming out of ITV1 and how much of this would be placed with ITV's digital channels.

5.73 Some media buyers also considered that the CRR remedy has increased the complexity of contract negotiations, with agreements becoming increasingly legalistic where every aspect of the deal is covered. While these more formalised agreements may have the advantage of certainty, it was also considered by some media buyers and advertisers that they reduce flexibility. Media buyers have also commented that the CRR remedy has changed the timing and nature of negotiations, shifting from a start date during the summer to as late as mid-November as broadcasters wait to see what revenue can be released from ITV1.

5.74 The CRR undertakings limit the extent to which ITV can deviate from the current trading mechanism. Clause 10 (part (h)) of the undertakings state that ITV "shall not change their Current Airtime Sales System without the consent of the OFT in a way that materially alters the basis on and the way in which they offer Commercial Airtime for sale". Although this does not mean that the trading model cannot change, it is likely to limit changes that ITV may wish to make.

5.75 Previously, a number of stakeholders have also acknowledged that the existence of the CRR remedy has frozen the market at a point in time. For many buyers (and as a result sales houses) the CRR undertakings have essentially enshrined the status quo from 2003, potentially perpetuating the trading model as it operated in 2003. In order to be protected by the CRR remedy, buyers must keep the structure of their trading the same as it was in their last contract. To depart from that structure (i.e. to change their channel profile, target audiences, trading parameters etc), would require

[104] There is likely to be a degree of certainty about regular high performing programmes, such as Coronation Street on ITV1. However viewing figures for new programmes are likely to be uncertain and subject to variation for a number of reasons.

complete renegotiation of a contract. We understand that this has not tended to occur, or is certainly not widespread.

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?

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

International models of trading

5.76 To provide context to our analysis we have considered how features of the market vary by country. We understand that there is no 'standard' international model for trading airtime, although there are similar features in several countries. We note, as a backdrop to this overview, that all European countries are subject to maximum 12 minutes of advertising per hour (under the AVMS directive), while the U.S. has no such restriction.

5.77 There are several aspects of international trading models which differ from what we observe in the UK, most notably the existence of share commitments in the UK rather than volume commitments found in most other countries. Differences do not appear, on the whole, to reflect different regulatory approaches – indeed, in many cases, there is limited or no regulation of the way in which airtime is sold.

5.78 In many countries the basis of trading is a ratecard. Annual negotiations determine discounts to these prices, but baseline prices are effectively fixed in advance from month-to-month. However we understand that in most countries the ratecard exists as a starting point for negotiations and the actual price paid will be based on bespoke negotiations between broadcasters and advertisers or buyers.

5.79 As a result, like the UK, in many cases the final deals that are negotiated may not be completely transparent and often include an element of commission or unaccounted-for incentive payments. Even where ratecards exist, the final price agreed will almost certainly be 'off-ratecard', reflecting the detail of the negotiation around placement, frequency, time of day, programme identity, sequence of slots etc.

5.80 In several countries part of the schedule of advertising airtime is sold on a slot basis, although we do not believe any system has adopted slot trading or an auction method for the sale of its entire schedule of airtime (or even a significant proportion of its schedule).

5.81 Media buyers appear to play a major role, both in negotiating annual deals and planning campaigns with broadcasters on behalf of advertisers in a number of countries. In some countries advertisers negotiate directly with media owners, although as with the UK, this appears to be generally limited to large advertisers.

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?

Conclusion

5.82 In this section we have described the operation of the UK TV advertising trading mechanism. We have identified a number of key features, include ing:

- On the whole impacts, not slots are bought and sold;
- Annual bespoke negotiations take place, in which media buyers commit a share of advertising expenditure in exchange for a discount from broadcasters' price (e.g. SAP) and terms and conditions;
- Umbrella deals are prevalent, with the majority of annual deals negotiated by media buyers on behalf of a portfolio of advertising clients;
- In-year campaign negotiations based on delivery of impacts from demographic groups;
- Station Average Price is a clearing 'price' used during the advertising year, calculated after an advert is aired, on the basis of revenue received and impacts delivered;
- Airtime is a differentiated product;
- Impacts are bundled across the schedule and across channels;
- The market is highly concentrated, heavily influenced by the market strength of ITV;
- The UK model evolved from a slot trading model, but has largely stayed the same since the early 1990s. This limited evolution may be partly explained by the existence of CRR; and
- There is no consistent model of trading in other countries.

Section 6

Impact on competition

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

6.2 We are consulting on our preliminary findings that some of the features of the market may interact in ways which could prevent, restrict or distort competition in relation to the operation of the market for TV advertising in the UK under s131 of EA02.

6.3 Taking into account issues that have been raised by the CC[105] and the House of Lords Enquiry[106] and our understanding of the sector, we have grouped the potential competition issues into three areas:

- The extent to which firms in market can make meaningful and informed purchasing decisions;
- The level of switching as a result of the bundling of airtime against a back drop of a market which is highly concentrated on both the buyer and seller side; and,
- The possible lack of evolution of the TV advertising trading arrangements given developments in the sector as a whole.

Introduction

6.4 As set out in previous sections, the TV advertising market in the UK has a number of distinctive features. In this section we set out how these features may interact to prevent, restrict or distort competition between broadcasters and media buyers.

6.5 We consider the extent to which there could be offsetting benefits together with the potential impact of any restriction, prevention or distortion of competition on consumers in terms of both advertisers and viewers.

6.6 We interpret the phrase 'prevent, restrict or distort competition' broadly to encompass any reduction or dampening of actual competition or potential competition, noting that markets will operate effectively when firms engaged in the market are subject to competitive constraint from other firms already in the market and/or from firms that could readily enter it, and from their customers[107].

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[105] For instance, in the 2003 CC Report , the CC commented:
"Although it lay beyond the CC's terms of reference on the present occasion, we all believed that the Office of Fair Trading or the ITC/Office of Communications should look at other features relating to the sale of airtime that have caused us disquiet and consider undertaking a review of the wider market, with a view to ascertaining whether the nature of the deals struck, the trading mechanisms and the overall market structure substantially lessen competition in the sale of airtime on commercial television and how the system might be changed to enable it to operate more effectively and efficiently.", paragraph 1.26.

[106] "The television advertising industry needs a transparent trading system which enables fairness, flexibility and certainty" HoL Report, paragraph 174.

[107] OFT's Guidance, paragraph 4.2.

Features which may affect competition

6.7 The features set out in the previous section are interrelated and we are interested in the extent to which the features may interact with one another and may prevent, restrict or distort competition in the relevant market. This interaction could in turn have an impact on end-consumers and viewers in terms of the price advertisers pay as well as the choice and extent of innovation in the market for both advertisers and viewers.

6.8 In Section 5 we discussed the features of the TV Advertising market in the UK.

In this section, we will discuss more specifically the interaction of these features and their scope for preventing, restricting or distorting competition under the following themes:

- The interaction of the system of annual SoB commitments between broadcasters and media buyers; umbrella deals between media buyers and advertisers and the role of SAP in relation to pricing in the market;
- Bundling and market concentration; and
- The lack of evolution in the market, together with the impact of CRR on the market as a whole.

6.9 We also consider the impact on consumers, both in terms of advertisers and viewers.

Transparency of pricing

6.10 In the conclusions to its enquiry into the regulation of TV advertising the HoL Report stated that:

> "A more transparent method of trading television advertising airtime is needed and it is unfortunate that the industry has been unable to produce their own solution"[108].

6.11 As indicated earlier, the comment about price transparency echoes similar sentiments expressed by the CC[109]. We note that the CC's concerns about price transparency have taken place against a trend of a fall in the price of television airtime over this period.

6.12 In order to explore the issue of price transparency we consider the scope for the interaction of: the annual nature of the deals negotiated between media buyers and broadcasters; the focus on SoB as the basis for those negotiations; the role of the SAP pricing metric; and the umbrella deals between media buyers and advertisers, to prevent, restrict or distort competition in the market. It is possible that these features could reduce price transparency in the market and this lack of transparency could restrict, prevent or distort the ability of advertisers to make informed decisions about the choices available to them. However, as set out in Section 5, we also recognise that the same features do offer certain benefits to broadcasters and media buyers

[108] HoL Report, paragraph 173.
[109] In the 2000 CC Report, it commented:
"Discounts agreed are confidential, leading inevitably to a lack of transparency with respect to the realized prices for airtime, although this may be at least partly offset by the pooling of aggregated data by media buyers and media auditors", paragraph 4.113.

(e.g. in terms of risk sharing and reduced transaction costs) which could offset - in part or in whole - these concerns.

6.13 In general terms competitive markets are associated with a degree of price transparency. If prices are transparent then economic agents can react to the price signals in a timely manner and respond effectively to changes in demand and supply so as to lead to an efficient allocation of resources. For instance, in a competitive market one would expect buyers to be able to compare the prices they are being offered by different sellers and to make informed purchasing decisions accordingly. A corollary of price transparency is that – prices could be expected to be lower than would be the case in the absence of price transparency and also there would be likely to be a degree of uniformity in prices.

6.14 We recognise that TV production and broadcasting are characterised by high fixed costs and low marginal costs and that there is an element of product differentiation between channels and audiences for programmes are heterogeneous. As a result, we would not expect TV advertising to conform to the model of a "perfectly competitive" market. Indeed, given the cost structure of TV broadcasting we would expect there to be a degree of price discrimination by broadcaster in respect of the different audiences they deliver. Given the differentiated nature of TV channels and audiences we would not expect uniform pricing across all audience demographics.

6.15 We also recognise that full price transparency e.g. firms publishing their prices/discounts – if combined with other factors – could actually provide a focal point for collusion and so distort competition between broadcasters. Our benchmark for thinking about pricing arrangements is therefore not complete price transparency but rather the ability of economic agents to be able to make meaningful and informed comparisons of the prices from different sellers on a regular basis and to be able to adjust their purchasing decisions on the basis of that information.

6.16 As noted in Section 3, we regard TV advertising as part of a two-sided market. Television channels offer programming to attract viewers on one side of the market while on the other side of the market they sell access to those audiences to advertisers. In considering the impact on competition in the market we are, in the first instance, focusing on the advertiser side of the market. We return to the issue of the viewer side of the market later in this section when we consider the impact of any prevention, restriction and distortion of competition on viewers.

Pricing Transparency

6.17 SAP is often referred to as the 'price' for TV advertising. In this section we examine the role that SAP actually plays in terms of the operation of the trading mechanism and consider what factors actually determine the cost of television advertising and how transparent these arrangements are.

Role of SAP

6.18 As set out in Section 5, SAP is calculated on a monthly basis for a particular audience demographic on a particular channel as the total amount of advertising revenue received by that channel in that month divided by the total number of commercial impacts for that particular demographic delivered by the channel in that month.

6.19 In a 'typical' market, suppliers and buyers would be able to contract for the delivery of particular goods or services (to a specific level of quality) at a specific price.

However, SAP is not used in this way: it is not used as a firm 'price' which a broadcaster and media buyer can contract at in advance for the delivery of commercial impacts. It will also vary for reasons outside the direct control of the media buyer or broadcaster: for instance, it will vary as a result of the amount other advertisers commit to a channel. Furthermore, it is not a genuine 'average' unless all media buying agents buy the same audience demographic in that month. The actual price (or cost per thousand) paid by advertisers is calculated after taking account of discounts off (or premiums on) SAP that have been negotiated by media buyers.

6.20 Taking into account the way in which it is calculated, we consider that SAP is more a notional benchmark than a 'market price' in a conventional economic sense. SAP operates more as a means of reconciling the amount that media buyers/advertisers have committed upfront with the impacts actually delivered and determining what share of commercial impacts delivered by a channel in a particular month is received by the different media buyers. A feature of this system is thus that the media buyers with the largest discounts off SAP will receive the larger share of the impacts for any particular audience demographic.

6.21 In addition, SAP should provide a relative pricing benchmark across different channels. That is, a high SAP for a particular demographic audience on a specific channel should provide a signal to media buyers that it would be better to try to reach that audience demographic using advertising on other channels with a lower SAP for that demographic audience first and to use the channel with the high SAP for the incremental delivery of campaign objectives (if necessary). That should mean that the bulk of the advertising expenditure for an advertising campaign focused on achieving certain reach and frequency targets – other things being equal – should go to channels with the lower SAP for the audience being targeted. SAP will also fluctuate according to seasonal factors and so provides a benchmark for seasonal effects.

6.22 SAP thus plays a role in the planning of individual campaigns but the key determinant of pricing in the market – the levels of discount off SAP – actually takes place in the context of the annual negotiations between broadcasters and media buyers.

Transparency: broadcasters and media buyers

6.23 As set out in Section 5 a key feature of the TV advertising market in the UK is the process of annual negotiations between media buyers and broadcasters towards the end of each year. It is the outcome of this negotiation process which has the most influence on the pricing of individual advertising campaigns over the following year. Implicit in this process is the notion that media buyers and broadcasters are trading 'share for share' i.e. a SoB commitment in return for a share of commercial impacts delivered by that broadcaster.

6.24 In theory, negotiations over the level of the SoB commitment that a media buyer is prepared to give to a broadcaster should be influenced by the broadcaster's SOCI performance from the previous year. That is, if a broadcaster's SOCI has increased because it is attracting larger audiences for its programming then that should signal that that broadcaster is better able to deliver on factors such as reach and frequency and so the media buyer should want to consider increasing its SoB commitment to that broadcaster. Similarly, if a broadcaster's SOCI is declining, one would expect media buyers to look to re-assess the level of their SoB commitment to that broadcaster and to commit their adverting expenditure to more successful broadcasters. On this basis, one would expect – all other things being equal – that advertising expenditure would move between broadcasters in response to changes in their SOCI performance[110]. In order to retain media buyers' SoB commitment, broadcasters would have to respond by offering better discounts and/or terms and conditions.

6.25 Previous discussions with industry players indicates that in recent years responsibility for the purchase of advertising has increasingly involved firms' procurement departments in addition to the marketing function. This has resulted in an increasing focus on the level of discounts which media buyers are able to deliver to their clients e.g. which media buyers are able to deliver the largest discounts.[111] One reason for this focus on the level of discount – rather than absolute price - is that it is relatively easy to track results e.g. for auditing purposes.

6.26 Thus there may be a concern that this annual deal round process and the increasing focus on discounts has tended to mask fundamental changes in the underlying pattern of supply and demand for TV advertising. That is, media buyers have ended up focusing on maintaining existing SoB positions in return for better (i.e. higher) discounts and there has not been the switch in advertising expenditure between broadcasters that perhaps might have been expected given the extent of audience fragmentation with the move towards DSO or an adaptation in the terms and conditions being offered. That said, media buyers will tend to be negotiating simultaneously with sales houses and so should have a good idea of what offers are available from different broadcasters/sales houses.

6.27 As indicated above, we consider that a feature of a market which is effectively competitive is that buyers can make meaningful comparisons between the prices being offered by different sellers and can base their purchasing decisions on the prices being offered at that point in time. In the UK market for TV advertising the ability to make meaningful price comparisons appears to be limited. After the annual deal process, media buyers will know the level of discount that they will receive but neither they nor broadcasters will know in advance the level of viewing for particular programmes. Contracting at a fixed price in advance would be risky for both sides and the current mechanisms do appear to be one way of responding to that risk.

6.28 Broadcasters do have the ability to manage the actual delivery of impacts across a month to try to avoid a situation of having over- or under-delivered against the advertising that has been booked with them but there is still the need for a reconciliation process at the end of the month. As we understand it, it is not until after the end of the month – once SAP is known - that broadcasters and media buyers can then calculate the extent to which broadcasters have under- or over- delivered for that month and therefore the extent to which particular campaign objectives have been met

Price transparency: media buyers and advertisers

6.29 Furthermore, the actual price charged to an advertiser will depend on its contract with the media buyer and how the media buyer chooses to share the discount it receives from a broadcaster between its different clients. It is not the case that the media buyer simply passes through the price it is charged by the broadcaster.

[110] Media buyers will typically need to purchase airtime from each sales house rather than purchase just from one seller so it is a question of them changing the SoB between different sales houses rather than withdrawing from a sales house altogether.

[111] Of course the fact that an advertiser might receive a higher discount off SAP compared to the previous year does not mean that the overall amount they spend will also go down. If the monthly SAP for a channel is higher than in the previous year then the advertiser could still end up spending more even if they have a higher discount than in the previous year.

6.30 That said, we recognise that in practice there is a reasonable amount of information in the industry e.g. about the SAP from the same month in preceding years for different broadcasters (e.g. so that media buyers can factor in seasonal effects); about the overall level of advertising in the market (e.g. whether it is 'up' or 'down' from the previous year) etc so that broadcasters; media buyers and indeed advertisers should have a reasonable idea of changes in the level of SAP.

6.31 Although some information about price expectations should be available *ex ante* to advertisers, it is not clear that detailed pricing information is shared systematically with the advertisers (or the extent to which advertisers monitor underlying prices). We would expect expectations about SAP to be shared with the advertisers to explain how much they need to commit to achieve a particular advertising campaign's objectives. However, we understand that individual advertisers will not have visibility of the detail of the terms agreed between broadcasters and media buyers e.g. the discounts off SAP for particular demographics or the specific terms and conditions agreed between media buyer and the broadcaster's sales house in return for a specific SoB commitment by that media buyer.

6.32 Our understanding is that an advertiser will typically agree particular contractual terms with a media buyer and provided that media buyer then delivers on those contractual terms, the advertiser will not typically receive disclosure of the underlying deal terms between the media buyer and the various broadcasters it deals with.

6.33 Another aspect of the annual nature of the deal process is that once an media buyer has agreed its annual deal with a broadcaster it has obviously committed itself to meet certain share of broadcast targets over the year ahead. As a result it will structure its behaviour over the year to ensure that it meets the SoB commitment it has agreed with that broadcaster. We understand that penalties for failing to meet a SoB commitment can be significant, and that there is increasing scrutiny by broadcasters that media buyers have complied with their SoB commitments.

6.34 As a result, media buyers then end up spreading their advertising expenditure across different broadcasters to ensure that they will meet their various SoB commitments while still aiming to deliver specific campaign objectives regarding reach and frequency. However, this could mean that the planning of individual campaigns may be distorted by the need of the media buyer to meet its SoB commitment rather than being focused on what would be optimal for the individual client. That is, an advertiser may want a campaign which focuses on a limited number of channels but a media buyer may want to structure the campaign to build in expenditure across a greater number of channels in order to meet their SoB commitments.

6.35 It seems to us that the combination of the annual deal process as well as the use of SAP and umbrella deals has the potential to constrain the ability of advertisers to make meaningful comparisons of the prices being offered by different broadcasters over the course of the year and to adapt their purchasing decisions accordingly. Media buyers will also be constrained from switching expenditure between different broadcasters by the need to ensure that they meet their SoB commitments. We would expect that the limitations on the ability of media buyers/advertisers to switch advertising expenditure between broadcasters during the course of the year could restrict competition in this market and reinforce existing market positions[112].

6.36 Furthermore, as annual deals start to take into account other facets of promotional activity on TV – e.g. sponsorship, VOD advertising, product placement etc – the

[112] This is in spite of the general deflation in the real cost of television advertising since 2000.

distinction between these different media will tend to become more blurred and it could become increasingly difficult to isolate a specific price for TV. It could therefore become increasingly difficult for advertisers to have a clear sense of what they are paying for specific advertising on TV as opposed to paying for advertising on TV and other TV-related promotional activity.

6.37 At the same time we are aware that the players in this market include large, sophisticated organisations and that the SoB/SAP interaction is well understood by them. At first glance, the system of trading and pricing may appear opaque to the outsider but firms active in the market do understand how it operates and should be able to adjust their behaviour, at least in part. We also recognise that umbrella deals are likely to reduce transactions costs for both broadcasters and advertisers and provide a degree of flexibility for advertisers to adjust their marketing plans over the course of the year. It is therefore possible that any adverse impact on competition in the market discussed above is offset (in part or even wholly) by operational practices and the efficiencies that the current arrangements provide.

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?

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?

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

Bundling & Market Concentration

6.38 Previous reviews of aspects of the TV advertising market have noted the strength of the ITV sales house (and the ITV1 channel in particular) both in absolute terms and also relative to other sales houses. For instance, the ITV sales house accounts for around 44.6% of NAR and together the top three sales houses now account for around 88% of NAR[113].

6.39 Those reviews have also noted that the buyer side of the market is also concentrated although not quite to the same extent as the seller side. Here the top 6 media buyers accounts for around 83.2% of all TV advertising expenditure. The remainder of the market is accounted for by a large number of small media buyers operating at national or regional level and who tend to serve smaller clients.

Broadcasters' Sales Houses

6.40 A number of CC reports into mergers between the regional Channel 3 licensees have established that the ITV sales house has a strong market position in the TV advertising market, and that ITV1 in particular has a strong market position in relation to the provision of mass audience programming.

6.41 In the 2010 CC report the CC found that ITV remained in a strong negotiating position with respect to media buyers in general[114]. In the CC's view, media buyers which sought to reduce their SoB commitment to ITV1 were likely to be offered

[113] 2010 NAR data is not currently available as it was still in the process of being compiled at the time of publication.
[114] 2010 CC Report, paragraph 23.

significantly less favourable terms on their remaining ITV1 advertising. Those terms included both discounts off the price of advertising airtime as well as a wide range of other contractual terms which were important to media buyers. The CC found that any worsening of terms and conditions, particularly in relation to discount, would undermine the ability of a media buyer to compete with other media buyers for advertising clients. As a result, media buyers are unlikely to switch or threaten to switch a sufficient amount of their expenditure away from ITV1 so as to constrain ITV.

6.42 The CC did not, however, directly consider the position of media buyers with respect to other broadcasters' sales houses. It is therefore possible that the bargaining relationships between the media buyers and other broadcasters were more equal or, indeed, the balance of bargaining power might lie with the larger media buyers.

6.43 Although ITV remains the largest sales house, the recent consolidation amongst other sales houses means that Channel 4 sales and Sky now each account for 26% and 17.4% of NAR respectively. It is possible that the strengthened market position of Channel 4 and Sky means their bargaining position has improved so that they may be able to adopt a stronger negotiating position with respect to media buyers.

6.44 The strengthened market positions of Channel 4 and Sky are not automatically a competition issue: we recognise that the market shares attributable to the Channel 4 and Sky sales houses are below the 40% level that has conventionally been associated with single firm dominance. Given the fact that TV advertising is a differentiated product market and the selling side is now so concentrated, it is possible that a sales house with a market share of less than 40% might nevertheless have a degree of market power without being dominant in the market.

6.45 In the UK, the ratio of a broadcaster's share of NAR to its share of commercial impacts is referred to as its 'power ratio'. Thus, a power ratio of 100 would indicate that a broadcaster's share of NAR was equal to its SOCI. In the absence of product differentiation and/or market power – if all audience demographics were valued equally by advertisers - one might expect a broadcaster's share of industry revenue to be roughly in line with its share of commercial impacts.

6.46 However, in the situation where audiences are differentiated, even in a competitive market, one would expect some broadcasters' share of industry revenue to be above their SOCI.

6.47 In 2009 the power ratios for ITV1 and Channel 4 were in the order of 123 and 140 respectively i.e. significantly above 100. In contrast, taking all of the channels sold by the Sky sales house together we estimate that its power ratio would be approximately 88.

6.48 As indicated above, given the product differentiation between broadcasters, it is not surprising that some power ratios are above 100. However, it is difficult to disentangle any market power effects from those attributable to product differentiation.

6.49 In the case of ITV1 the level of its power ratio has been attributed to its position in respect of the delivery of mass audiences – an area where the CC found that ITV1 had a strong market position – as well as factors such as the 'brand' association of being advertised on certain channels i.e. firms wanting their adverts to appear on certain channels or even around certain programming.

6.50 In the case of Channel 4, its high power ratio has been attributed to its position in respect of the delivery of particular audience demographics (e.g. younger, more affluent audience demographics) as well as factors such as the Channel 4 brand. However, 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.

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

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

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

Bundling of airtime

6.51 When media owners contract with media buyers for the delivery of individual advertising campaigns they do not typically contract for the delivery of specific volumes of impacts against specific advertising slots. Instead they contract for the delivery of a package of commercial impacts that deliver certain campaign parameters e.g. in terms of reach, frequency, distribution over the day etc in a way that has an outcome equivalent to bundling[115]. It is the media owner that takes responsibility for packaging or bundling together the delivery of commercial impacts across different parts of a channel's schedule – e.g. peak versus off-peak - or even, in some cases, across different channels, in order to meet the agreed campaign objectives.

6.52 Bundling *per se* is not a competition issue. Indeed – as set out in Section 5 - allowing the broadcaster to take responsibility for the scheduling of the delivery of commercial impacts enables the broadcaster to optimise the delivery of commercial impacts i.e. schedule adverts most efficiently given the expected audiences for different programmes. However, in a differentiated product market, we accept that different types of impacts are likely to be valued differently by media buyers and advertisers and this can give rise to position of market strength in respect of specific types of impacts. Where some broadcasters have a particular strength in the delivery of a specific type of commercial impact (whether by time of day or in particular programmes etc), it is possible that bundling could give rise to competition issues. Thus, given that impacts are bundled, it is possible that bundling impacts where there is less competition in supply with impacts where there is more competition in supply might enable a broadcaster to leverage their market strength in respect of one set of impacts to other types of impacts.

6.53 For example, given its position of market strength in the delivery of mass audiences, ITV1 could bundle the impacts delivered by its mass audience programming with impacts delivered by other programming on the channel. The effect of this bundling could mean that media buyers have to purchase more impacts on ITV1 than they strictly might want to, which in turn would reduce the amount of 'other' impacts media buyers need to purchase from ITV's competitors to meet their campaign goals. In

[115] Bundling involves offering several products together as one combined product and includes some situations where products are linked through the use of discounts. Here impacts from different day-parts on a channel are bundled together into one combined product.

order to compete with ITV for these other impacts, competing sales houses would then need to offer very high discounts.

6.54 As discussed above, the bundling of airtime can take place within a single channel or across different channels. Given the recent consolidation in the market, it is likely that media buyers will have less discretion about how the delivery of impacts is achieved.

6.55 However, as indicated in Section 5, it is possible that media buyers might accept that placing responsibility for the optimisation of the delivery of commercial impacts with the broadcaster – and thus the broadcaster taking the risk for the performance of its schedule – delivers certain offsetting benefits.

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?

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?

Media Buyers

6.56 As set out above, the top six largest media buying groups accounted for around 83% of the advertising expenditure committed to TV in 2010. In addition, we estimate that the largest single media buying group Group M accounts for some 30% of TV advertising expenditure in its own right.

6.57 As indicated in Section 5 media buyers typically negotiate ‘umbrella deals’ with broadcasters and we would expect one benefit of these arrangements to be reduced transaction costs for both broadcasters and media buyers/advertisers. That is, rather than have to negotiate a large number of bi-lateral annual deals with individual advertisers or even negotiate on a campaign by campaign basis, umbrella deals allow broadcasters and media buyers to benefit from a more limited number of contracts. Equally they allow advertisers to benefit from the economies of scale available from being part of a buying group: contracting with a media buyer removes the need for an advertiser to maintain an internal buying team. Umbrella deals also provide advertisers with a degree of flexibility in that, as part of a umbrella deal, an advertiser will have access to a broadcaster’s schedule but it will have more flexibility as to exactly what and when it advertises compared to negotiating directly with a broadcaster.

Alignment of incentives

6.58 Umbrella deals are a mechanism by which media buyers can aggregate the buying power of their individual clients to obtain better overall terms from the broadcasters’ sales houses. However, the way in which those better terms are then ‘shared out’ between advertisers is then at the discretion of the media buyer and may be on a completely different basis from that used by a broadcaster[116]. It is therefore possible that umbrella deals actually confer on the media buyers the ability to discriminate

[116] The implication of this position would be that umbrella deals do not in fact serve to generate lower prices for advertisers compared to a position (say) where the advertiser negotiated directly with a sales house. That is not to say that umbrella deals result in prices that are higher than an individual advertiser could achieve in its own right but – based on these arguments – it is not clear that there is any significant pricing benefit to an advertiser from being part of an umbrella deal.

between different advertisers and the ability of advertisers to switch between media buyers is limited by the nature of their deals with the media buyers. That is, 3-4 year deals between advertisers and media buyers mean that advertisers only have the opportunity to make comparisons of the contractual terms they are being offered by media buying every few years and this would limit their ability to switch advertising expenditure between media buyers.

6.59 We understand that competition between media buyers to secure the media buying/media planning account of a particular advertiser does involve competition on pricing terms e.g. with media buyers offering to meet specific pricing targets (discounts off SAP, discounts relative to auditors' pool etc) but then the advertiser is tied into those terms for the duration of the contract.

6.60 As part of the process of competing for clients, the larger media buyers are likely to be better placed to commit to specific pricing guarantees – because they are able to manage how the discounts they receive from broadcasters as part of their annual deals are allocated between different clients - whereas smaller media buyers probably have to rely on offering more of a bespoke service to a client because they would not be so well placed to offer specific pricing commitments. Advertisers thus are likely to have a choice between different types of agency deals. This does not seem to us to give rise to any particular competition issues.

6.61 However, once committed to a particular media buyer, it is not clear to us that the interests of the advertiser and the media buyer will necessarily be completely aligned. At an aggregate level over the year a media buyer will be focused on making sure that it meets the terms of its annual deal with the broadcaster in order to avoid penalties i.e. it will want to ensure that it meets the SoB that it has committed to in the annual deal. It is therefore possible that a media buyer may – in some cases – in its media planning and buying role commit more advertising revenue to a particular sales house than is strictly required to meet the objectives of a particular advertising campaign. That is, it may not allocate advertising revenue in the most efficient way for an individual client but will instead allocate advertising revenue in a way that enables it to meet its SoB commitment with the broadcaster. That is not to say that a media buyer will always act in this way but rather, the nature of umbrella deals combined with market power at the media buyer level, could mean that the incentives of the advertiser and media buyer may not always be aligned.

6.62 For example, the annual contract between a media buyer and broadcaster will specify a particular discount off SAP against a particular audience demographic. As indicated above, given the differentiated nature of this market, one might expect an element of price discrimination between different advertisers. If the broadcaster was dealing direct with advertisers one would expect such discrimination to be based on differences in the advertisers' elasticity of demand. That is, an advertiser with a high elasticity of demand for a particular demographic audience with that broadcaster might receive a high discount off SAP and an advertiser with a low elasticity of demand for the same audience with that broadcaster might receive a low discount off SAP.

6.63 In practice, given the nature of the contract between the advertiser and the media buyer, and the role of umbrella deals, the actual price an individual advertiser ends up paying will depend on a range of factors which may not be directly related to the advertiser's elasticity of demand e.g. the bargaining power of the two parties. As a result it could be the case that the advertiser with the high elasticity of demand in fact ends up paying a higher price than the advertiser with a low elasticity of demand for the same demographic audience.

6.64 We note that advertisers make use of auditors to ensure that the advertiser receives the terms which they have contracted for with a particular media buyer and that those terms are 'competitive' relative to the market or whatever pricing benchmark[117] has been agreed between the advertiser and media buyer. However, it is possible that the media buyer is not offering the advertiser the best terms that it could (i.e. it is not sharing out the discount from the broadcaster equally) and as a result the advertiser may be paying more than it needs to whereas other advertisers may be getting a better deal (although this is not per se a serious competition concern).

6.65 More generally, we would expect the advertiser's ability to switch at the end of a contract to impose a certain discipline on this sort of behaviour. That is, we would expect it to be in the interests of the media buyer to avoid acting in such a way as to provoke clients into switching at the end of a contract and the fact that contracts are likely to be coming up for renewal regularly should impose constraints on media buyers' behaviour. However, as indicated above, it is not clear to us the extent to which advertisers are actually protected from this behaviour and that the broadcaster/media buyer interaction delivers what advertisers actually want.

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?

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?

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?

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

Innovation in the TV advertising market

6.66 As set out in Section 3 the TV sector going through a period of considerable change and in particular there have been a number of innovations in the way in which content is distributed and consumed as well as changes in the content itself e.g. the increase in the number of channels, the development of DVR devices, IPTV and connected devices the introduction of VOD and HD services etc. However, in contrast, the way in which TV advertising is planned and sold has not been subject to the same degree of change. That is, the way in which TV airtime is traded remains the same as when ITV1 had a *de facto* monopoly on the supply of TV airtime and there is still the focus in planning terms on the ability of channels to deliver reach and frequency.

6.67 In this section we consider the extent to which this is the result of the interaction of some of the features of the market that we have previously identified. We note that the fact that there is a lack of innovation in the trading mechanism would not automatically give rise to a competition concern if it was the case that the airtime trading system was already reasonably efficient, delivered what advertisers want and was sufficiently flexible to accommodate changes going forward whilst perhaps also allowing innovation at the margins.

[117] We note that advertisers/media buyers do not simply compare prices relative to (say) a market average but have developed a number of different price comparisons.

The role of CRR

6.68 It is difficult to discuss innovation in the way in which TV advertising is traded in the UK without considering the CRR remedy that applies to ITV1. As set out in Section 2, the CRR Remedy was put in place to protect media buyers and advertisers from the increase in ITV1's market power as a result of the merger of Carlton and Granada. In addition, the merger undertakings also require ITV to seek regulatory approval for any change to the underlying airtime trading mechanism.

6.69 Although CRR applies specifically to ITV1, it has been suggested that it has also had the effect of changing the way in which other broadcasters have competed with one another. For example, it has been suggested that – knowing that media buyers are able to remove a certain proportion of their SoB commitment from ITV1 in proportion to the reduction in ITV1's SOCI each year[118] – some broadcasters have chosen to focus simply on competing for that revenue rather than competing more aggressively with one another. That is, we understand that at the time of the annual deal round, negotiations between other broadcasters and media buyers would focus on the reduction in SoB commitment to ITV1 under the CRR ARM and what proportion of the money 'coming out of ITV1' a particular broadcaster expected to transfer to its sales house rather than seeking to negotiate their deals more broadly. That is, competition between other broadcasters became narrowly focused on the division of the money coming out of ITV1 rather than reflecting broader changes in the underlying demand and supply conditions.

6.70 The implication of this position is that CRR could have had the effect of restricting or distorting the degree of competition that might otherwise have been expected between broadcasters' sales houses given the way they were competing pre-CRR. However, we do recognise that without CRR to constrain ITV1, it is possible that there ITV1 would have been better placed to exploit its market strength and the result would have been less competition between other broadcasters.

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

CRR as a potential barrier to the evolution of the trading mechanism

6.71 We understand that it is likely to be difficult to vary the way airtime is traded across the whole market because the CRR merger undertakings have prevented ITV from changing the underlying trading mechanism for ITV1 without regulatory approval. That is, it would be complicated to have one trading mechanism for ITV1 and one for other broadcasters.

6.72 It may also be the case that CRR has in effect ossified the TV advertising market in the UK with media buyers sticking to contractual terms that reflected the pattern of demand and supply in 2003 rather than seeking to update their contracts with ITV and other broadcasters in response to the changing demands of media buyers and their clients and in the way in which content is being delivered.

6.73 As set out in previous sections, the existing trading mechanism has a series of features - bundling of airtime, annual SoB commitments etc - which were developed when there were a limited number of channels and ITV had a monopoly on the provision of TV advertising. However, with the increase in the number of TV channels

[118] In fact ITV1's Adult SOCI has fallen each year between 2003 and 2010, from around 42% to around 28%.

and as audiences have become more fragmented one might have expected greater commercial pressure on the trading mechanism to evolve to reflect these changes and developments.

6.74 More recently there have been the developments in the way in which content is delivered and consumed by audiences e.g. VOD catch-up services, HD services, Internet connected devices, IPTV etc but, as we understand it, the ability of content providers to monetise these new ways of connecting to and differentiating between these audiences has so far lagged behind the advances in delivery platforms. For instance, we understand that some broadcasters are currently only able to offer genre-based packages of advertising around VoD content and are not able to offer more targeted advertising.

6.75 In part, this may be due to issues around the development of mechanisms to measure these audiences at an effective level of disaggregation or commercial arrangements for sharing data on the way in which audiences are using/interacting with the new distribution technologies. At the same time it is also possible that such issues could be exacerbated by the way in which advertisers, media buyers and broadcasters are locked into particular ways of trading TV airtime. In order to experiment with new forms of advertising – e.g. more targeted advertising with less focus on reach, media buyers (and advertisers) would need to be prepared to move away from their CRR protected contracts.

6.76 Given ITV1's position in the market, it is likely that it would need to be involved in any significant change i.e. it is difficult to envisage changes to the trading mechanism which were not initiated by or did not involve ITV1. It is thus possible that the restriction imposed on changes to the way in which ITV1 can trade airtime has in effect stifled the evolution of alternative trading mechanisms and prevented the dynamic evolution of the market as a whole. We note that when CRR was originally established in 2003, it was envisaged that it would act as a back-stop and that media buyers could move away from their existing contracts to negotiate different types of deals with ITV1.

> "The CRR remedy is designed to give all existing customers a fall-back option ... Customer would not be precluded from negotiating different deals if they wished."[119]

6.77 It was not envisaged that it would remain the main way of trading in the market in the medium term – it is now 8 years since CRR was introduced.

6.78 We also consider that CRR is now potentially a blunt tool in that it applies to the way in which ITV1 trades all of its airtime whereas the key market power concern that has been identified is in relation to its ability to deliver mass audiences. As indicated in our evidence to the CC's 2010 review of the CRR remedy, we argued that there was scope for the CRR remedy to be lifted provided that there were certain safeguards in place in relation to ITV1's ability to deliver mass audiences i.e. to target any remedy on the immediate areas of concern. It is possible that in order to develop a more targeted remedy, there may need to be changes in the way in which TV airtime is traded.

6.79 In terms of benefits, the CRR remedy has had the effect of protecting media buyers[120] from ITV1 exploiting the increased market power it derived as a result of the Carlton-Granada merger.

[119] 2003 CC Report. paragraph 1.18.

Question 22: To what extent do 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?

Summary of Potential Effects

6.80 Section 5 set out some of the potential effects that particular features of the market could have. This section has discussed how some of the same features could also give rise to potential competition issues. Based on the above discussion we consider how these issues could impact on consumers and viewers.

Consumer Effects

6.81 As set out at the beginning of this section, we regard TV advertising as a two-sided market. In this section we consider the potential impact on both sets of consumers: advertisers and viewers.

6.82 We anticipate that, if there is a restriction of competition in the market for TV advertising, both viewers and advertisers could have been affected in terms of lack of programme innovation and the level of prices for TV advertising could have been higher than otherwise would have been the case.

Lack of programme innovation

6.83 The way for a channel to increase its audience share (and with it its SOCI) is to invest in attractive content to attract larger/more diverse audiences e.g. by commissioning original new content or more expensive acquired material. However, there will be a time lag between the additional investment in a schedule and the actual transmission of the new material. In respect of original programming there will be a risk that the new programming does not perform as well as expected in terms of delivering audience share. This problem tends to be less significant in relation to acquired material where it is possible to assess the sort of audience that that material is likely to generate based on how it performed when first broadcast.

6.84 If competition between broadcasters is prevented, restricted or distorted then there is likely to be distortion in the allocation of TV advertising revenues between broadcasters so that some broadcasters receive a disproportionately high share of advertising revenue and, equally, other broadcasters receive a disproportionately low share.

6.85 If it is the case that the annual nature of the deal round - combined with umbrella deals - has meant that the focus of negotiations between broadcasters and media buyers is on SoB and SOCI, then that could mean that broadcasters have been more risk averse when it comes to making programming decisions, particularly against a backdrop of increasing audience fragmentation as the penetration of digital households has increased. That is, broadcasters might have focused on investing in programming which is more predictable in terms of the size and composition of the audience. In that respect investing in new, original content is likely to be more risky

[120] For instance, in its 2010 CC Report, the CC commented:
"We concluded that these changes of circumstance since 2003 did not warrant ITV's release from the CRR Undertakings and that a remedy was still required to address the likelihood that adverse effects would otherwise arise. In particular, we were concerned that, absent an effective remedy, ITV would be able to worsen terms to advertisers overall through seeking higher SOB commitments, reducing discounts or worsening terms and conditions", paragraph 26.

than purchasing acquired material and the result could have been a lack of experimentation or innovation on the part of broadcasters motivated to protect their SOCI position. That said, we do recognise that a SoB/SOCI relationship would reward broadcasters if their programming did better than expected.

6.86 From the number of channels that have entered the UK market in the last decade it is clear that this annual deal process has not represented a significant barrier to entry to the market. However, it is possible that the lag that an annual deal process introduces between broadcasters investing in their schedule and seeing a return for that investment could have acted as a deterrent to new entrants to significantly increase their investment in content. This could have been compounded by the fact that in any case spending more on content will not automatically guarantee larger audiences.

6.87 Both viewers and advertisers would be affected by this reduction in competition between broadcasters if broadcasters tend to stick to programming that is known to deliver predictable audiences. More innovative programming expands the choice available to viewers and also influences the way in which viewers interact with programming. Given that advertisers are also interested in tapping into the emotional attachment viewers have to programming they may have been denied the opportunity to experiment with the way in which they promote their products via TV advertising e.g. to move away from a focus on reach and frequency and to consider alternative campaign designs.

The price of TV advertising

6.88 We recognise that in general terms the CPT for TV advertising in the UK has fallen over the last 10 years which reflects the supply of commercial impacts increasing faster than overall industry revenues (together with any deflationary effects specific to CRR). However, if competition in the market for TV advertising has been prevented, restricted or distorted then it is likely to be the case that the price level may nevertheless be higher than would be the case in a market which was effectively competitive and/or that the pattern of prices across different broadcasters has been distorted. We are not, however, in a position to say how much lower prices might have been.

6.89 We would also expect there to be some relationship between the amount spent on advertising and prices to end users. We recognise that that relationship is likely to depend on a range of factors (e.g. the extent of competition in the downstream market) and so it is difficult to be categorical but prices to end users might be higher than would otherwise be the case.

6.90 It could also be the case that if the price mechanism is not working effectively then potential new advertisers could be ‘priced’ out of advertising on TV. As a result, viewers/consumers would be deprived of information about products or services that could be useful to them in future purchasing decisions or shaping their preferences.

Potential offsetting benefits

6.91 It is worth noting that it is possible that the higher prices paid by advertisers might have had a beneficial impact on viewers if it was the case that competition between broadcasters meant that the additional revenue was invested in content to maintain or increase investment in programming rather than (say) paid out to shareholders.

6.92 However, given the differentiated nature of TV channels and audiences it is impossible to assess the likelihood that viewers have actually benefitted from the prevention, restriction or distortion of competition in the TV advertising market.

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?

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?

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

Preliminary Conclusions

6.93 In the course of our assessment, we have taken into account a wide range of evidence and considered the impact of the features identified. On this basis we are consulting on our preliminary conclusions that some of the features of the markets we have identified may interact in ways which could prevent, restrict or distort competition in relation to the operation of the market for TV advertising in the UK.

6.94 We are particularly concerned about the impact of these features on choice and innovation for advertisers and viewers both in terms of the distribution of revenue between broadcasters as well as investment in innovative programming. We also recognise that it is possible that prices to advertisers may be higher than otherwise would have been the case but we are not in a position to evaluate how serious a concern this might be, particularly since prices appear to have fallen in real terms over the last decade or so.

Section 7

Possible decision on a reference

Summary

7.1 In this consultation we set out possible problems associated with the interaction of the features of the market. We also outline possible offsetting benefits. We are asking interested parties to provide responses, explaining the significance and scale of the relative problems and merits of the way TV advertising is traded. We will use these responses to conclude whether we have reasonable grounds to suspect that the features of the market prevent, restrict or distort competition in the sale and purchase of TV advertising. We also set out the criteria Ofcom will consider when deciding whether to exercise its discretion to refer the UK TV advertising market to the CC under s131 EA02 for investigation. In the event that, in light of the consultation responses, we decide that a market investigation reference to the CC is appropriate, we have set out the draft terms we would intend to use when making the reference in Annex 1.

Introduction

7.2 In Section 6, we discussed how the features of the market may prevent, restrict or distort competition in the UK market for TV advertising (identified in Section 4). However we also described number of possible offsetting benefits. We have asked stakeholders for input to help understand where the balance of these costs and benefits lies. In this section, we explain how we will decide whether exercise our discretion to make a market investigation reference.

7.3 If we conclude, following consultation that features of the market interact in such a way to prevent, restrict or distort competition we believe that there is a reasonable prospect that there would be a number of appropriate remedies available to the CC. In this case a market reference would allow the CC to investigate the potential competition issues and assess the extent to which they may lead to consumer detriment and develop appropriate remedies.

Legal test and criteria for exercising our discretion to make a reference

7.4 As described in Section 2, under Section 131 of EA02 Ofcom "may…make a reference to the Commission if [Ofcom] has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom".[121]

7.5 In the event that we have a reasonable suspicion to believe the features of the market adversely impact on competition, Ofcom has the discretion to refer the market identified to the CC for an investigation. In order to assess whether it is appropriate to

[121] Section 131(1) EA02.

make such a reference, the OFT's Guidance outlines four criteria that we should consider before we decide to make a reference[122], namely:

- The suitability or otherwise of using our CA98 or other sectoral powers;
- Whether the problem could be addressed through undertakings;
- Proportionality and whether the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response; and
- Whether there is a reasonable chance that appropriate remedies will be available.

7.6 We review the criteria below. We are not, at this stage, making a proposal about whether it would be appropriate to make a reference to the CC.

Application of CA98 or alternative powers

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

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

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

- When we have reasonable grounds for suspecting that there are market features which prevent, restrict or distort competition, but do not breach the CA98 prohibitions; or
- When action under CA98 has been or is likely to be ineffective for dealing with the competition issue identified[123].

7.10 In Section 6 we described that there may be justifiable concerns that the combination of features of the market may prevent, restrict or distort competition in the sector. We identified particular potential concerns around:

- Possible poor transparency of pricing signals;
- Bundling of airtime may limit switching; and
- Possible barriers to evolution of the trading model

7.11 We have explained that the features which give rise to these possible areas of concern appear to apply to the whole market and not just a single player.

[122] OFT's Guidance, paragraph 2.1.
[123] OFT's Guidance, paragraph 2.3.

7.12 Whilst it may be possible to define some aspects of the possible concerns as potential infringements of CA98 (either in the form of abuse of dominance or anti-competitive agreements) we doubt that one or more CA98 investigations would be appropriate to address these. While we have indentified possible concerns about the consequences of a combination of features, some of these features may not raise competition concerns if considered in isolation and others are unrelated to the conduct of a particular party or a specific agreement (or series of agreements. However, when considered together these features may have a detrimental impact on competition. A CA98 investigation which targeted one issue might therefore not be able to address an underlying cause of the competition concern.

7.13 A CA98 investigation is geared to address specific conduct or issues and any remedies aimed at addressing the infringement identified. However, we have identified a variety of possible issues and effects on competition and therefore a CA98 investigation may, in our view, be an inappropriate tool to deal with the range of potential industry-wide competition issues we have provisionally identified.

7.14 In addition, we have suggested that there may be concerns with different levels of the supply chain, some of which are not licenced broadcasters and so would not fall within the remit of our s316 powers.

7.15 As a result, our preliminary view is that it would not be more appropriate to address the concerns under either our CA98 or our sectoral powers.

7.16 Finally we have noted that the existence of CRR may be reinforcing some of the features we have identified and may limit the extent to which the trading mechanism can change. As a result any remedy which is designed to tackle problems which arise from the interaction of the features of the market may require CRR to be amended. Since the CC is the only body that can undertake this, it seems appropriate for the CC to consider the possible competition concerns and any necessary changes to CRR in the round.

Undertakings in lieu of a market reference

7.17 We need to take account of possible undertakings that could be offered by media buyers, advertisers or broadcasters to address the possible concerns raised and so obviate the need for a market investigation reference.

7.18 Ofcom has power under s154 EA02 to accept undertakings instead of making a reference to the CC. However, we have shown that the possible adverse effects on competition arise from the complex interrelationship between several features of the market and involving unilateral conduct of several firms as well as industry structure. As a result, we are not currently in a position to judge with any certainty whether particular undertakings would effectively address the problems identified.

7.19 Moreover, trying to negotiate undertakings with several parties, in circumstances in which possible adverse effects on competition have not been fully analysed, is likely to pose serious practical difficulties.

7.20 Nonetheless, we will consider any proposals for undertakings that may be offered by parties in the course of this consultation.

Proportionality and scale of the suspected problem

7.21 According to the OFT's Guidance, we should only make a reference where we have reasonable grounds to suspect that the adverse effects of the features on competition are significant. In order to assess this we consider whether the suspected adverse effects are likely to have a significant detrimental effect on consumers through higher prices, lower quality, less choice or less innovation[124].

7.22 We realise that a reference to the CC would involve not just costs to the CC itself, but would also impose a substantial burden on stakeholders, including potentially significant uncertainty to the sector. Where adverse effects are not likely to be significant, the OFT takes the view that the burden on business, particularly in terms of management time, and the public expenditure costs of an investigation by the CC are likely to be disproportionate in relation to any benefits that may be obtained from remedying the adverse effects. The OFT's Guidance notes three factors which are relevant to determine whether a market reference is proportionate:

- The size of the market;
- The proportion of the market affected by the feature giving rise to adverse effects on competition; and
- The persistence of the feature giving rise to adverse effects on competition.

The size of the market

7.23 As described in Section 3 the TV advertising sector is an important feature of many consumer-focused markets and around £4bn is currently spent on TV advertising annually. It is critical for financing TV content for many broadcasters and is the main source of revenue for commercial Public Service Broadcasters.

7.24 Given the two-sided nature of TV advertising, any possible prevention, restriction or distortion of competition may in turn negatively impact two sets of consumers: advertisers and TV viewers. In particular there could be adverse effects on the efficient allocation of advertising revenues across broadcasters, innovation by broadcasters and the consumer experience, both in terms of higher prices and access to content.

The proportion of the market affected

7.25 We consider that a significant proportion of the market we have identified could be affected by the features that possibly prevent, restrict or distort competition. We have indicated that we understand that the features which may lead to competition concerns are largely replicated across the entire sector and also at different levels of the market.

The persistence of features giving rise to adverse competition effects

7.26 We believe that it is likely that the features of the market set out in Section 5 are likely to persist. We have described how the trading mechanism appears to have remained stable for many years and may have been essentially 'frozen' by the operation of CRR which, although only applied to ITV1, may have an impact on the entire trading model. Given the potential barriers to evolution of the trading model, it

[124] OFT's Guidance paragraph 2.27.

is possible that, absent intervention, that any possible concerns we have identified may be expected to persist.

Conclusions on proportionality

7.27 We believe that if we conclude that there is a reasonable suspicion that the features of the market may prevent restrict or distort competition then it is feasible that a market reference would be a proportionate response.

Availability of remedies

7.28 In accordance with the OFT's Guidance[125], Ofcom should take into account the likely availability of appropriate remedies in the event that suspected adverse effects on competition were found by the CC to exist. The design of an appropriate remedy will depend on the nature of the problem identified by the CC, in the event that we market a reference. However we believe that there may be ways of addressing the possible areas of concern we have identified.

7.29 If the CC finds that price transparency is a problem which limits the efficient switching of advertising revenues by media buyers and advertisers there may be a number of ways of improving price signals. For example rate cards or some form of slot trading, such as an auction, would lead to greater price transparency at the point of sale or change the balance between amount sold under umbrella deals and amount sold on a slot basis. If the concern is more about the ability of advertisers to respond to price signals it may be appropriate to seek ways to align the objectives of media buyers and advertisers or to introduce more line by line deals.

7.30 Alternatively if it is concluded that bundling across a schedule is likely to limit switching then it may be appropriate to introduce a more disaggregated sale of impacts. For example broadcasting sales houses could unbundle different parts of the schedule.

7.31 Obviously the CC will consider the precise nature of any remedy and in doing so will need to consider that moving away from the current system is likely to involve some trade-offs, i.e. the loss of some of the efficiencies we have identified in order to address possible concerns. In addition, we note that any changes to the trading system may need to be reflected in changes to the CRR undertakings, since they currently appear to limit the way ITV trades airtime to the existing trading mechanism.

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?

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

[125] OFT's Guidance, paragraphs 2.30 to 2.32.

Annex 1

Draft terms of a potential market investigation reference

A1.1 In the event that, in light of the consultation responses, we decide that a market investigation reference to the CC is appropriate, we set out below the draft terms we are minded to use when making the reference.

TV Advertising

A1.2 Ofcom, in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act), hereby makes a reference to the Competition Commission for an investigation relating to the manner in which TV advertising is traded in the UK.

A1.3 Ofcom has reasonable grounds for suspecting that a feature or a combination of features of the market or markets for the sale and purchase of TV advertising prevents, restricts or distorts competition, in particular, in connection with:

1.3.1 possible poor transparency of pricing signals;

1.3.2 bundling of airtime may limit switching; and

1.3.3 possible barriers to evolution of the way in which TV advertising is traded.

A1.4 [DATE OF REFERENCE]

Definitions

A1.5 For the purposes of this reference:

A1.6 "**TV advertising**" means the transmission of television airtime on a television channel that a broadcaster or sales house may sell to third parties to show advertisements in.

A1.7 "**Ofcom**" means the Office of Communications.

Annex 2

Responding to this consultation

How to respond

A2.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 22 July 2011**.

A2.2 Ofcom strongly prefers to receive responses using the online web form at https://stakeholders.ofcom.org.uk/consultations/tv-advertising-investigation/howtorespond/form, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 4), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.

A2.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email tvadvertisingmir@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.

A2.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Siobhan Walsh
Competition Group
Riverside House
2A Southwark Bridge Road
London SE1 9HA

Fax: 020 7783 4109

A2.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.

A2.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 5. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

A2.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Siobhan Walsh on 020 7783 4145.

Confidentiality

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

A2.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.

A2.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at http://www.ofcom.org.uk/about/accoun/disclaimer/

Next steps

A2.11 Following the end of the consultation period, Ofcom intends to publish a statement in the Autumn.

A2.12 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see: http://www.ofcom.org.uk/static/subscribe/select_list.htm

Ofcom's consultation processes

A2.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 3.

A2.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.

A2.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Graham Howell, Secretary to the Corporation, who is Ofcom's consultation champion:

Graham Howell
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA

Tel: 020 7981 3601

Email Graham.Howell@ofcom.org.uk

Annex 3

Ofcom's consultation principles

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

Before the consultation

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

During the consultation

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

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

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

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

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

After the consultation

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

Annex 4

Consultation response cover sheet

A4.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, www.ofcom.org.uk.

A4.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.

A4.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.

A4.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at www.ofcom.org.uk/consult/.

A4.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

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

Nothing	☐	Name/contact details/job title	☐
Whole response	☐	Organisation	☐
Part of the response	☐	If there is no separate annex, which parts?	

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

DECLARATION

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

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

Name Signed (if hard copy)

Annex 5

Consultation questions

A5.1 There are 27 questions in this consultation document. When responding please explain your answers or views fully, providing examples and supporting evidence, where possible.

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

Question 2: Are there standard measure 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)?

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?

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

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?

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?

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

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?

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?

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?

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

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

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

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

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?

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?

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?

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?

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?

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

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

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?

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?

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?

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

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?

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