

Annex 5

Regulatory Impact Assessment

Introduction

- 1.1 This annex when read in conjunction with the rest of this consultation document represents an Impact Assessment (IA), as defined by Section 7 of the Communications Act 2003 (“the Act”).
- 1.2 IAs form part of best practice policy making and are commonly used by other regulators. This is reflected in Section 7 of the Act, which means that generally we have to carry out IAs where our proposals would be likely to have significant effect on businesses or the general public, or where there is a major change in our activities.
- 1.3 We analyse the impact on our stakeholders (e.g. listeners and broadcasters) and, where possible and appropriate, attempt to quantify the costs and benefits. Where it is not possible to quantify costs and benefits, we instead use a qualitative approach to discuss the types of costs and benefits generated by the options under consideration.
- 1.4 In accordance with Section 7 of the Act, in producing this IA, we have had regard to such general guidance as we consider appropriate, including related Cabinet Office guidance and our own IA guidelines¹.
- 1.5 Ofcom has various statutory duties in relation to regulation of broadcast radio services. These are set out in Section 3.
- 1.6 The Government’s Digital Britain report asks Ofcom to consult on changes to the regulation of localness on radio, subject to legislative change that it intends to ask Parliament for. This is in the context of our strategic vision for the radio industry that sets out three tiers of services: at the UK-wide, local, and small-scale levels. These points are all elaborated in Section 2.
- 1.7 The evidence base against which the impacts of our proposals are assessed consists of facts about the current radio market, qualitative and quantitative research on radio audiences, evidence about the current services delivered on commercial radio, and the economic picture for commercial radio. These are all elaborated in Section 4.
- 1.8 A separate Equality Impact Assessment follows.

Citizen and consumer interest

- 1.9 Our principal general duty – to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition – is the primary consideration in considering the impacts of our proposals.
- 1.10 A number of public purposes may be identified for the commercial radio sector². These include: sustaining citizenship and civil society, through the provision of news

¹ http://www.ofcom.org.uk/consult/condocs/ia_guidelines/condoc.pdf

² This has been discussed in previous consultations. For example, see *The Future of Radio: Localness on analogue commercial radio and stereo and mono broadcasting on DAB*, Ofcom, 7

and other information valued by communities; and representing and reflecting the UK, its nations, regions and communities.

- 1.11 Some public purposes may be provided by BBC radio services, but plurality in the provision of some services is important, particularly in relation to news, and therefore it is not sufficient as a matter of policy to leave the provision of these purposes to the BBC.
- 1.12 The two key objectives of policy are:
- To enhance choice, diversity and innovation for consumers at the UK, national, regional, local and community levels; and,
 - To secure citizens' interests through the provision of radio designed to meet public purposes.
- 1.13 It is desirable to achieve these objectives with as a little intervention in the market as possible. These objectives plus this bias against intervention, have provided where appropriate the set of criteria against which we assess our proposals.

Encouraging new UK-wide services - Section 5, Proposals 1 and 2

- 1.14 We would like to see the development of plurality and competition in national commercial radio broadcasting. This would include maximising possibilities for new entry to the market and the provision of new or different content including, where stations see a role for this and it is technically possible, local or regional content. This would in turn depend on some form of increase in spectrum capacity for such plurality and competition, including the possibility to differentiate content according to region or locality. We note below how this might be possible under a transition to DAB platform. A proposal to form, in effect a DAB multiplex with national coverage by merging regional DAB platforms would offer the possibility to differentiate content at the regional level.
- 1.15 A greater range of services would enhance consumer and citizen value from radio broadcasting. It might also remove the need for imposing obligations on stations concerning local content, where the commercial outcome can be expected to deliver output that consumers and citizens value.

Present position

- 1.16 Greater provision of plurality and choice across the UK has been limited by the relative lack of availability of spectrum, resulting in few national stations and a small set of regional FM stations. Given the relative lack of plurality and competition that results from this, there is a risk that content that listeners value, such as local content, would not always be provided, compared to the outcome that might have occurred were spectrum and the number of stations more abundant. Hence content output is subject to regulation by Ofcom to ensure that listeners have access to a minimum level of local or regional content.
- 1.17 Regulation currently requires that FM regional commercial stations must currently broadcast at least ten hours a day of locally made programming during weekday daytimes and four hours a day at weekends. While some of these regional stations,

such as Real Radio in central Scotland and south Wales, have made a selling point of their regional content, for others, such as Smooth or Galaxy (in the North East for example) the required regional content has also been strongly complemented by the type of music they broadcast. Smaller (non-regional) FM stations are also required to provide similar levels of locally made programming.

- 1.18 While it is clear that listeners value local content, it is less clear that this particular mix of regulation and localness output is optimal from the point of view of listeners or producers. It is possible for example that the current level of regulation on FM regional commercial stations is not at the right level, requiring more 'localness' than is optimal from the point of view of listeners. We note nevertheless that the evidence, as summarised in section 3 of the main document, indicates that listeners do value local content, for a variety of reasons.
- 1.19 We also note that, to the extent that stations would otherwise not have chosen to broadcast such local programming, these obligations will tend to increase station costs compared to a situation with no or fewer obligations.
- 1.20 Research suggests that advertisers would like to see more commercial UK-wide radio stations, with incremental audience delivery being more important than specific formats or genres. Advertisers also see strengths in local services and content, since some buy into commercial radio in order to plan and buy accurately and flexibly on a multi-local basis.

Options

- 1.21 The main document set out three options aimed at encouraging new entry, new UK-wide services and possibilities for regionally differentiated content. Option A is the status quo.
- 1.22 Options B and C concerned use of the DAB platform. That is, given that spectrum for analogue broadcast is limited, one option for encouraging new UK-wide services is to facilitate a move to the DAB platform. We note in the main document that such a transition has been impeded by two main problems to date, concerning:
- the difficulty for commercial stations to meet high DAB carriage fees while simultaneously building a DAB audience and revenue base; and
 - the fact that the existing national multiplex uses a single frequency method such that regional programming or advertising opt outs cannot be offered.
- 1.23 Using existing brands is one way to develop new (digital) UK-wide radio stations quickly as this would facilitate relatively rapid audience build. One possible route, then, to new UK-wide stations would be to allow the existing regional analogue stations to become UK-wide DAB stations, while retaining quasi-national FM coverage. The creation of a UK-wide DAB service might result from the expansion of current regional multiplexes such that regionalised differences in broadcasting could be retained.
- 1.24 Option B is to facilitate transition to a national (DAB) platform by removing, or altering, regional stations' obligations to carry local programming, in return for carriage on a national DAB multiplex.

- 1.25 Option C is to remove existing regulation concerning locally made programming. This would have the effect of giving regional stations the choice to make some cost savings and so increase their commercial freedom, including where they so chose, a move to the DAB platform and UK-wide services and regionalised content where they saw a role for this.

Parties likely to be affected

- 1.26 We assess here the options in terms of achieving our overarching aims and the costs and benefits associated with each option, and including where relevant consideration of affected parties. Those likely to be affected by the options are:
- Radio listeners
 - Radio industry, local, regional and national providers
 - Advertising industry
- 1.27 There may also be impacts on the competitive position in the associated radio and advertising markets.

Options and assessment

- 1.28 Our main policy lever in terms of encouraging new UK-wide services through the use of existing brands is to facilitate a transition to the DAB platform by removing for regional stations obligations concerning broadcast of locally made programming. This might be done in isolation or explicitly in return for a station making the transition to the DAB platform. We assess the options against the status quo.

Option A – The status quo

- 1.29 Were regional stations to remain regulated on the basis of present obligations, we would not on the basis of present market conditions or bearing in mind the experiences of provision of the DAB platform expect to see regional stations pursue a transition to DAB. On this basis, analogue transmission would continue with no increase in the availability of new spectrum to accommodate new UK wide services or new entry.
- 1.30 Our analysis of station profitability gives us no reason to think that under this option regional station viability would be compromised or that the option would encourage exit from the market. To this extent then, we would expect the status quo to continue to deliver some regional content as specified in obligations on regional stations. To the extent that listeners value these, consumer and citizen interests would continue to be protected.
- 1.31 To the extent that advertisers value some availability of regional differentiation and the ability to target certain geographical audiences, this option preserves that facility. Continued advertiser interest in this respect can enhance the commercial viability of regional stations and so contribute to the delivery of content valued by listeners. Given that this option does not expand the availability of spectrum or encourage new entry, we would not expect to see any significant change in the competitive environment for radio advertising.
- 1.32 The option is however - absent migration to DAB - unlikely to deliver further choice and competition in radio at national or regional level. This is simply because radio

spectrum for analogue broadcast is scarce. Analogue broadcasting allied with limited spectrum can result in limited choice in some localities. For example, spectrum in less densely populated areas adjacent to more densely populated areas has sometimes been used to serve the more densely populated area. This has denied the opportunity for some local output. This option is unlikely to contribute to our overall objective of encouraging new UK wide services or possibilities for regionalised services.

Option B

- 1.33 Option B has two potential effects which need to be assessed. First, we consider effects where a station chooses not to take this option. Second, we consider effects where it does take the option. We also need to consider the likelihood that stations will choose to take the option and so realise the associated costs and benefits.
- 1.34 In the first case, the effect will be to retain the status quo, as assessed under Option A above. Consumer and citizen interests will continue to be protected regarding current levels of localness output. However further developments regarding increases in spectrum capacity and possibilities for the development of further choice and competition in radio at national or regional level are unlikely to occur.
- 1.35 In the second case, national DAB capacity (of two multiplexes) is such that at present bitrates, around 20 commercial UK-wide stations might be carried.
- 1.36 Regional stations moving to nationwide broadcast as a result of this option would face a more competitive environment. Greater competitive pressure could be expected to result in higher quality programming, so allowing consumers a greater choice between local commercial services and national commercial services.
- 1.37 While it is difficult to assess how any one station might react to this environment, it is likely that a range of commercial strategies would evolve, each with the aim of enhancing audience share. Some might choose to focus on particular music genres for example, or others on particular audience segments or localities. This would also enhance choice and competition at all locations, offsetting any 'underprovision' of services that may have been a consequence of a limited number of regional stations in any one locality. We note that the possibility to provide competition at a national level would be provided by Digital One, which does not allow regional differentiation of content. Nevertheless the possibility to create a new regionalised multiplex with, in effect, national coverage through the expansion of regional multiplexes could provide a way for UK-wide stations to provide differentiated regional content if that is what listeners want.
- 1.38 Furthermore, since any transition to DAB platforms under this option is voluntary, this option would not see the imposition of additional costs through regulation. Stations would be able to make their own assessment of the case for the move to DAB and reduced obligations concerning localness against maintaining the status quo.
- 1.39 We note that since the consumer and citizen benefits of this transition depend on more spectrum availability and the prospect of greater competition and entry, it is appropriate to link any removal of regulation of localness associated with limited spectrum to the expansion of spectrum capacity via the DAB platform. This includes linking it to a DAB platform that offers possibilities for regional variation in content.
- 1.40 To the extent that stations choose to transition to DAB in the longer term and competitive pressures are enhanced there, competition in the related advertising

market should also benefit. Regional advertising may also benefit under possibilities for a second national multiplex with regional opt-out capability.

- 1.41 Concerning the likelihood of stations taking up the possibility to transition to DAB, in our view dropping obligations concerning locally made programming on a regional station in return for a transition to the DAB platform would provide encouragement for regional stations to make the transition. Cost savings obtained as a result of meeting fewer obligations for example provides one way of ameliorating the costs of transition to DAB described under Option C. These cost savings for existing regional stations could include regional bases or regional programming.
- 1.42 Risks and costs under this option are primarily linked to the extent to which stations may or may not choose to take up the possibility to transition to DAB in return for having regulation on localness dropped. To the extent that this is an insufficient incentive, the option risks merely extending the status quo. From a consumer and citizen perspective this would preserve existing benefits, but nevertheless reduces the prospects for an expansion in spectrum capacity and possible future competition and diversity in radio that this could bring.
- 1.43 This option also carries the risk that migration to DAB occurs but local content is not provided under the enhanced competitive environment. Such an outcome in a competitive market would tend to indicate that the demand for it was insufficient to justify the cost.

Option C

- 1.44 Option C is to remove all regional stations' obligations concerning broadcast of locally made programming, but with no requirement for national DAB carriage. This could in principle offer regional stations the freedom to decide to pursue a commercial strategy without the costs imposed by such obligations. Some stations may choose to invest the savings they derive from relaxation of the localness regulations in non-local programming that regionally based consumers and advertisers might value such as 'name' talent. Absent the costs of localness obligations, it may in principle also be in some regional stations' commercial interests to pursue a transition to the DAB platform.
- 1.45 We do not however see this as a likely strategy for most regional stations, were they to be freed from locally made programming obligations. The investment required to move to a DAB platform and simultaneously create a digital audience are likely to be significant and to fall on existing stations which choose to pursue this. Once a critical mass of digital listeners is attained it will be much less costly for competitors to enter as a digital broadcaster. There is therefore a 'free rider' problem where there is an incentive for any one party to wait for others to finance the transition to DAB platform and the creation of the necessary critical mass. Since this incentive applies to all parties, no party is likely to make the first move or investment and so the transition is unlikely to happen.
- 1.46 Consequently there is a significant likelihood that under this option the industry structure would largely remain unaltered. New entry would be unlikely to occur, and new UK-wide services are unlikely to emerge.
- 1.47 Moreover removing the obligation from regional stations would leave them free to choose what level of local content and output might be broadcast. While some might continue to find some commercial benefit in doing so, it is by no means clear that this will always be the case for all regional stations, or that the level of commercial

provision will be equal to or enhance the level compared with present regulatory obligations. Given that it is unlikely that spectrum capacity will be enhanced through this option, it is also likely that the industry structure will remain unchanged with the consequence that there remains a risk that content that listeners value, such as local content, would not always be provided. Removal of obligations concerning localness for example might be manifested in regional stations choosing to accrue any costs savings to themselves rather than continuing to invest in local content.

- 1.48 Given the value that listeners attach to local content, this option would risk losing directly these benefits that the regulation is aimed at bringing to listeners in terms of local content. The present market structure, characterised by lack of spectrum, market concentration and lack of opportunity for new entry is unlikely to foster the competitive vigour that might otherwise see more commercially driven provision of local content. There would be a consequent loss in consumer and citizen value. There is a significant risk that any longer term benefits in terms of moves to UK-wide services, new entry, and enhanced competition in provision of radio content would not be realised.
- 1.49 In addition to this, removing localness obligations from regional stations without imposing a requirement for national DAB carriage would afford regional stations an unfair competitive advantage over local stations (who would still be required to fulfil certain localness obligations).

Appraisal

- 1.50 Option C appears least able to meet our objectives since it offers many of the drawbacks with few of the benefits. That is, it risks the loss of local output without a significant expectation that benefits offered by a transition to DAB will be realised.
- 1.51 Option A is unlikely to provide regional stations with a commercial or regulatory environment that encourages them to switch to a digital platform. Hence it would not lead to any wider benefits in terms of plurality of radio provision, although it can be expected to maintain present benefits.
- 1.52 Option B we see as offering protection to consumers and citizens in some manner whether or not stations pursue the transition to DAB. We nevertheless consider that the effect of this option will be to encourage a transition to DAB, with accompanying longer term benefits of increased spectrum capacity, the possibility of entry, improved competition and the development of the market. This could include, where there is a commercial incentive, the provision of regionally diversified content. Overall therefore we see Option B as the one most likely to deliver against our objectives.

1.53 Table 1 below summarises our assessment of the options.

Table 1 Summary appraisal options for encouraging new UK-wide services

Option	A. Status quo	B. Remove obligations in return for transition to DAB	C. Remove obligations
Expected response / effect	<ul style="list-style-type: none"> - Regional stations do not make transfer to DAB platform - Local output remains largely unaltered 	<ul style="list-style-type: none"> - Regional stations encouraged to, and make, transition to DAB 	<ul style="list-style-type: none"> - Some regional stations likely to reduce or remove local output
Impacts on:			
Operators	<ul style="list-style-type: none"> - Little change for existing operators - No new spectrum for potential new entrants 	<ul style="list-style-type: none"> - Where transition to DAB is made, enhanced competitive environment - Where transition to DAB is made, regional stations likely to respond to increased competitive pressures in variety of ways 	<ul style="list-style-type: none"> - Some cost savings and additional freedom in terms of commercial operation
Listeners	<ul style="list-style-type: none"> - Status quo remains - Little prospect of longer term benefits in terms of wider choice 	<ul style="list-style-type: none"> - if there is no transition to DAB localness is provided through regulation. - If stations make transition to DAB, enhanced competition, new entry, market development and possible market-led provision of regional content. 	<ul style="list-style-type: none"> - Reduction in availability of local output
Citizens	<ul style="list-style-type: none"> - Any citizen benefits from existing local content output retained 	<ul style="list-style-type: none"> - If no transition to DAB, citizen value obtained from local output mandated under regulation - At best, citizen value obtained from enhanced competition and provision of any local output, although market may not fully capture BSV [broader social value] 	<ul style="list-style-type: none"> - Reduction in any citizen value obtained from local output
Appraisal against objectives	<ul style="list-style-type: none"> - Unlikely to achieve objectives 	<ul style="list-style-type: none"> - Encourages move to DAB whilst allowing for provision of regional content and hence option most likely to meet objectives 	<ul style="list-style-type: none"> - Unlikely to achieve objectives - Risks losing some present benefits

Regional services in the nations

1.54 The main document presents evidence that there is particularly strong listener demand for content produced in and focussed on the nations. This suggests that

such content delivers value to consumers and, by extension that the loss of such content would be especially detrimental to consumers' interests.

- 1.55 National identity has been shown to be particularly important to the populations of Scotland and Wales and research indicates that there is a strong desire amongst the people of the nations to preserve these identities.³ Both the study conducted by Essential Research in 2007 and the qualitative section of the local media research conducted by Ofcom in 2009 provided evidence that radio can play a role in the formation and strengthening of bonds between its audience and the geographic area which coverage is focussed on. It would therefore seem logical to argue that programming which is made in and focussed on the nations fosters, and solidifies national identity, thereby fulfilling the strong popular desire that national identity be preserved, promoting community cohesion and enhancing listeners' sense of belonging.
- 1.56 In addition to this, national programming has the potential to enable listeners to be better informed about issues affecting the nations and therefore better able to participate in national debates. This enhances the quality of democracy in the nations. For these reasons, programming made in and focussed on the nations delivers clear value from a citizen perspective. By extension, the loss of such content would be detrimental to citizens' interests.
- 1.57 In view of the citizen and consumer value attached to content produced in and focussed on the nations we propose that regional stations in Scotland and Wales must retain their specific nation focus.

Proposal

- 1.58 In the light of the analysis undertaken above, we therefore make the following proposals:

Proposal 1

Regional analogue stations (as defined by Ofcom – in Figure 1 above) may request to share all their programming. Ofcom may consent to this where those stations provide a version of the shared programme service on a national DAB multiplex. Where they do, our guidelines will be that they should not generally be required to broadcast local material and locally made programmes.

Otherwise, such regional analogue stations would be treated as large local FM stations and the relevant rules would be applied [see Proposals 3, 4, 6].

Due to the specific needs of the nations, regional stations in Scotland and Wales should have to retain their specific nation focus. In Wales, where there are separate regional services for South Wales and North & Mid Wales (not yet launched), these could combine to form a national service for Wales, provided that service was carried on either a national DAB multiplex or all local DAB multiplexes in Wales.

³ Ofcom local media research, April-May 2009. See also *The Future of Radio: Localness*, produced for Ofcom by Essential Research, 22 November 2007, available at <http://www.ofcom.org.uk/consult/condocs/futureradio07/localness.pdf>

Proposal 2:

Where any relevant statutory requirements are met, Ofcom should allow the six existing regional multiplexes (plus one of the three London multiplexes) to combine and extend their areas in effect to form a multiplex with national coverage but with the ability to offer regional opt-out programming and advertising, provided we are satisfied that:

- *doing so would be calculated to maintain or promote the development of digital sound broadcasting in the UK otherwise than by satellite;*
- *the licensees' proposed coverage plans are satisfactory;*
- *the licensees have the ability to maintain the licensed service; and*
- *there are sufficient safeguards in place to protect the rights and interests of stations carried on the multiplexes and the rights and interests of other multiplex operators (and the stations they carry);*

We would also be likely to expect one of the following criteria to be met, namely that the combination and extension of the multiplexes:

- *would promote choice in national radio services, in the interests of listeners;
or*
- *would be conducive to the maintenance or promotion of fair and effective competition in national radio services.*

We envisage a short consultation upon receipt of such a request.

Regulating for localness within a sustainable, universal local tier – Section 6, Proposals 3 and 4

Considerations for identifying and assessing options

- 1.59 In general, economic theory suggests that competitive markets can be expected to produce efficiently the goods and services which consumers value. Certain factors, such as a firm holding market power, might prevent such an outcome. A firm with market power might choose to maximise profits through reducing costs and quality, compared to what it might have been under a more competitive outcome. Regulatory intervention may be one way of addressing or ameliorating the extent of such ‘market failure’, for example by prescribing quality standards.
- 1.60 We described and discussed the idea of market failure in our second review of public sector broadcasting⁴. We also set out the economic and social policy arguments for intervention in the radio market during our first round of consultation on radio⁵. We noted a number of specific causes of market failure, such as market power and externalities. Any consequent need for intervention needs to be guided by a careful assessment of the source of any market failure.
- 1.61 In describing and discussing the idea of market failure, we also identified some aspects of the broadcasting industry and the ways in which consumers and citizens receive value from broadcasting as particularly relevant to determining whether broadcast markets might be susceptible to market failure. We note here particular features relevant to the commercial local radio sector and the implications for identifying and assessing regulatory options.
- 1.62 Radio broadcasting depends on the availability of radio spectrum. The availability and suitability of the spectrum for analogue radio broadcast has historically been limited, and has resulted in a relatively limited number of radio stations in any one area. Consequently radio stations have had some degree of market power in local advertising markets. A radio station that has market power has fewer incentives to innovate and maximise quality of output, including local content, compared to a more competitive market where a radio station with any such lack of provision would lose market share. Such market power would potentially result in an under provision of services, compared to the level which would maximise the sum of consumer and producer value. To this extent the market would be subject to market failure. Regulatory requirements regarding output and local content are one way in which this potential under provision and effects of market failure has been ameliorated.
- 1.63 Commercial local radio remains a medium that is free at the point of use to all listeners. Unlike broadcast television, pay services have not developed in radio broadcasting and hence neither have mechanisms to exclude non-payers from listening. This is likely partly because to do so could involve large costs in rolling out equipment necessary to implement a subscription service, with the likelihood that any net benefits here would be smaller than the existing advertiser funded model. In general, absent other mechanisms for funding output, an inability to exclude non-payers from a market and from consuming would normally be expected to result in all

⁴ See *Ofcom’s Second Public Service Broadcasting Review Phase One: Annex 11*, Ofcom, 10 April 2008, available at: http://www.ofcom.org.uk/consult/condocs/psb2_1/

⁵ See *Radio – Preparing for the future: Appendix D*, Ofcom, 15 December 2004, available at: http://www.ofcom.org.uk/consult/condocs/radio_review/radio_review2/appendixD.pdf

consumers choosing not to pay ('free riding') even where they have a positive consumer value for the product. This would result in an under provision of the good in question, and would be an example of 'market failure'.

- 1.64 However, commercial local radio is instead predominantly funded by advertiser revenue and sponsorship, with no charge for listening. To the extent that the return to the commercial radio station from sale of advertising is sufficiently well correlated with the value to listeners, this model of commercial radio provision can be an efficient way of delivering value to listeners (including the value they derive from interaction with other listeners) and avoiding market failure. Where advertising-generated profits are not well correlated with the value derived by listeners, the end result could be underprovision of the service, compared to the optimal level. This would be an example of market failure.
- 1.65 Commercial local radio can in principle also deliver significant broader social value. Essential Research have provided evidence that broadcast local content can foster for example a sense of belonging to a community.⁶ Moreover, as the main document has shown, local radio plays an important role in keeping people informed about what is happening in their local area. Commercial local radio can therefore be thought of as facilitating an informed local democracy and debate.
- 1.66 Since broader social value may be generated for any one citizen merely from the fact that the service exists even if he or she does not listen to the service,, it is conceivable that a purely commercial model of delivery would under-provide such services. This is because advertisers will only pay to reach those actually listening. An outcome with under provision would indicate some degree of market failure and so could be grounds for some regulatory intervention, where such intervention is effective and proportionate.
- 1.67 Overall, we take the view that commercial local radio makes an important contribution to consumer and citizen value. The evidence suggests that this is to a large degree based on the value of local content. At the same time, the market environment and business model for commercial radio funding may place limits on the level of localness and local output in some cases. That is, there are costs associated both with providing local output and focusing on smaller local areas, such that the degree of provision of 'localness' will at some point be constrained by the need to remain viable. Consequently we can refine our assessment of the regulatory options available concerning localness in radio in terms of the objective of preserving or maximising localness, subject to aiming to ensure that the resulting regulatory and commercial environment is reasonably likely to remain viable.
- 1.68 Our aim is to ensure that the second tier of radio services – the large local tier – is able to be sufficiently well resourced to provide the service expected of it in terms of local news, information and sense of belonging, while still being sufficiently local to be relevant to the communities it serves. We therefore assess which of the options is most likely to achieve this, in terms of:
- the option's ability to ensure or deliver increased cost savings and hence viability, as indicated by our analysis; and
 - the option's ability to provide more as opposed to less 'localness'.

⁶ See *The Future of Radio: Localness*

1.69 We also take into account any significant costs and benefits for each option in terms of any:

- Potential effects on competition in related markets;
- Uncertainty introduced through changes in regulation; and
- Costs of regulatory compliance.

1.70 These costs and benefits will primarily and most directly concern:

- radio listeners;
- citizens; and
- commercial radio station operators.

1.71 Other parties or industries that may be more indirectly affected include the market for radio advertising, BBC radio provision, and the local media industry.

Assessment of options

1.72 The main document sets out our five options for achieving our objectives:

- A Maintain the status quo – have a set of guidelines concerning local hours and co- location for all stations with the definition of “locally made” programmes remaining based on station’s existing broadcast areas
- B Use a different population figure to define such stations which benefit from the greater flexibility in our local hours and co-location guidelines, again with the definition of “locally made” programmes remaining based on station’s existing broadcast areas, but without necessarily having defined areas in which stations may co-locate or merge
- C Abandon specific criteria and treat all requests for co-location and programme sharing, on a case by case basis without reference to any specific guidelines.
- D Publish a map of new, defined areas for the whole country, based on existing DAB multiplex areas and the need to balance viability with local affinities. This would make the areas fit for a digital future – many multiplex areas are already based on the analogue areas of original ILR stations or on counties and so have an editorial coherence. We would use the areas as a basis for deciding whether to consent to requests by stations to co-locate and/or to merge by programme sharing (we would be more likely to agree to these between stations in the same area). Outside those areas Ofcom may grant permission for stations to co-locate or programme share if our existing co-location policy criteria are met.
- E Remove rules and regulation concerning localness and local production. For example, it would be possible to allow all stations to co-locate anywhere in the UK.

1.73 The base point for our assessment is the consideration and effects of the Option A, the status quo. We base our assessment on those parties most likely to be directly

affected by the options. Furthermore we note that Options B to E represent additional flexibilities to radio operators rather than binding requirements. Consequently any impacts, costs and benefits will depend, among other things, on the extent to which radio operators may choose to operate within the amended flexibility afforded by the option or not.

Option A – the status quo

- 1.74 Local Media Research conducted by Ofcom in 2009 found that 74% of weekly listeners who were interviewed stated that they were satisfied with the quality of local radio.⁷ Option A, the status quo would therefore appear to deliver a broadly acceptable level of local output, including in terms of delivering broader social value. These benefits are delivered to the extent that radio operators providing them remain viable.
- 1.75 The key question is therefore whether stations might be expected to exit the market in the light of the viability of providing such output. The extent to which smaller stations providing such output may be commercially viable, either now or in the face of a structural or cyclical downturn in the radio advertising market, is not clear. That is not to say that the status quo will see the exit of all or even a majority of local stations; rather that under this scenario there is a plausible risk of some closures in some areas and the associated loss of any local commercial content.
- 1.76 The work undertaken by Value Partners in 2009 suggests that a significant proportion of smaller stations (MCA less than 300 000) are presently recording a negative operating profit. Given that these are presently subject to current regulations regarding co-location and programme sharing (and hence scale), the financial position is likely to reflect, among other things, the implied costs of these regulations. Value Partner work estimated the benefits of co-location and mergers, and hence the implied cost of the current regulations, and found that removal of these costs had the potential to shift some stations from a negative to a positive operating margin. While not conclusive proof, this is indicative that the status quo means that current regulations are binding⁸ on some stations and moreover increase the risks to their viability.
- 1.77 It seems probable therefore that the effect of this option would be for the current regulations to remain binding on some stations and so risk viability and exit of a significant portion of smaller radio stations. Listeners will suffer the cost to the extent that such stations exit, but continue to receive value in those areas where stations do not exit. Similarly, there will be a loss of citizen value to the extent that some local content is not provided. There will be a cost on operators both in terms of those that are obliged to exit the market, and on remaining stations to the extent that existing obligations represent an additional cost.
- 1.78 Overall this option seems unlikely to deliver significantly against our objective. This option carries a higher risk of marginally viable stations exiting the market, since it does not permit additional commercial flexibility. Such exit would tend to reduce plurality of content for listeners while not guaranteeing everywhere appropriate local content.

⁷ Ofcom local media research, April-May 2009

⁸ 'Binding' in this context refers to the idea that, absent regulation, a firm would not choose to meet fully the requirements of the regulation. That is, the regulation 'binds' the organisation to an output that it would not otherwise have chosen, all other things being equal.

Option B

- 1.79 Option B, using a different population figure to define stations which benefit from the greater flexibility in our local hours and co-location guidelines, such that stations with coverage below this figure would be freed from such rules, could in principle enable smaller stations to co-locate and/or merge and so enhance viability. It would give stations some flexibility and allow them to exercise commercial judgement concerning any decisions to co-locate and/or merge and hence achieve relevant cost savings. As noted under our discussion of Option A, there is some evidence to suggest that a significant proportion of smaller stations (MCA less than 300 000) could benefit from, and would therefore choose to use, the additional freedom granted by a relaxation in order to enhance their viability.
- 1.80 Hence the option could have the effect of helping to secure the financial viability of these stations. Given that this option places no restraints on which stations might choose to merge or co-locate, stations would be free to choose on the basis purely of commercial strategy and to this extent any such decisions are likely to maximise the available benefits to viability and hence to station operators.
- 1.81 However this option takes no account of local affinities and allegiances or levels of competition in different areas. It would leave these decisions to commercial considerations, and to the extent that some stations chose to merge it is not clear that the outcome would always align local output with local preferences and the delivery of broader social value. This is because removing the regulation would not address the fundamental lack of competitive pressure that results from a relative lack of spectrum, and so commercial decisions by stations may not always align with the interests of consumers and citizens. To the extent that a significant portion of stations merge therefore this option is likely to see a reduction in 'localness' compared to the status quo.
- 1.82 Under this option therefore listeners and citizens will benefit to the extent that in the absence of the freedom given by this option, some portion of stations would choose to exit the market. The trade off would be that, to the extent that stations chose to merge or co-locate, listeners and citizens would continue to receive a service, but with a reduced level of local content; that is, content would be related to a larger geographic area rather than smaller.
- 1.83 This option can be expected to deliver well against part of our objective, which is to encourage possibilities for the maintenance of viable local stations. However it is not clear that this option would result in station choices that act overall to maximise the value derived from localness, since decisions on mergers or co-location would not necessarily align fully with consumer and citizen interests, including taking account of expressed local affinities.

Option C

- 1.84 Option C, the abandonment of specific criteria for local output and the adoption of a wholly case-by-case assessment of local radio station's request for amended conditions would have the principal benefit of allowing some commercial flexibility while allowing Ofcom as regulator to make an assessment concerning the impact on local provision.
- 1.85 Under this option and on the basis of the VP modelling work, again we might expect a significant portion of smaller stations to seek amended conditions, in order to enhance viability. To the extent that regulation under the status quo is binding and

hence adversely affecting viability, this option again helps to ensure viability. Under this option, any station's decision to seek amended conditions would be subject to a wholly case-by-case assessment by Ofcom and so introduces a degree of uncertainty from the station operator's perspective. Such uncertainty could tend to reduce a station's incentive to seek a relaxation in conditions. Hence the criteria for judging cases are key. The stricter the criteria, the less likely are stations to be able to choose to exercise flexibility under this option and the more likely any marginally viable stations are to exit the market.

- 1.86 The process would also involve a significant degree of input and judgement from Ofcom as the regulator. It would likely require a public consultation exercise each time a change was requested. It might risk introducing a perverse incentive for stations to prove themselves on the brink of being unviable in order to seek regulatory approval. It is not clear that such an approach would deliver significantly enhanced viability compared to the status quo option.
- 1.87 From the listener's and citizen perspective, one possible outcome of this option would be that few stations seek or succeed in achieving relaxation of conditions, and that, as under the status quo option, there is some exit from the market with accompanying loss of service and value to listeners and citizens. A more likely scenario would be that some stations are able to achieve some relaxation of conditions and so do not in this event exit the market. The result is that some localness would be lost as some smaller portion of stations exit the market, while other stations merge or co-locate such that some service is retained, but with local content given on a less refined geographic basis.
- 1.88 This option could in principle deliver a good outcome against our objectives if Ofcom were in a position to identify correctly and optimise the trade off between any station requests and the need to reflect local needs and affinities, where these conflict. In practice such judgements would inevitably carry a degree of subjectivity and would be made on the basis of a relative paucity of information and data. Nevertheless it might in more narrow terms be expected to deliver well against our objective of enhancing possibilities for stations to remain viable. However it also has the disadvantage that it could potentially introduce an incentive for stations to emphasise their lack of viability in order to strengthen their case for relaxation of some regulatory requirements.
- 1.89 The relative balance of these advantages and disadvantages would be partly determined by the process and criteria for assessing case by case applications. However, there is a risk that, if the process becomes burdensome or if the criteria cannot be defined or applied with sufficient precision, this option will fail to deliver the maximum benefit to consumers and citizens.

Option D

- 1.90 Option D is the provision of a geographical framework – ie. map – which would guide where some relaxation of 'localness' requirements might be acceptable. This option aims at striking a balance between allowing some commercial freedom for existing local radio stations to co-locate and/or merge, but in a way that maps to relevant local affinities and with the aim of preserving relevantly targeted local output. The option provides some flexibility for stations to merge or share in order to enhance viability.
- 1.91 Operators who are presently budget constrained may choose to react to such an option by seeking merger or co-location within the constraints that the map

represents. Given the VP analysis, again this could be a significant portion of stations. It is not clear, however, to what extent stations which would wish to merge would always be able to do so given the geographical framework laid down under this option. It is likely, all other things equal, that the requirement to remain within the confines of the Ofcom determined map would prohibit some sub set of marginally viable stations being able to exercise choice here, with the result that some choose to exit the market.

- 1.92 Listeners and citizens may benefit from this option to the extent that the geographical framework aims at reflecting the minimum acceptable level of refinement of geographical base. Where some stations choose to exit the market there would be a loss of plurality of broadcasting, but nevertheless it is likely that most listeners would retain access to some form of local content, even if the geographic region becomes wider. This option does carry a risk however that a pre-determined or too inflexibly determined map would fail properly to recognise or maximise local affinities and the delivery of broader social value. In this case this option risks restricting choice and changing listening habits in ways that do not maximise consumer and citizen value.
- 1.93 This option aims at striking a balance between allowing stations further degrees of freedom in terms of achieving an appropriate level of operating costs and hence viability, and providing listeners and citizens with a minimum and well defined sense of relevant local areas and hence content. There are risks nevertheless in terms of the need to define these areas and potential impacts on the choice set of marginally viable stations. However compared to Option C it reduces the need for other types of regulatory judgement and the associated risk of getting this wrong and does not have the risks of perverse incentives. This option appears more likely to meet our objectives than the status quo. Given that this option is designed to recognise local affinities in a structured manner, where the map is appropriately designated, it appears to meet our objectives better than Options B and C.
- 1.94 This option may also have some additional advantages in that it could help to deliver some improved coverage from merging some small adjacent multiplexes, or of extending existing multiplexes into currently unserved areas.

Option E

- 1.95 Option E is the removal of all rules and regulation concerning localness and local production. For example, it would be possible to allow all stations to co-locate anywhere in the UK.
- 1.96 This option would give all stations flexibility and allow commercial judgement to determine the amount of local content and production. As noted under Option A, there is some evidence to suggest that smaller stations are more likely to take advantage of such a facility. This option thus has the advantage of maximising opportunities for stations to make unconstrained commercial decisions concerning co-location and merger such that the likelihood that stations remain viable is maximised.
- 1.97 The clear downside is that such an approach could have a large and also unpredictable effect on the volume and type of local content (if any) broadcast. There is also no guarantee that local content broadcast would always fit well with local affinities. The approach could represent a large step change in the type of content that listeners value and would not meet our objectives in this regard well. Compared with Options B, C, and D, which all offer some degree of trade off and the need to protect consumer and citizen interests through providing listeners with valued

local content to some degree, this option does not perform well against our objectives.

- 1.98 In any event, the reality is that Option E is possible neither under present legislation nor under proposed legislation.

Appraisal

- 1.99 Of the options outlined, Options A (the status quo) and E (removal of regulatory requirements) can be expected not to deliver strongly against the objectives. The status quo for example risks exit of non-viable smaller stations while Option E offers no guarantee that it protects consumer-citizen interests compared with Options B, C, and D. Options B,C and D enhance commercial flexibility of stations to some degree, with Option B more focused on the smaller and more likely marginally viable stations, and so help to preserve viability and reduce exit. Option C might meet our objectives well in principle but requires a great deal of information and regulatory judgement that in practice would make it difficult to achieve a good outcome. Options B, C, and D carry an increased risk that commercial freedom may not produce outcomes that meet sufficiently consumer-citizen interests in terms of local output and affinity. Option D attempts to strike an appropriate balance here, by creating the potential for greater commercial freedom, so enhancing viability and reducing chances of exit, while providing a geographical framework more directly linked to consumer-citizen interests.

Proposal

- 1.100 Overall therefore we see Option D as the one most likely to deliver against our objectives. We therefore make the following proposals:

Proposal 3

Ofcom will define a set of areas covering the whole UK, as shown on the map⁹. These proposed areas will deliver the localness listeners value, taking into account existing transmission areas, scale/viability, and local affinities.

Within defined areas, stations would be able to request to co-locate (and produce their 'locally made' programmes). Ofcom would be likely to consent to such requests provided we were satisfied that the stations involved would continue to meet their licence obligations to provide local material relevant to listeners in their licensed areas.

Outside these areas, we would continue to consider requests for co-location on a case-by-case basis using the existing criteria of size, affinities and financial viability.

Proposal 4

Within defined areas, stations would be able to request to share all of their programming, effectively allowing them to come together to become larger, more viable stations. Provided any statutory requirements are met, Ofcom would be likely

⁹ The map is illustrative only. A list of the areas showing which analogue stations and which local DAB multiplexes are included in each defined area is shown in Annex 10.

to consent to such requests provided we were satisfied that the stations involved continued to meet their licence obligations to provide material that remains locally relevant to each part of their licensed areas. We envisage short consultations in most cases.

Where stations not in the same defined area request to share programming we will continue to consider requests on a case-by-case basis using the existing criteria of size, affinities and financial viability in our localness guidelines (well as being likely to require that the relevant stations satisfy us that they will continue to meet their local material obligations). We envisage short consultations in most cases.

Table 2 Summary appraisal options for regulating localness within a sustainable universal local tier

Option	A. Status quo	B. Relax rules for stations under a certain size	C. Judge requests for relaxation of conditions on a case by case basis	D. Publish map of suggested minimum local areas, use this as a basis for deciding where to allow co-location and programme sharing	E. Remove all regulation
Expected response / effect	<ul style="list-style-type: none"> - Most local radio stations deliver 'localness' - A significant portion of stations, for whom the existing requirements exceed their budget constraint, may exit - Listeners continue to receive value, to the extent that stations do not exit 	<ul style="list-style-type: none"> - Marginally viable stations may choose to merge or co-locate - Some loss of localness in terms of refinement of geographical area - Mergers may occur that do not necessarily reflect local affinities 	<ul style="list-style-type: none"> - Marginally viable stations may choose to merge or co-locate, but subject to uncertainty of case by case basis - Likely to result in more exit compared with Option B - Could introduce perverse incentive for stations to over emphasise their non-viability - Depends substantially on policy / certainty for judging case by case basis 	<ul style="list-style-type: none"> - Marginally viable stations may choose to merge or co-locate, but subject to constraints of pre determined map - May result in more exit compared with Option B - Some small improvements in coverage possible 	<ul style="list-style-type: none"> - Marginally viable stations may choose to merge or co-locate – likely to be smaller stations - Potentially large loss of localness in terms of refinement of geographical area - Mergers may occur that do not necessarily reflect local affinities
Impacts on:					
Operators	<ul style="list-style-type: none"> - Risks exit of marginally viable stations 	<ul style="list-style-type: none"> - Greater commercial flexibility for marginally viable operators under a certain size - Likely that a significant portion of stations would choose to make use of flexibility here - Smaller risk of full exit compared to Options A, C, D 	<ul style="list-style-type: none"> - Some flexibility to merge or co-locate, so may help operators stay in market - Likely that a significant portion of stations would choose to make use of flexibility here - Smaller risk of full exit compared to Options A, D 	<ul style="list-style-type: none"> - Some flexibility to merge or co-locate, so may help operators stay in market - Setting out map increases certainty for operators compared with Option C. - Likely that a significant portion of stations would choose to make use of flexibility here - Smaller risk of full exit compared to Options A, D 	<ul style="list-style-type: none"> - Full commercial flexibility for marginally viable operators - Likely that a significant portion of smaller stations would choose to make use of flexibility here - Smaller risk of full exit compared to Options A, C, D
Listeners	<ul style="list-style-type: none"> - Risks reduction of service and less local output 	<ul style="list-style-type: none"> - Less risk of exit and some geographic areas having no coverage or less choice - Commercial choice of stations may not reflect local affinities 	<ul style="list-style-type: none"> - Localness of output maintained or protected, to extent there is no exit - Case by case basis allows local affinities to be recognised 	<ul style="list-style-type: none"> - Localness of output maintained or protected, to extent there is no exit - Setting out map allows local affinities to be recognised and established in advance 	<ul style="list-style-type: none"> - Less risk of exit and some geographic areas having no coverage or less choice - Commercial choice of stations may not reflect local affinities
Citizens	<ul style="list-style-type: none"> - Loss of some local output, reduces any BSV that this would otherwise give 	<ul style="list-style-type: none"> - Any redirection of local output to areas that do not map to local affinities risks 	<ul style="list-style-type: none"> - Localness of output maintained or protected, to extent there is no exit 	<ul style="list-style-type: none"> - Citizen value of local content associated with particular geographic areas can be 	<ul style="list-style-type: none"> - Any redirection of local output to areas that do not map to local affinities risks

		reducing BSV associated with geographic boundaries better aligned to local affinities	- Case by case basis allows local affinities to be recognised, and any BSV given here is maintained	recognised and established in advance	reducing BSV associated with geographic boundaries better aligned to local affinities
Appraisal against objectives	- Risks viability of a significant portion of smaller stations and hence local output	- Maximises choice and hence likelihood of lack of exit for marginally viable stations - Some risks for delivering appropriate local content	- Introduces uncertainty for stations wishing to benefit from relaxation and so increases likelihood of exit, compared to Option B	- Trades off allowing stations flexibility to achieve relevant cost savings and so reducing exit against need to recognise and preserve local output at suitably refined level	- Maximises choice and hence likelihood of lack of exit for marginally viable stations - Higher risks for delivering appropriate local content compared with other options

Allowing mergers of local multiplexes within the defined areas – Section 7, Proposal 5

1.101 Within these specified areas, multiplex operators could seek Ofcom's consent to offer the same services across the relevant local multiplexes, in effect merging them into a single area, as far as programme services are concerned.

1.102 The *Digital Britain Final Report* suggests that new legislation will be aimed at:

*encouraging, where appropriate, adjoining multiplexes to merge and extending existing multiplexes into currently un-served areas rather than awarding new licences*¹⁰

1.103 *If the appropriate* legislation is passed, Ofcom may by changing the assigned frequencies, be able to align the frequencies of adjacent multiplexes (provided they carried the same programme services) so as to improve coverage now or make future expansion of coverage more effective.

1.104 Individual cases will likely be subject to consultation following an approach made by multiplex operators to Ofcom, as Ofcom will consider each on its merits, but we are proposing a general approach constituting a policy decision, the options for which will be a simple binary choice and are therefore not specified in the consultation document:

- Option A: do not align frequencies of adjacent multiplexes
- Option B: align frequencies of adjacent multiplexes

1.105 The extent to which this option is pursued across the UK, then, is subject to the incentives upon multiplex operators in a series of local instances. It would be difficult at this stage to make a general prediction of how many approaches might be made to Ofcom.

1.106 The affected parties will be

- Multiplex operators
- Operators of stations carried on those multiplexes
- Radio listeners

1.107 **Option A**

- Would result in no improvement to coverage, which would be to the detriment of listeners who could benefit from that coverage and/or improvement or maintenance of local digital sound broadcast services.
- Would be at no cost to multiplex operators
- Would carry an opportunity cost for station operators, who would lose a potential opportunity to increase their MCA

1.108 **Option B**

¹⁰ *Digital Britain Final Report*, Radio Chapter, para 26

- Would be at the cost of re-engineering the multiplexes: these would be carried by the multiplex operators, but passed on to stations – likely conflated with increased transmission costs arising from covering areas of increased size
- The costs to stations might also be indirect: by losing the ability to target specific areas
- On the other hand, there would be some operating cost savings for multiplex operators, which may in turn be passed on to stations
- Most importantly, coverage would generally be improved and/or local digital sound broadcast services would be maintained or improved, both in the short-term and the longer term, and this would benefit listeners and stations, who could make more advertising revenue from their increased MCA

Table 3 Summary appraisal of options for allowing mergers of local multiplexes

Option	1. Status quo	2. Align frequencies
Expected response / effect	- n/a	- Some multiplex operators will apply to merge local multiplexes within defined areas, by aligning frequencies of adjacent multiplexes
Impacts on:		
Multiplex operators	- n/a	- Possible operating cost savings, but capital investment needed
Service operators	- n/a	- Transmission costs could change to reflect costs and savings of multiplex operators - Possibly indirect cost, losing ability to target advertising, but also possible indirect gain, in increased MCA
Consumers and citizens	- No improvement of coverage or services	- Improvement of coverage or services
Appraisal against objectives	- Would not improve coverage or services, or improve chances of viability	- Could meet objectives of improved coverage, and greater possible viability for stations and multiplex operators, if cost savings are realised

Proposal

- 1.109 Overall, we suggest that the benefits might outweigh the costs: a sustainable local structure will be realised, allowing a migration to universal, local DAB transmission, with the consumer benefits of greater choice of, and competition in, services and the extension of those services into un-served areas, and the additional functionality on DAB. We therefore make the following proposal:

Proposal 5

Within the defined areas, local multiplexes should be allowed to merge, including by sharing frequencies (if possible), and be extended into any un-served localities within the defined area, where Ofcom consider that appropriate. We are likely to do so where:

- *any statutory requirements are met;*
- *we consider each of the following criteria are met:*
 - *the merger and/or extension would be calculated to maintain or promote the development of local digital sound broadcasting otherwise than by satellite;*
 - *the licensees' proposed coverage plans are satisfactory;*
 - *the licensees have the ability to maintain the licensed service; and*
 - *there are sufficient safeguards in place to protect the rights and interests of stations carried on the multiplexes and the rights and interests of other multiplex operators (and the stations they carry);*
- *One of the following criteria are met, namely that the merger and/or extension:*
 - *would not unacceptably narrow the range of programmes available on local digital sound programme services to those living in the area or locality covered by the multiplexes;*
 - *would be conducive to the maintenance or promotion of fair and effective competition in that area or locality; or*
 - *is supported or demanded to a significant extent by those persons living in that area or locality.*

We envisage short consultations in most cases.

This proposal is subject to the relevant legislation being passed by Parliament.

An enhanced news option for local FM stations – Section 7, Proposal 6

1.110 This proposal concerns the specific question of giving local stations the choice of enhancing their news provision. The policy objective here is to secure more and better news provision for listeners via local radio.

1.111 We have this policy objective because our research shows that the type of local content most valued by listeners is news; and news is also the most important content type from a citizen perspective. This is discussed at greater length in the consultation document,

1.112 News, however, is not the only type of local content valued. Our research suggests that other types are also important, including 'softer' types of local content that have a community-building and identity-reflecting function for listeners, and that content produced locally is important. We would therefore not offer an option of stations only providing news, and not other types of locally made, locally focused content.

- 1.113 We do not propose to increase the regulatory burdens on an industry that our analysis shows is facing difficult times. For this reason we do not propose to force any station to alter its current programming if it does not wish to. We propose instead to give stations an option of carrying on with present local content requirements, if that is their freely taken commercial decision.
- 1.114 Changing the balance of local programming, and complying with a strengthened news requirement, would carry costs for stations, and we anticipate that there would need to be an incentive for stations to select an option that carried these costs. Our proposal is therefore that in return for an enhanced news requirement, stations should be allowed to reduce the number of hours of locally made programming, although still provide a substantial quantity of such programming.
- 1.115 We propose here that that reduced number should be seven, down from ten hours per day. The number seven was chosen because industry responses to our 2007 consultation *The Future of Radio* argued that, if Ofcom considered that regulation of hours of local content was appropriate, then the limit should be set at seven hours on weekdays in order to allow stations maximum flexibility.¹¹ A reduction of three hours here seems to us to be substantial enough to have a possible material impact, but small enough to guarantee locally produced content in quantities that serve the needs of audiences.
- 1.116 The affected parties will be:
- radio stations
 - radio listeners (from citizen and consumer perspectives)

Assessment of options

1.117 The policy options are:

- A Status quo (continue to require 10 hours of local content per day during weekday daytimes, including breakfast, and a minimum of 4 hrs/day at weekends during daytime plus local news at peak times)
- B Offer stations the choice instead of having an enhanced news option, whereby during week days, local news should be broadcast at least hourly during day times, rather than only at peak times; this would be in return for broadcasting seven hours of local content per day rather than ten. Weekend requirements would be the same.

Option A

¹¹ *The Future of Radio: Localness on analogue commercial radio and stereo and mono broadcasting on DAB*, para A2.17

- 1.118 Option A would have the benefit of continuing the present level of local content, which our research suggests is valued by listeners.

Option B

- 1.119 As we discuss below, there is reason to believe that reducing locally made content in return for increased news provision would be commercially advantageous to some stations. Consequently, it is probable that Option B would result in a reduction in the amount of locally made hours broadcast on local commercial radio. The research conducted by Ofcom in 2007 found that most respondents 'were surprised and concerned' when the possibility that the amount of local material and locally-made content might be reduced was raised. This could be interpreted as suggesting that Option B will in the short term cause a degree of detriment to listeners.
- 1.120 However, research also consistently shows that the local content type most valued is news, and so it seems probable that, overall, consumers would be content with the improvement of news delivery, at the cost of a limited number of locally produced hours. (There is no research that specifically examines this trade-off, but we would welcome views and evidence on this)
- 1.121 The discussion in the paragraph above has a parallel discussion in the citizen rather than the consumer perspective. On one hand, local content is important for citizens: research shows it playing an important role in instilling a sense of local identity and in serving groups who might be particularly dependent upon the radio such as the elderly, shift workers and those who live in rural areas. Thus, locally made content benefits society as a whole. On the other hand, the citizen benefits to enhanced news provision are clear: news plays an important role in local democracy, in the holding to account of local authorities, and in the democratic participation of individuals in local communities.
- 1.122 To the extent that stations chose to take advantage of the freedoms afforded to them, Option B would have the benefits of increasing the quantity and quality of local news delivered by local commercial stations. In view of the particularly high value listeners place on local news, there is reason to believe that an increase in the amount of local news will largely counter-balance any detriment to listeners occasioned by a reduction in locally made content.
- 1.123 Option B would also possibly allow some limited cost savings by stations, if they were to centralise production further (by reducing locally made programming). This would deliver some cost savings: our estimate published in *Building on the Myers Review* was that, if all stations opted for this possibility, the industry as a whole could save up to £3m per annum. This was based on the assumption that a given station might save one presented shift as a result of the local hours requirement being reduced by three hours per day.
- 1.124 On the other hand, it is possible that the provision of an enhanced news service could imply costs for stations, particularly if it was necessary for example to employ more journalists. Our initial assessment is that this would not be necessary in many, if any cases. Because news is already a requirement, stations will have invested already in staff and equipment necessary to produce and broadcast it. It is likely that changing the nature of the news, and the frequency with which it is broadcast, would not alter these fixed costs. We therefore anticipate modest net savings in the case of most if not all stations choosing this option.

1.125 These savings are not the primary motivation for the policy, but rather intended as an incentive for stations to select the option. To the extent that they do help the chances of station viability, however, they would have a positive effect, in line with arguments made above in this Annex, and from this perspective too – as well as the news one – have a positive net effect on listener welfare.

Table 4 Summary appraisal of options for offering an enhanced news option for local stations

Option	1. Status quo	2. Enhanced news option
Expected response / effect	- [Local content produced as at present]	- Some stations are likely to opt for the enhanced news option, and so across the UK, in some areas listeners to local commercial radio will have an enhanced news service but possibly fewer locally produced hours per day.
Impacts on:		
Stations	- [None, compared to present]	- For stations who select the option, there may some costs and some savings and benefits. Both are likely to be limited, and there will probably be little overall net effect in financial terms.
Listeners	- [None, compared to present]	- For listeners to stations who select the option, there will be benefits, from both citizen and consumer perspectives, in the enhanced news provision, and possible costs, in terms of a decreased quantity of locally produced hours.
Appraisal against objectives	- Locally produced content continues to be guaranteed at current levels, with the benefits for consumers that entails.	- Locally produced content does not drop substantially, but news provision is enhanced.

1.126 Overall, the impact is mainly on listeners rather than stations: for the latter, as any changes would be voluntary, it is reasonable to assume that stations making the change would be better off, with an approximate cancelling out of costs and savings as the worst case. It is also possible that, if listeners do value news more highly, there might be some increased listenership and hence advertising revenue. For listeners, and distinctly from both consumer and citizen perspectives, there is a small cost in terms of locally produced hours, but a greater gain in terms of enhanced news provision. Overall, then, the objective of improving news provision on local radio would be achieved, to the extent that stations select this option.

Proposal

1.127 Our proposal is therefore:

Proposal 6

Any FM station (or stations which are allowed to share programming) generally should produce locally-made programming for either:

1. *A minimum of 10 hrs/day during weekday daytimes (including breakfast) and a minimum of 4 hrs/day at weekends during daytime plus local news at peak times, or*
2. *A minimum of 7 hrs/day during weekday daytimes (including breakfast) and a minimum of 4 hrs/day at weekends during daytime plus local news at least hourly during daytime (weekdays) and weekend peak.*

The rules concerning local material within locally made programming would also change: the localness guidance would still apply generally, but we propose some revised guidelines, the key new requirement being that local news should be regularly refreshed and updated (the full proposed guidelines are in Section X).

We may allow particular stations to broadcast less local material and locally produced programmes where in exceptional cases particular factors make that appropriate. No licensee would be required to produce more local output than they do currently.

Reduced hours for AM stations, except nations stations – Section 7, Proposal 7

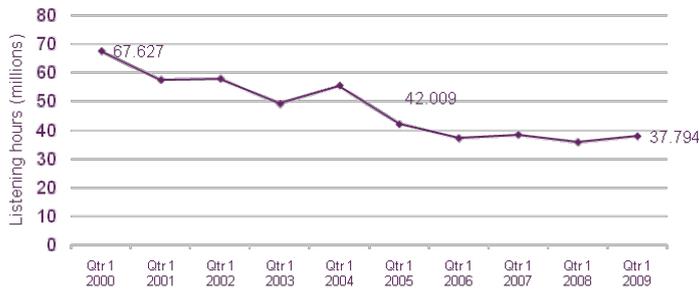
The present position

- 1.128 The first batch of local commercial stations licensed in the 1970s and 80s all simulcast on both AM and FM. In those days, the majority of listening was on AM. But in the late 1980s simulcasting broadly stopped as it was seen as wasteful of limited frequencies. Stations were allowed to and encouraged to offer different services on AM and FM. Subsequently FM listening grew while AM declined.

Today, of the 25.6 million weekly listeners to local commercial radio around one tenth (2.9 million adults) listen on AM. The majority of the services now offered on AM are simulcast on digital platforms including DAB.

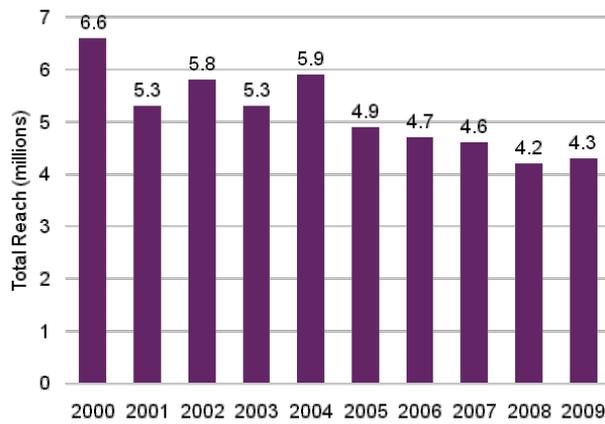
- 1.129 Total listening hours for local commercial stations broadcasting on AM have fallen by 11 per cent in the past 5 years and by 44 per cent in the past decade. Similarly, there has been a steep fall in the actual numbers of listeners who tune in to local commercial AM stations over the past decade. As figure 3 shows, a substantial proportion of the reach of local commercial stations which broadcast on AM is now accounted for by listeners who tune into these stations' DAB simulcasts.

Figure 1 Year on year changes in total listening for all AM ILR



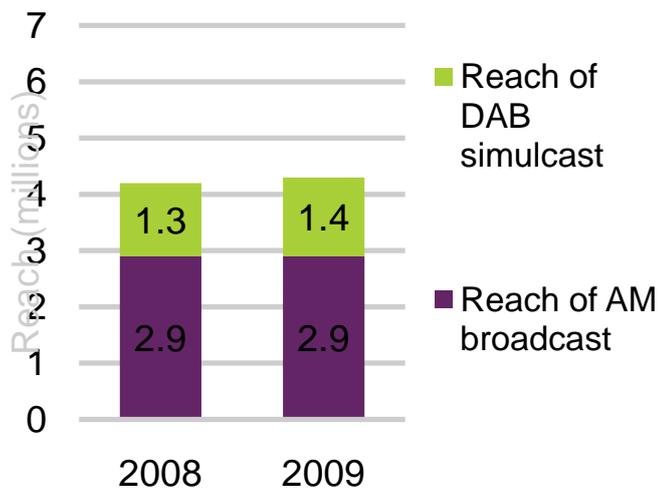
Source: Rajar/Ipsos/MORI/RSMB

Figure 2 Total reach of all local commercial stations broadcasting on AM



Source: Rajar/Ipsos/MORI/RSMB Q1 2000-2009

Figure 3 Breakdown of reach of local commercial stations broadcasting on AM



Source: Rajar/Ipsos/MORI/RSMB Q1 2000-2009

- 1.130 The ongoing decline in local commercial AM listening is likely to reduce AM ILR's potential to maintain advertising revenues and therefore poses a serious threat to the sustainability of local commercial AM stations. The sustainability of these stations is further undermined by the fact that AM stations are faced with higher transmission costs than stations broadcasting on FM and by the fact that the AM band offers lesser sound quality than both the FM band and DAB, placing AM stations at a competitive disadvantage.
- 1.131 Given the especially acute nature of the decline in listening to local commercial AM stations, the higher transmission costs these stations face and the inferior sound quality offered on AM, the business model for local commercial AM stations is likely to be vulnerable to financial pressures, over and above those we have analysed in the main document for (smaller) local stations broadcasting on FM. This is particularly the case for services which carry the additional financial burden of simulcasting the service on the local DAB multiplexes.
- 1.132 Under the digital upgrade outlined in the Government's *Digital Britain Final Report*, all listening on AM would cease on a common date: 2015 if DAB coverage and penetration criteria are met.
- 1.133 At present, our guidelines are that local commercial AM stations should generally broadcast four hours per day of locally produced programming. Stations in Scotland, Wales and Northern Ireland are required to produce a minimum of 10 hours of programming within the nation where the station is based. Even producing this localness comes at a cost.

Options

- 1.134 We suggest in this consultation that local AM stations are particularly exposed to the current financial conditions of the industry; that they are experiencing a listening decline compared to FM stations; that their current relatively low localness obligations mean that it might plausibly be suggested that listeners do not in any case listen to such stations primarily for localness; and that the Government's proposed policy of digital upgrade will in any case lead to the end of this tier of the industry. In this situation, we believe that costly regulation is not proportionate to the degree of any market power the AM stations might possess. We therefore propose ending the localness requirement upon these stations.
- 1.135 The exception, however, is in the case of stations in the nations, where localness programming has a particular value. We suggest that during weekday day times local commercial AM stations based Scotland, Wales and Northern Ireland produce a minimum of 10 hours of programming within their home nation (unless the station already does less than this).
- 1.136 The objective of this proposal is to make AM ILR more viable and thereby increase the chances that some form of localness is preserved on the AM band (at least where the market dictates its provision), thus maximising citizen and consumer value.
- 1.137 We assess here the options of adopting our proposed policy, or remaining with the status quo:

Option A Status quo

Option B AM stations generally need no longer produce locally made programming or carry local material. But a minimum of 10 hours during weekday daytimes should be produced within the nation where the station is based (unless the station already does less than this).

- 1.138 The relaxation of localness regulation would give local commercial AM stations the freedom to centralise more production. We anticipate that this would allow a significant proportion of local commercial AM stations to make cost savings and would, by extension, place these stations in a better position to confront the severe structural and cyclical pressures currently being placed on their business model.
- 1.139 As with our other proposals, this one is to allow stations the freedom to relax their locally produced hours, not a requirement to reduce. Each station would have the freedom to make its own commercial decision as to the impact reducing local hours would have on revenues and adapt its strategy accordingly.
- 1.140 The principal benefit of the proposal is in reducing the costs of running an AM service. We anticipate corresponding improvements in viability resulting from the changes. Maintaining the status quo would constrain local commercial AM stations' ability to cut costs, thus limiting their ability to confront the financial challenges with which they are faced and making them more likely to become unviable and exit the market.
- 1.141 In view of the cost savings likely to be associated with centralising production, we believe that if the proposal were adopted many local commercial AM stations would take advantage of the freedom to cease producing content locally, resulting in a reduction in the availability of locally produced content on the AM band. On the other hand, if audiences value the local content, AM stations may be under some incentive to provide it anyway to compete with the FM stations.
- 1.142 As we have discussed, locally produced content has been shown to provide both citizen and consumer value. However, as has been demonstrated, listening to local commercial AM stations only accounts for a small fraction of total listening to local commercial radio. Moreover, in view of the relatively low localness obligations to which local AM stations are subject, there is reason to believe that citizens and consumers do not primarily listen to these particular stations because of the local content they provide. Consequently, we suggest that any reduction in citizen and consumer value which resulted from the proposed policy would be low.
- 1.143 In addition to this, for reasons outlined above we believe that it is likely that the number of local commercial AM stations that would survive would be greater than under the status quo. Where stations close, their local provision will by definition be removed entirely, and so, to the extent that market incentives would dictate that some of these stations continued to incorporate localness into their programming in some way in the absence of a regulatory requirement to do so, this proposal has the effect of preserving localness.
- 1.144 Of course, local content is not the only content broadcast by AM stations that is valued by listeners. Even broadcasting no local content, AM stations add to the range and diversity of stations available to consumers. An increase in station viability also therefore increases the chances of this provision.

1.145 As outlined above, there is evidence that content made in the nations delivers particular value to both citizens and consumers.

Local AM radio in the nations

1.146 In addition to this, Scottish and Welsh AM stations are required to produce considerably more material in their home nation than in their local area (10 hours vs 4 hours). We would therefore suggest that listeners are more likely to tune in to a local AM station on account of its national content than on account of its local content.

1.147 For these reasons, we posit that the removal of nationally produced hours from the AM band would significantly reduce citizen and consumer welfare.

1.148 Furthermore, given the potential for local AM stations to share nationally produced programming with other AM stations in their home nation, we would argue that the nationally produced hours requirements impose less constraints on stations' ability to cut costs than the locally produced hours requirements do. We also note that listening to AM ILR has declined less in Scotland than it has in the rest of the United Kingdom, indicating that Scottish local AM stations may be less likely to become unviable than other local AM stations.

1.149 In view of the particular value of content produced in the nations, the fact that we believe nationally produced programming is likely to impose constraints on stations' ability to cut costs and given the indications that Scottish local AM stations may be more viable than their counterparts in the rest of the United Kingdom, we propose to maintain the requirement that local AM stations produce 10 hours of programming in their home nation.

Table 5 Summary appraisal for proposals to abolish localness requirements on AM

Option	A. Status quo	B. Remove requirements for AM stations to broadcast locally made content with continued requirement for content produced in the nations
Expected response / effect	<ul style="list-style-type: none"> - Most local AM radio stations deliver 'localness' - Some stations may exit the market, due to their costs (including those of producing local content) exceeding their revenues - Listeners continue to receive value, to the extent that stations do not exit 	<ul style="list-style-type: none"> - Many stations, particularly those under financial pressure, cease to produce content in their local area - Some stations continue to incorporate localness into their broadcasting in some way (albeit not necessarily via locally made content) - Local AM stations make cost savings. Some stations that would otherwise have exited the market continue to broadcast
Impacts on:		
Operators	<ul style="list-style-type: none"> - Risks exit of significant number of stations 	<ul style="list-style-type: none"> - Smaller risk of full exit compared to status quo
Listeners	<ul style="list-style-type: none"> - Risks reduction of service and less local output as a result of exit of local commercial AM stations. This would reduce consumer value. 	<ul style="list-style-type: none"> - Any immediate reduction of localness likely to have a relatively small negative impact on consumer value - To the extent that exit is mitigated, listeners in the nations continue to have

		<p>access to the nationally produced content which they value, mitigating any negative effects on consumer value</p> <ul style="list-style-type: none"> - By increasing viability of the AM stations option may in the medium term deliver more localness on the AM band than the status quo would, thus maximising consumer value - Other, non-local content is more likely to be provided by AM stations, increasing choice and diversity
Citizens	<ul style="list-style-type: none"> - Risks reduction of service and less local output as a result of exit of local commercial AM stations. This would reduce citizen value. 	<ul style="list-style-type: none"> - Any immediate reduction of localness likely to have only a marginally negative impact on citizen value - To the extent that exit is mitigated, listeners in the nations continue to have access to nationally produced content which, mitigating any negative effects on citizen value - By increasing viability of the AM stations option may in the medium term deliver more localness on the AM band than the status quo would, thus maximising citizen value
Appraisal against objectives	<ul style="list-style-type: none"> - Risks viability of a significant portion of local commercial AM stations and hence local output 	<ul style="list-style-type: none"> - Maximises chance that localness will survive on the AM band in some form, and that other content valued by listeners is provided

Proposal

1.150 On balance, we conclude that Option B maximises the chances of survival of a maximum number of AM stations, and therefore, in the medium term, increases the chances of a range and diversity of services being provided, and local content being provided through commercial incentives, in the absence of a regulatory requirement. But we suggest that the particular value of the local content produced by AM stations in the nations is such that this should continue to be protected. Our proposal is therefore:

Proposal 7

AM stations generally need no longer produce locally made programming or carry local material. But a minimum of 10 hours during weekday daytimes should be produced within the nation where the station is based (unless the station already does less than this).

Formats – Section 8

- 1.151 We make no recommendation in respect of this proposal, and either outcome would be a continuation of existing policy (maintaining music Formats), so there is no Impact Assessment associated with this.