



PUBLIC SERVICE BROADCASTING IN THE UNITED KINGDOM

A Longer Term View

Robin Foster and Kip Meek
with a foreword by Gavyn Davies OBE

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Robin Foster and Kip Meek

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INGENIOUS CONSULTING NETWORK

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FOREWORD

GAVYN DAVIES OBE

The speed of technological change in the television and broadband markets is becoming bewildering for anyone except a switched-on 13-year-old. The days when television meant nothing more than a handful of dominant channels ended with the arrival of multi-channel cable and satellite systems, and the arrival of digital options has further expanded the available choices. But all this was just a minor revolution compared to the arrival of broadband, which enables users to access content where and when they choose, and to access moving images, data, sound and communication simultaneously. The new generation is comfortable with multi-tasking, thinking nothing of watching a football match on live television while talking to friends on Skype and listening to music through a single earphone. In the old days, people who could listen to an earpiece while watching a monitor and talking rapidly were called newscasters. Now they are called kids.

No one knows for sure how or when this ongoing revolution will reach a steady state, but in this paper Robin Foster and Kip Meek sketch out some possible pictures of the world in 10 years' time, and ask what should be the role of public service broadcasting (PSB) in that world. They make the case that in a world of limitless choice there should still be a role for "public service" content, which implies that there will still be market failure in that world, and therefore a need for government intervention to ensure that quality is protected in at least one corner of the total landscape. They also argue that there will still be an important role for a powerful supplier of PSB, remaining as an integrated institution with access to all the relevant delivery mechanisms at any given time. For them, the BBC is the only institution which can fulfil that role, though they argue that it needs to change some aspects of its behaviour and governance in order to prepare itself to serve the public rather than to serve its own institutional interests.

Foster and Meek are sceptical in the long term about whether any other PSBs can survive in their present form. They suggest either that ITV and Five should be released from their public service obligations so that they can flourish as commercial enterprises, or that they could continue as modest public service broadcasters while being more commercially focused. For Channel 4, they are undecided between an organisation that cuts its cloth to match its commercial income, or one that is fully commercial.

On the future of ITV, it seems to me that the conclusion reached is sad but inevitable. The management's desire to remain as a PSB seems to be fading in ITV as the harsh realities of unyielding commercial competition from Sky, other digital providers – and now broadband – come home to roost.

My take on Channel 4 may differ slightly from that of the authors. Channel 4 retains a strong desire to be a PSB, but it lacks the scale and financial viability to challenge the BBC, except on the margins. I personally hope that the current government review of the market finds a way to keep Channel 4 in its present form, not least because the BBC has always benefited from competition from other suppliers with PSB mandates. However, I am concerned that Channel 4 will only be able to avoid privatisation if it is allowed to top-slice the BBC licence fee, which would be a huge error. Top-slicing will, in the long run, result in inadequate funding of the BBC, and will allow politicians to “reward” well-behaved broadcasters with increasing shares of the revenue after each review. Just think how Alastair Campbell might have enjoyed that! Furthermore, if the umbilical link between the BBC and the licence fee is broken, I believe that the public's acceptance of the licence fee will wane more rapidly than it is doing already. Finally, does the management at Channel 4 realise what life will be like once it is in receipt of public money? The Brand/Ross episode at the BBC should warn them that life will not be easy once they receive the kind of tabloid scrutiny that the BBC takes for granted each day

of its life. Still, Channel 4 will need some form of help, or public funding other than from the licence fee, if it is to cheat the grim reaper (i.e. the Treasury, needing the money from an asset sale), as I hope it does. There are sensible ways in which the BBC could help Channel 4 in the new world, but it is crucial that the two organisations remain distinct. Channel 4 would lose its purpose if it simply became BBC 5.

As for the BBC itself, I am encouraged that the Cameron Conservative Party has now joined the rest of the political system in fundamentally supporting its existence even after the age of broadband has fully arrived. This is a big change compared to the political environment faced by the BBC when I was Chairman, and I think it stems from a recognition that the wild west world of broadband may not be quite as perfect as supporters of the free market previously believed. The failure of the free market banking system has changed the political climate on market failure once and for all. And, anyway, how can anyone sensibly argue that the internet would be a better place if the BBC's online services had been strangled at birth, as might have happened all too easily?

This paper argues that if the BBC is to be allowed this dominant role as a PSB supplier, it needs to change its governance, for example by delineating more clearly the difference between the Trust and Ofcom, and improving the transparency of its decision-making process. I must say that I had fondly hoped that these problems had been adequately addressed by myself and other Chairmen, but I now think that outsiders are never likely to be satisfied about this. One solution (and a very bad one) would be to hand regulation of the BBC over to Ofcom, but the authors are right to suggest that the latter organisation may have too much on its rather large plate already. So I think that BBC governance should stay as it is, recognising that it will always be likely to be a bed of thorns for those fortunate enough to lie on it.

EXECUTIVE SUMMARY

Change has been a feature of British broadcasting for many years, but its pace is increasing. We are in the midst of a rapid transition to digital technology and are simultaneously experiencing the proliferation of platforms over which broadcast-type products can be received – not just television and radio, but also computers and mobiles. With these changes come new opportunities – for example, the opportunity for greater interactivity and participation. This in turn creates the possibility of more effective delivery of content, including public service content.

However, an increasingly converged digital world also brings substantial threats, including the erosion of existing commercial broadcaster business models and the fragmentation of audiences and funding. The effect of these threats could be sharply to reduce investment in quality programming and original UK content. Other concerns include the possible creation of new competition bottlenecks and the establishment of an enduring digital divide, with many excluded from the potential benefits offered by new digital services and technologies.

This pamphlet seeks to develop a clear understanding of what this changing context will mean for the future of public service broadcasting (PSB) in the UK. We consider the public policy objectives for broadcasting and the mix of markets and public interventions that will best deliver those objectives. We aim, so far as possible, to set the debate within the context of longer-term trends and developments rather than fixating on what should happen to existing institutions and funding in the near term.

Our conclusion is that the UK has an opportunity, presented by high-speed broadband, to rebalance policy in favour of unlocking market potential rather than simply fixing market failures. There will

still need to be interventions to secure public service content on a significant scale, but those interventions need to be redesigned, and refocused around a strong but more open and market-sensitive BBC at the heart of the system. Now is not the time for any significant increase in direct spend on PSB; indeed, over time its cost to the nation may reduce.

THE CASE FOR PUBLIC INTERVENTION IN UK BROADCASTING

Four key public policy objectives for broadcasting can be identified that look set to continue to influence policy in the future. These are: driving consumer satisfaction, ensuring that wider social or citizenship benefits are delivered, achieving a fair distribution of access and take-up across society, and supporting a thriving and dynamic UK creative business sector that contributes to the overall health of the UK economy.

Traditionally, a number of market failures have existed in the way that broadcasting markets work that have been used to justify corrective public intervention to meet these objectives. For example, broadcasting has what economists refer to as “public good” characteristics – one person watching a programme does not prevent others from doing so at the same time, and it is (or at least until recently it has been) difficult to prevent people who have not paid from watching (since anyone with a TV can do so). Broadcasting also creates “externalities”: benefits or costs that are not fully reflected in market transactions, for example, the benefits to society of an informed citizenry with shared culture and values. Broadcasting can also be both a “merit good” and an “experience good” – its value being recognised only after or upon consumption. Finally, high fixed costs in broadcasting and substantial barriers to entry mean the industry can tend towards a monopolistic structure, and the way that much commercial broadcasting is funded by advertising leads to a focus on mass market appeal at the expense of niche and minority interests.

In response to these market failures, a UK model of intervention has developed – often in a piecemeal fashion. This “PSB ecology” currently consists of both structural and regulatory interventions. Structural interventions include a major publicly funded institution (the BBC) alongside a second publicly owned institution (Channel 4), and a number of other licensed commercial broadcasters which broadcast some public service content in exchange for certain privileges (primarily ITV and Five). Regulatory interventions require, for example, UK-originated and regional-originated content and the use of independent producers. Alongside these there has been some reliance on market mechanisms – competition between PSBs and other broadcasters for audiences, competition for ideas, talent and value, and some use in the past of competitive tender processes to allocate PSB franchises.

Although this framework has been widely credited with helping to encourage quality programming and impartial news across the sector, it has also created some problems. For example, in the absence of competitive market discipline there is the danger in institutions of inefficiency and less incentive to innovate, while the regulatory environment may distort the commercial marketplace. These concerns require that any future model of intervention should be carefully designed and subject to proper scrutiny, particularly where a rapidly changing environment means that the scale and scope of appropriate interventions may be changing and existing structures are out of date.

BROADCASTING IN 2018

In this paper, we therefore attempt to assess how the UK broadcasting market will change over the next 10 years, and the extent to which those changes will affect the case for, and scale and scope of, continued intervention. A number of scenario analyses of the future environment have been undertaken by different experts in recent years, which we have adapted and clustered to create four possible

visions, delineating what we see as the limits of plausibility in 2018. In particular, these scenario clusters reflect differences in the speed of technological adoption and the degree to which consumption fragments.

Scenario analysis

At one end of the suggested range of outcomes is a picture of “gradual evolution” – in which the speed of technology adoption continues at its current pace, and linear (rather than online) television viewing continues to dominate, albeit with some limited fragmentation of content. At the other extreme is “radical transformation” – in which there is a very fast pace of technology adoption leading to a dramatic decline of linear TV accompanied by the fragmentation of market power amongst thousands of content suppliers. Between these two extremes sit “fragmentation” – characterised by a divide in audience behaviour, with some viewers adapting to the new online world and others wedded to the linear model – and “consolidated transformation” – in which non-linear services broadly replace linear ones but consumers look to trusted suppliers to navigate the market.

Commonalities across scenarios

This scenario analysis allows us to identify a number of key trends which occur in any vision of the future. For example, in all scenarios new distribution platforms battle for supremacy and challenge the status quo, there is substantial growth in consumers accessing content online, and consumer expectations will demand new modes of interaction and engagement. At the same time, the high fixed-cost nature of conventional commercial models will threaten profitability, the value of regulatory assets in such a competitive world will likely diminish, and new competition makes old commercial models increasingly difficult to sustain – incumbents will have to compete with either very many niche players or a few large global players.



Uncertainties about the future

As well as these commonalities, the scenario analysis also reveals major uncertainties around how broadcasting in the UK will develop over the next 10 years, in particular related to speed of change and, crucially, the extent to which existing broadcasters successfully transfer online. It is also unclear to what extent a digital divide will emerge and what the impact will be on the health of UK creative industries.

Both the commonalities and the uncertainties have implications for consumers, the existing PSB ecology and the industry, and all are in some ways susceptible to intervention in pursuit of public policy objectives. The challenge will be to manage the opportunities and risks presented by the rapidly changing environment and to understand the required scale, scope and type of intervention in the future.

DESIGNING A NEW MODEL OF PSB INTERVENTION

Historically, UK broadcasting has been characterised by a high degree of public intervention. We believe that the new market developments are challenging the effectiveness of the current PSB infrastructure and that incremental changes to the current model will, on their own, be an inadequate response. This belief that incremental change is not suitable is no longer unorthodox: Ofcom, both in the most recent PSB review and in its first review made a similar point.¹

Our analysis suggests that a broader approach to policy is needed, which covers the wider communications sector and not just PSB. It recognises that public objectives for broadcasting in future must be met in a variety of ways, using a range of levers and, in some instances, without intervention at all.

¹ Ofcom, *First Review of Public Service Television Broadcasting* (London: Ofcom, 2003–5), and Ofcom, *Second Review of Public Service Television Broadcasting* (London: Ofcom, 2008).

Our understanding of how the industry is changing suggests a number of common threads or broad parameters that should condition any future assessment of the nature of public policy intervention.

The impact of high-speed broadband

First, the expansion of open access to high-speed broadband networks in the UK and abroad will support the expansion of commercial provision of diverse and innovative new content and services. Properly regulated markets, with their decentralised decision-making, scope for trial and error, and ability to rapidly exploit technological change, will be well placed to help secure consumer value and a dynamic UK media economy. The potential of the market to deliver more than it can in the conventional broadcast world will be unlocked, reducing some of the market failures that prompted public intervention in broadcasting in the past. Digital and online broadcasting, for example, are less prone to the market failures inherent in an advertising-funded linear model, and some public good characteristics, such as non-excludability, will diminish. Information problems are reduced as more content is consumed on demand, and more information is available about the content available.

Modern communications infrastructure will offer the potential for improved access for citizens to content and services from a vastly expanded range of sources, and will allow new and potentially more democratic relationships between citizens and the media to emerge. Some of the established purposes of traditional PSB may be better achieved by new rather than old media. This implies that securing universal access to high-speed broadband should be a central feature of the new PSB world, just as securing access to broadcast TV was to the old one.

Policy implication 1

High-speed broadband provision should be prioritised ahead of any new PSB interventions

A greater role for market provision

The increasing role for the market and for public participation in provision of PSB-type content also suggests that now is not the time for any significant increase in direct spend on PSB. Rather, the market should be given more space to develop and commercial broadcasters should have the flexibility they need to respond to the competitive challenges ahead.

Policy implication 2

There should be tight scrutiny of any new claims for increased funding of PSB

Given the competitive challenges ahead, and their potential importance to the long-term health of the UK media and production sector, key existing commercial players like ITV and Five should be given as much flexibility as possible to develop their commercial strategies, forge new alliances and prepare for the world of high-speed broadband. Channel 4 faces similar competitive pressures. To help secure a dynamic domestic commercial media sector, one option would be to free all three broadcasters from their existing PSB obligations and allow them to play a full role as commercial players in the UK and world marketplace. Any continuing PSB obligations for these commercial firms should be designed to be affordable and consistent with their commercial strategies.

Policy implication 3

Commercial players should be given as much flexibility as possible in what is an increasingly competitive market

Addressing enduring market failures

However, although some of the market failures that public intervention has in the past sought to address will become less marked, there will remain gaps and shortfalls which call for continuing public support, albeit redesigned to reflect the radical changes described above. In particular, certain content genres, such as impartial well-resourced news, will remain unlikely to be guaranteed by the market. PSB may also need to provide a bulwark against declining investment in UK content and erosion of standards. And finally, some information asymmetries will remain between consumers and producers, making it difficult for consumers to assess quality and “trustworthiness”.

In response to these continuing market shortfalls, we argue that there remains a crucial role for at least one strong institution as the primary conduit for the delivery of public service content. Although we recognise that such institutions have their disadvantages, we argue that such a body will have a culture and values that are well aligned with PSB delivery, that it will be able to avoid the potential conflict between public service and commercial objectives and that it can, if properly governed, be flexible enough to respond to changing demands.

Most importantly, only a large institution will be able to ensure reach of PSB content and to condition the market in terms of quality and content standards – both of which are crucial whether the future is one of consolidation or fragmentation. It will also be able to provide a counter-balance to the market power of large commercial broadcasters in a consolidated world.

By 2018, the BBC will inevitably be the only public institution able to play this role – with the scale and scope to compete, to reach large audiences, to guarantee large-scale investment in UK content, to set standards and to operate across all media.

Policy implication 4

The BBC should be at the heart of any new system for 2018

However, if this is to happen the BBC will need to change. It must:

- become more open and collaborative – for example, by helping share resources with other public service providers and by promoting awareness of other sources of public service content;
- develop a more devolved and diverse commissioning structure;
- place increasing emphasis on new media platforms rather than linear channels – acting as a pioneer for digital and broadband developments; and
- establish a clear governance structure which protects the commercial sector from undue adverse impacts and, in particular, provide clarity on the BBC Trust's regulatory role.

In time, the BBC might be able to use new media (for example on-demand) services and platforms to deliver its purposes more efficiently and hence reduce its overall reliance on public funding.

Ensuring plurality of provision

We also consider whether intervention is required to ensure plurality of PSB provision in the future and what form this might take. By 2018,

we argue, the proliferation of commercially available sources of content will be such that intervention to ensure plurality of specifically public service provision, over and above the funding of the BBC, will be considerably less necessary than it is today. However, two types of PSB intervention may be merited over and above the BBC.

First, “market-tuning” interventions – enabling commercial PSBs that value their public service status to take on limited obligations – may help influence the overall character of UK broadcasting by encouraging existing commercial broadcasters to do more of what is both good for them as private businesses and good for the country as a whole. The case for retaining a “family” of PSB providers in this way may also bring benefits in terms of securing wider support for maintaining investment in UK-originated content and securing editorial standards (particularly in a context where regulation is through broad principles rather than detailed rules, as seems appropriate in an online world).

Second, a limited number of carefully targeted “market-changing” interventions could be used to secure plurality in the provision of certain genres of PSB content which will be under-supplied by mainstream entertainment-led commercial broadcasters. Such genres might include the provision of local or regional news, or the continued provision of a wider range of children’s content. New as well as existing providers could be considered.

In both cases, PSB providers should be properly incentivised to take on these obligations, rather than simply have the obligations imposed on them. This could take the form, in some cases, of regulatory assets (spectrum access, for example) and in others of direct payment. Careful assessment of costs will be needed, as well as the benefits of any such intervention – new public investment should be limited in amount, and carefully targeted on those measures that will deliver most public value.

Policy implication 5

A limited number of “market-tuning” and “market-changing” interventions should be considered to ensure plurality of PSB provision and maintain content standards

Finally, if specific interventions to secure plurality of provision are to be made, we think there is also a case for a greater role for contestable contracts than at present. We argue that this would provide for a fair and transparent approach to awarding tenders for supply and would certainly provide a better option than guaranteed direct financial support of a second public institution like Channel 4. Although we recognise contestability is not appropriate in all cases – for example, for micro-contracting of programmes, or for hard-to-specify aspects of PSB – we believe that, in some cases, contracts could be put out to competition and, in the longer term, that there is a case for an extended contestable approach.

Policy implication 6

A fair and transparent approach to awarding PSB contracts is needed, including an element of contestability in some cases

Funding PSB in the future

The BBC benefits from scale and from the dependability of its funding; its funding model also gives it a political independence which is vital for the central pillar of public service broadcasting. The scenario analysis also suggests that, as broadcasting expands into new media, a weakening of the BBC would not be good for either PSB provision or the industry. The inference we draw is that top-slicing is not an appropriate model for the BBC. The price of this privileged position is

the demanding governance regime identified above. Allocation of parts of the licence fee to other broadcasters would also raise potentially difficult accountability issues and might lead to competition concerns.

Policy implication 7

The BBC's funding should continue to be provided by the licence fee, subject to periodic review

There may be scope in the short to medium term for using remaining regulatory asset value (for example, position on the Electronic Programme Guide (EPG) or access to spectrum) to secure some transitional PSB obligations outside the BBC, but it should be recognised that the value of these is likely to decline in the longer term. Small amounts of direct government funding may also be appropriate for some modest interventions outside the BBC – for example, to ensure plurality in news supply in Scotland, Wales and Northern Ireland. Larger-scale interventions are unlikely to be either affordable or desirable.

Policy implication 8

Additional sources of funding could come from regulatory assets or direct government funding

It is far from clear that Channel 4's commercial challenges derive from the fulfilment of its public service obligations; as a consequence, a guaranteed receipt of public funds may not serve public objectives but instead be used to put a threatened business model on "life support". Channel 4 (like ITV, Five and other broadcasters) could, however, apply for public funds to meet specific public service

objectives via a system of contestable contracts. Ultimately, the issue of Channel 4's ownership (public or private) should be addressed by asking the question, "What is the best route to resolving its commercial challenges?"

Policy implication 9

Channel 4 (as an entity) should not be in receipt of public funds

In conclusion, intervention to secure the public interest in this new world will need to be redesigned to remain effective and cover a wider range of policy levers, not just PSB. It should focus on unlocking future market potential rather than just filling in market shortfalls. If we get it right, there is a real chance that a new balance of markets and intervention will deliver better outcomes than those we have today.

1. INTRODUCTION

The UK television broadcasting sector is characterised by a high degree of public intervention in the form of public funding, regulation and institutional structures.² Collectively, these approaches make up what we usually call “public service broadcasting” (PSB). PSB covers not just the output of the BBC, but also much of the programming delivered by the not-for-profit, state-owned Channel 4, and the licensed commercial public broadcasters, ITV and Five.³

This PSB ecology, which has evolved over several decades, has been widely credited with helping to encourage the provision of (and consumer demand for) high-quality UK programming and impartial news across the broadcasting sector as a whole.⁴

But the broadcasting sector is rapidly changing. New technologies and high-speed internet access mean that people can increasingly watch what they want, when they want, and on a growing array of devices. In August 2008, for example, more than four million people in the UK used the BBC’s online video service iPlayer⁵ and, according to recent research, almost two-thirds of people have used the internet to watch audiovisual content.⁶

Against this fast-moving background, Ofcom is conducting its latest review of the future of PSB, and the government’s Digital Britain project is examining a wide range of policy issues, of which the future role of

2 In radio, the degree of public intervention is even higher: the BBC achieves more than 50% of total radio listening in the UK. This report, however, confines itself to a consideration of PSB as it affects television

3 There are currently 10 PSBs in the UK: British Broadcasting Corporation (BBC); Channel 4; Channel 4 Television Corporation (Channel 4); Channel Five Broadcasting (Five); GMTV Ltd; ITV plc (ITV); S4C; STV Group plc; Teletext Ltd; and UTV Media plc.

4 For example, Ofcom, *Review of Public Service Television Broadcasting Phase 3 - Competition for Quality* (London: Ofcom, 2005), 1.2, states: “We concluded that, taken together, they [the PSBs] were performing well in their delivery of impartial and independent news, and high quality UK originated programming, across a range of genres.”

5 Nielsen//Netratings, *Netview*, August 2008.

6 Internet Advertising Bureau and Thinkbox, *TV and Online: Better Together* (2008).



PSB is just one. In this changing context, significant questions arise about the future scale and scope of PSB, and how it should best be delivered. This paper is intended as a contribution to that process of debate and sets itself two core objectives.

First, it aims to change the starting point from a debate about the future of PSB (by which we often mean the future of existing institutions) to a debate about what sort of broadcasting and new media we want in the UK, and what mix of markets and public interventions will best deliver it. Answering these questions requires a perspective that is wider than that covered by Ofcom's duty under the Communications Act, to "maintain and strengthen the quality of public service television".⁷ It also requires a clear view of the range of policy objectives that might be set for the broadcasting sector, of how these should be prioritised, and of what the trade-offs are that might need to be made.

Second, as far as possible, it aims to set the debate within the context of longer-term trends and developments. Too often, industry discussions tend to get fixated on what happens to existing institutions and funding in the near term, rather than the fundamental issues for the longer term. We do this by looking at a range of scenarios for the UK broadcasting and new media sector in 2018.

7 UK Parliament, *Communications Act* (London: TSO, 2003), 264.

2. POLICY OBJECTIVES AND THE ROLE OF PUBLIC SERVICE BROADCASTING

In this chapter, we address the rationale behind intervention in the broadcasting industry and delineate the situation as it exists today. We begin by considering the policy objectives for broadcasting in the UK, and visit the arguments for public service intervention, from both an economic and a social perspective. We outline the existing intervention framework and, finally, consider the possible downsides of intervention.

OVERALL POLICY AIMS

UK policy objectives for broadcasting have evolved over time, but have typically involved a mix of economic and social aims. Arguably, there are four broad objectives that have influenced policy in the past and that will continue to influence policy in the future (although their relative importance might change):

- consumer satisfaction, which is often related to choice, quality, innovation and value for money;
- wider social or citizenship benefits, including support for democracy, a well-informed society, and support for our cultural heritage and identities;
- a fair distribution of access and take-up across society, particularly given the role of broadcast media in helping individuals to play a full role in society;
- a thriving and dynamic UK creative business sector that contributes to the overall health of the UK economy.

WHY PUBLIC INTERVENTION?

There has been much discussion over the years about why public intervention is needed in broadcasting markets to help deliver these objectives. It is not the purpose of this paper to revisit these arguments in detail, but it is worth briefly recapping them here to set the scene for our later discussion.

The core approach has been to focus on how well broadcasting markets work (or do not work) and on the incidence of market failures which might justify corrective government action. In the *The BBC and Public Value*,⁸ Gavyn Davies discusses these market failure arguments, an overview of which is provided below.

“Public good” characteristics

Broadcasting has what economists would call “public good” characteristics. One person watching broadcasting content does not prevent another person from watching the same content (it is “non-rivalrous”) and it is difficult to prevent people who have not paid for the content from enjoying its benefits (it is “non-excludable”). This suggests that any charge for broadcast content risks excluding some consumers whose valuation of it would exceed the extra cost of its provision (zero) – an inefficient outcome.

Externalities

Broadcasting comes with external benefits and costs – or “externalities” – that are not fully reflected in market transactions. Positive externalities, for example, might include the benefits to society of having better-informed individuals. Negative externalities might include the possible impact on society of individuals consuming content that incites them to violence. Broadcasters are neither paid by the market for the wider societal benefits of their programmes nor

8 Gavyn Davies, *The BBC and Public Value* (London: Social Market Foundation, 2004)

charged for their costs to society. Without intervention, then, we would expect “positive” content to be underprovided and “negative” content to be overprovided.

“Merit good” characteristics

Broadcasting can be thought of as a “merit good”. Merit goods are goods that are valuable for an individual, but their value is only recognised by the individual after the time of use. Children, for example, may not want or choose to watch educational programming, even though they might look back later in life and see that they have benefited from it in the long term.

“Experience good” characteristics

Broadcasting content is often an “experience good”. Its characteristics can only be ascertained upon consumption. When people are choosing a television programme, for example, they do not really know whether it will be what they want until they have watched it. Compare this to buying, say, a particular screwdriver, which they can assure themselves is the right kind before handing over the money for it. In a free market for broadcasting, these informational asymmetries between the provider and the consumer lead to sub-optimal levels of demand for certain types of more adventurous, ambitious or challenging content that people do not know they will enjoy.

Monopolistic structure

The broadcasting industry has high fixed costs (costs that do not vary by the size of a company or its amount of production) and substantial entry barriers. This makes it very difficult for new entrants to compete. As a result, in a free market there is a risk that big players will emerge

and the industry will lean towards a structure characterised by only a small number of firms, each wielding huge market power. Firms with market power can overcharge and under-supply, and consumers will lose out.

Undersupply due to business models employed

Much commercially provided broadcasting content is advertiser-funded and not paid for directly by consumers. Under these business models, content often tends towards that of wide and mass-market appeal, and not necessarily to that which satisfies the demands of all consumers such as niche and minority interests.

This market failure analytical framework has greatly sharpened the PSB debate in recent years, and has helped focus policy-makers' attention on those aspects of provision that are seen to be important in delivering agreed public purposes (or "Reithian Broadcasting", as Davies describes it) and for which the market is unlikely to guarantee the socially optimal outcome.

Some broadcasting commentators have argued, however, that a "wider social goals" approach is a better starting point for a discussion of PSB than one based on economics and markets. They assert that a market failures framework will inevitably lead to a narrow and significantly scaled-back version of PSB. An overview of some of these broader social arguments is provided below.

Basic citizen's rights

Some suggest that broadcasting, even if the market were working well, is "too important to be left to the market". It is argued that access to news and information is a basic right and should not be seen as just another good to be bought and sold.

Impartiality and accuracy

It is also argued that the provision of broadcast content, especially news and analysis should not be left wholly to private suppliers, even if they are prepared to provide it – they will always have their own agendas to pursue, which could reduce the accuracy and impartiality of news provision.

Range of content

A “narrow” market failure approach could be seen as implying a very limited range of public service programming, which would ultimately fail to reach and influence many citizens.

Universality

Universality is also seen as a key “non-market” objective. Intervention will be required to secure universal free-to-air provision, to ensure that the benefits of public service content are available to all.

Most, if not all, the arguments advanced by the “social goals” protagonists, however, can be restated quite clearly within a market failure framework. For example, as noted above, markets will tend to under-provide impartial news compared with the socially optimal amount. Intervention to guarantee universal access to such news services is a response to that market failure.

As Ofcom concluded as part of its first PSB review, there is probably little difference in the practical policy implications of these two approaches. Even the most ardent supporters of social goals would presumably agree that, when deciding levels of public intervention, some consideration should be given to what the market will provide, and to how market mechanisms could be harnessed to achieve their objectives. And using the market failure framework, a judgement still

has to be made about what the scale of the failure is likely to be, and hence what an optimal supply of “desirable” content would look like.

Looking ahead, therefore, we need to agree on a desirable outcome for the range, quality and diversity of content provision in the UK, understand what the market can and cannot deliver, and then assess to what extent intervention might be needed to bring about the desired outcome. Given the range and importance of the potential market failures identified above, the scale and scope of intervention might need to be substantial, but should be subject to proper scrutiny. In the rest of this paper, we attempt to assess how the UK broadcasting market will change over the next 10 years, and the extent to which those changes will affect the case for, and scale and scope of, continued intervention.

There are also other objectives besides consumer satisfaction and specified social goals that need to be added to the mix. For example, many would point to the potential for UK content production as a key contributor to the UK economy and a major area of potential for international growth, and government may have a role in helping to facilitate or stimulate this. At a time of global economic turmoil, the weight attached to this particular policy objective might increase.

EXISTING MECHANISMS OF INTERVENTION

Having explored the case for why PSB is important in the face of market failures, we come to the question of how the desirable economic and social outcomes can best be achieved. What combination of markets and state provision, incentives and regulations, can be constructed that will work over time and in the longer term?

The existing UK model uses a range of approaches. First, it encompasses *structural interventions*:

- a major publicly owned and funded institution, with defined PSB objectives: the BBC;
- a second publicly owned institution, but with no direct public funding: Channel 4.
- licensed commercially funded PSBs, which are required to broadcast some specified public service content (like national and regional news) in return for certain privileges (for example, spectrum capacity for digital services and EPG prominence) – such as ITV, Five, Teletext, etc.

Second, it includes *regulatory interventions*:

- a series of regulations that apply to all broadcasters, covering editorial standards, impartial news and so on;
- further regulations that apply only to the public service channels (channels 1–5), which require the provision of, for example, UK-originated production and production outside London to encourage regional development of the industry and to represent all of the UK on screen;
- regulations that cover contracts between broadcasters and producers for programme rights, and the extent to which broadcasters must use independent producers for their programming;
- a competition framework, which promotes the interests of consumers through competitive markets, backed up by consumer protection legislation.

Third, it involves some reliance on *market mechanisms*:

- PSBs compete for audiences against each other and other broadcasters in a highly competitive market, which helps ensure that programming is tailored to audience needs (although the BBC does not compete with its commercial counterparts for funding);
- prompted by the regulatory framework, PSBs commission a large part of their programming from external independent suppliers, which has introduced a significant element of competition in programme supply – competition for ideas, talent and value;
- at one stage in the history of UK PSB, the commercial PSB franchises were allocated via a competitive tender process, with awards made on both quality and financial grounds.

This combination of approaches has underpinned what many in the industry refer to as the “PSB ecology”. Later in this paper, we will look at how changes in the market will affect the future usefulness of these types of intervention.

THE DOWNSIDE OF INTERVENTION

Although publicly funded institutions such as the BBC can address public good and externality concerns, they might also create problems. Other interventions – such as the support for commercial PSBs – may also impose costs. For these reasons, intervention for the future requires careful design and highlights the twin risks of over-regulation and out-of-date regulation in what is a fast-changing market.

Without market discipline in a large publicly funded institution, there may emerge internal productive inefficiencies which offset the efficiency gains associated with universal free provision. There may

also be less incentive for innovation, which reduces dynamic efficiency. At the same time, there is a risk of public spending crowding out what would have been profitable private sector provision. Equally, regulations imposed on commercial companies such as ITV and Five might distort competition in the wider commercial market place. The costs of meeting some PSB obligations might outweigh the public value delivered – this can be hard to calculate. There may also be high transactions costs associated with the regulatory infrastructure needed to support the chosen system.

Moreover, current interventions were largely designed when the UK broadcasting market was a relatively stable and closed space, with the four main broadcasters accounting for almost all viewing. We face a completely different world ahead, in which there are many more content providers and packagers, and in which some of the old market failures and policy priorities no longer apply. In the rest of this paper, we therefore first explore what those market changes might be over the next decade and, second, examine the scale and nature of intervention that might be needed to achieve overall policy goals.

3. BROADCASTING IN 2018

In the following section, we consider what the broadcast world will be like in 2018. Based on the collation of recent studies, we outline four plausible futures: Gradual Evolution, Fragmentation, Consolidated Transformation and Radical Transformation. We consider the common trends across all four futures, and the crucial uncertainties. Finally, we address the implications of these futures on the broadcasting industry: for citizens and consumers, for the PSB ecosystem and for the creative industry.

SCENARIO ANALYSIS

An existing body of literature seeks to explore what the UK broadcasting landscape may look like in 2018. Most notably, a number of scenario analyses have been undertaken. Here we consider the findings of three key analyses – by Robin Foster for the Department for Culture, Media and Sport (DCMS),⁹ by Oliver & Ohlbaum Associates Limited¹⁰ and by Capgemini.¹¹ Further analysis of these scenarios is contained in the appendix.¹²

Although the results of each scenario study differ in detail, they are similar in their overall construction and hypotheses. We have therefore been able to cluster the scenarios into groups that reflect four contrasting views of the future. Because the development of the industry is characterised by a high degree of uncertainty, our scenario groups are designed to cover the range of potential market outcomes – including the extremes. We do not attempt to predict the most likely outcome, but instead to depict the sphere of possibility; in doing so, we aim to provide

9 Robin Foster, *Future of Broadcasting Regulation* (London: Department for Culture, Media and Sport, 2007).

10 Oliver & Ohlbaum Associates Limited, *Synopsis of Oliver & Ohlbaum's Economic Modelling of Future Scenarios for Public Service Content, Phase One* (London: Ofcom, 2008).

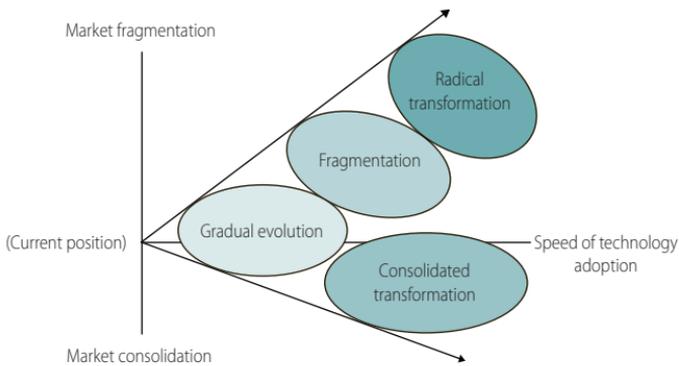
11 Capgemini, *BBC Response to Ofcom's Second Public Service Broadcasting Review, Phase 1: Summary of Market Modelling* (London: Capgemini, 2008).

12 These papers constitute the recent development in scenario trend analysis. We note that the Convergence Think Tank will also shortly release a paper on future broadcasting scenarios.

a framework for assessing policy decisions. Further, we note that public policy choices will have an effect on each different scenario's development.

Our analysis of the various scenarios suggests that two of the most important drivers of change are the speed of technology adoption and the degree to which consumption fragments between the providers of audiovisual content. We have found it helpful to use these drivers to cluster the scenarios into a smaller number of related groups. Figure 1 provides a stylised overview of the four futures against these drivers of change.

Figure 1: Overview of how UK broadcasting may develop, by speed of technology adoption and level of market fragmentation



The implications of this cluster analysis for how the future might look are briefly described below. Further detail on each of the scenarios is analysed, and the mapping of them against the framework represented above is provided in the appendix to this report.

- 1 Our "gradual evolution" future describes a world that looks relatively similar to today's situation. The speed of technology adoption continues at its current pace; linear (rather than

online) television viewing continues to dominate audiovisual consumption by a large margin. However, as consumers find more content online, there is some fragmentation in the industry and the share for public service broadcasters declines slightly. The advertising model continues to stagnate, as ad-skipping technology like high-quality personal video recorders proliferates, and there are increasing financial pressures on commercial PSBs. However, current players invest in new broadcasting methods and remain important.

- 2 “Fragmentation” is characterised by a developed technology infrastructure but the emergence of a divide in audience behaviour. For some (particularly the young and affluent), viewing behaviour migrates online, the internet becomes the most important platform for the distribution and online consumption of audiovisual content and consumption is shared across many new providers. For others, technology adoption is slow. Viewing remains predominantly through linear television, either because the modern network infrastructure has not been built out to their part of the UK, and they lack the skills and confidence to find and use new media content, or because they cannot afford to connect to the new networks and pay for the services available.
- 3 Under “consolidated transformation”, there is high and widespread adoption of new technology, spreading from the young to the older generations, and non-linear services broadly replace traditional linear consumption. Crucially, consumers look to trusted existing content providers to navigate the new market, and incumbent broadcasters become important gatekeepers online. Players consolidate their industry share across platforms and may engage in vertical integration.

- 4 Under the final and most extreme view of UK broadcasting in 2018, “radical transformation”, there is a very fast pace of technology adoption. High non-linear penetration across all demographics results in the dramatic decline of linear TV, and the term “broadcasting” in reference to linear television becomes essentially obsolete. The non-linear market successfully supports a wide range of new business models. However, unlike the consolidated transformation scenario, consumers’ empowerment to search for on-demand content themselves means that market power fragments to thousands of content suppliers. New entrants take precedence and PSBs may struggle to make an impact in the new online world.

The broadcasting landscape that actually transpires is unlikely to mirror precisely any one of these four scenarios, which are designed to delineate the limits of plausibility for 2018. The future that results will likely exhibit characteristics that fall in between these archetypes.

The value of this type of scenario analysis, however, is that it allows us to identify those market changes that are likely to occur irrespective of which future actually develops, and those that are scenario-dependent. From this, it is easier to assess the risks and opportunities associated with the key policy objectives, and to inform the debate on the required scale, scope and type of future intervention.

COMMONALITIES

Across all of these four archetype futures for the broadcasting market in 2018, there are a number of common trends, outlined below.

Significant change

Broadcasting in 2018 will almost certainly be a substantially different world from that of the past 30 years. Although the pace of

technological change is unknown, the general direction suggests a world in which different distribution platforms, such as the internet and digital television, battle for supremacy. New players challenge the status quo, and old players must develop new business models to cut through.

Continued growth in the importance of online

Increasingly, people will choose to view audiovisual content via the internet, giving them access to a wider choice of programming. This is true even in the evolution scenario: broadband penetration in the UK is still expected to be almost 85% by 2012 and the number of television programmes watched online is forecast to quadruple to more than 1.7 billion per year over the same period.¹³

Greater competition

As consumers migrate online, new competition will make the old commercial models increasingly difficult to sustain. In a future where the online market is fragmented, incumbents will be competing against a very large number of niche players. In a future where the online market is consolidated, they will have to compete against large global players. In all views of the future, this online environment will make it more difficult for PSBs to reach consumers. Even in Capgemini's "evolutionary" world, which does not depart substantially from today's situation, PSB volume of viewing falls by 15% by 2016.¹⁴ This will make it more difficult to convince consumers that PSB is delivering value. Public support cannot therefore be guaranteed.

Conversely, if public service content is to reach consumers at all, the growth in competition as a result of online development will make the few broadcasters that have the scale to cut through the noise (under

¹³ Screen Digest, *Broadband Intelligence* (2008).

¹⁴ Capgemini, *BBC Response to Ofcom's Second Public Service Broadcasting Review*.

radical transformation) or to compete with global players (under consolidated transformation) even more important for PSB. Particularly under scenarios in which the market is more fragmented, their ability to both invest in and promote quality programming will be unmatched.

Changing economics

There will be significant new opportunities in some scenarios to develop fresh ways of making and distributing content, to diversify into new markets, to forge new alliances, and to develop alternative sources of advertising. But conventional broadcast models will face pressures. The high fixed-cost nature of commercial broadcasters means that relatively minor falls in viewing can severely impair their profitability (for example, Capgemini's analysis suggests that even in their "evolution" scenario Channel 4 will be loss-making by 2012, unless it responds by changing its programming strategy).¹⁵ Even where broadcasters manage to retain significant market share in a digitally converged world (under "consolidated transformation"), lower online advertising yields could make them less willing to continue to invest at current levels in a range of UK programming.

Regulatory assets such as spectrum, which have been used to secure public service obligations from commercial PSBs, may continue to be of some value in the short to medium term. But they have highly uncertain long-term prospects. This is true across all views of the future, although under the "gradual evolution" scenario they will have more value for longer.

Market structures will change as new online players emerge and large international broadcasters enter the UK market. In an industry where scale is important, this competition may increase the rationale for consolidation of the more traditional content providers and lead to more vertical integration.

¹⁵ Ibid.



Changes in consumer expectations and behaviour

In all of the scenarios, there will be significant changes in consumer expectations and behaviour, although the speed of change and proportion of the population embracing it will differ. In particular, we will see increased use of on-demand and interactive content and services, and a much greater interest in sharing views and information, in taking part in online discussions and in creating content. In effect, this will represent a significant democratisation of media – which in itself could contribute to more effective achievement of some of the traditional aims of PSB. New media services and their use by citizens could help produce a more active, informed and engaged society, for example – perhaps with greater effectiveness than would ever be possible in a linear broadcasting world. Likewise, new media will open up public access to vast stores of information and data from around the UK and across international borders, enhancing what is currently provided by PSBs and perhaps ultimately supplanting some aspects of their prevailing output.

UNCERTAINTIES

Despite these many commonalities and although the trajectory of change is clear, some characteristics of broadcasting in 2018 are not yet evident. It is important that these uncertainties and the associated risks help inform policy design.

The overriding uncertainties are the extent and speed of change. These will depend, in part, on key decisions made about the development of broadband and infrastructure investment.

The crucial difference between “consolidated transformation” and “radical transformation” is the extent to which broadcasters successfully transfer online. In the latter case, consumers choose content via search engines from a vast array of providers, essentially cutting out the

traditional broadcaster. The extent to which this occurs will, of course, depend on a range of factors such as consumer preferences, the pervasiveness of piracy, the relative importance of traditional brands and, for the commercial PSBs, the degree to which viable online business models can be established.

It is also unclear to what extent a digital divide emerges (described by the “fragmented” view of the world). This would not be beneficial, making commercial provision of PSB content more difficult and meaning that many consumers miss out on the benefits of a more converged digital landscape. The extent to which a divide emerges can potentially be influenced by policy decisions, and broadcasters may need to play a role here.

Finally, the overall impact on the health of the UK production market is uncertain. As we noted, there are opportunities for the creative economy, but also real risks. In some views of the future, we see a drop in the ability of commercial PSBs to win revenues and invest in programming. Online advertising cannibalises revenues from broadcasting but does not channel funding into UK content, with a knock-on effect on UK content production. The powerful new internet players will be unlikely to invest in UK programming as their business models simply do not require it.

IMPLICATIONS

The implications for different stakeholders, both of the common threads between the various scenarios and of their differences, are discussed below.

For citizens and consumers

In all scenarios (although to differing degrees), citizens and consumers who participate online have the potential to gain from more choice

across broadcast and broadband platforms, as low barriers to entry and greater access to niche groups enable new business models.

However, while consumers will enjoy a larger quantity of programming, quality may be compromised in some scenarios. This is particularly the case where the online market is highly fragmented, and where technology consumption is split across platforms. Here, many players will not have the scale or inclination to invest in quality programming, or to take financial risks with challenging programming, instead choosing to focus on easy spends with mass appeal.

As noted above, a landscape characterised by “fragmentation” portrays an enduring digital divide in the absence of intervention, meaning that many consumers will be excluded from the benefits of digital and broadband developments. Furthermore, even if all citizens participate in the switch to online, there is a danger of polarisation in viewing of PSB, with its consumption strongly related to education and affluence.

For the PSB ecosystem

New media offers the prospect of a more effective delivery of public service content. It offers the chance to spread programme spend across platforms and, therefore, audiences, better access to production for minority groups, better provision of content for niche interests and new methods of delivery (with greater opportunities for interactive participation, for example).

Broadband access to the vast resource of information and content from public and private bodies in the UK and around the world could, over time, reduce the need for some types of content to be publicly funded.

There are also substantial risks to the PSB ecology. The existing model of public service content provided by commercial broadcasters

is under threat across all scenarios. Channel 4 and Five are particularly vulnerable. In some scenarios they may survive as niche broadcasters in the long term, but in an increasingly online world the viability of their current business models may be at stake.

As audiences fragment, and global competition increases, the BBC may find it harder to reach licence-fee payers and convince them that it is delivering value, with a consequent decline in support for PSB in its current form (particularly the licence fee). Further, the increasing on-demand nature of viewing, while bringing many benefits, erodes the “serendipity effect” of linear television, whereby consumers come across PSB content from which they will benefit by chance. This poses a new challenge for the BBC – how to find the new media equivalent of a linear scheduled channel which offers more choice and user control but also help and advice for users who are keen to discover new material and experiences.

For the creative industry

Looking across all four scenarios, while we feel that there is scope to maintain and develop a dynamic and thriving UK creative economy, UK content production could suffer, particularly in those scenarios where commercial PSBs face pressures, and audiences turn to US and other content providers for their entertainment.

The challenge for policy now is to manage new opportunities and risks presented by the rapidly changing environment – this could require significant change in the overall emphasis of public policy, and in the role that intervention to secure public service content is seen to play in future. The next chapter will explore our suggested model for the future of PSB in the light of the picture of the future presented here.



4. DESIGNING A NEW MODEL OF INTERVENTION

In this chapter we explore how a model for public service broadcasting might be designed in the context of the possible future developments outlined in the previous section. First, we consider the broad parameters that should condition the model, based on an understanding of how the industry is changing. Next we address the nature of the intervention in terms of the role of institutions, plurality and content standards. Finally, we consider a role for contestable contracts, and address the different funding mechanisms.

Given what we know about the trajectory of change and the key uncertainties, opportunities and risks, what should intervention look like in 2018?

BROAD PARAMETERS

As a first step in designing any new model for intervention in detail, it is worth considering its broad parameters. Drawing on the scenario analysis, we suggest a need to develop policies that broadly move us towards a world that has many of the features described in the “transformation” scenarios, while addressing the real concerns that might emerge along the way. That means helping to facilitate the potential benefits to citizens and consumers that are associated with modern broadband networks and the more open and competitive markets for services that they could support, while ensuring there is protection against the adverse effects of a digital divide, fragmentation and new sources of market power.

Close attention will need to be paid to high-speed broadband

We suggest first that policy thinking should begin by prioritising fair access and take-up of high-speed broadband as a precursor to ensuring access to high-quality content. Early broadcasting

interventions were aimed at creating a framework in which market gaps and shortfalls could be filled, through a combination of public funding and regulation. Looking ahead, we suggest a new approach to intervention, which is aimed first at unlocking market potential, alongside action to address any remaining shortfalls. We argue that, whereas the starting point in the old world was predominantly content, in the future ensuring access to high-speed broadband should play a much larger role.

This will potentially bring many transformational benefits to UK consumers, citizens and the economy as a whole. Broadband can help individuals gain access to a wealth of content and services from around the world that can help make them more informed and better educated, and help build a sense of community and shared values. More open access to communications and a vast increase in user participation make for a more democratic communications and media environment than has ever been possible in the traditional broadcast world. In fact, some of the aims of conventional PSB are better pursued in a broadband environment, such as Ofcom's PSB "Purpose 4: Representing diversity and alternative viewpoints". Broadband can help unlock further the potential of the market to deliver a high diversity of content. In so doing, it can ultimately help address some of the market failures associated with conventional broadcasting.

Therefore, just as securing universal access to broadcast TV was a central feature of the old PSB world, so a similar objective will become important for the new broadband world – especially as we move towards a society in which the majority have access to high-speed broadband, but a significant minority do not. As the scenarios underline, there are plausible outcomes in which a significant minority of UK households remain outside the digital and broadband revolution. Public interventions in one form or another will be needed to help address these concerns. Public broadcasting may have a role to play, for example in creating content which helps drive broadband

demand, or in increasing consumer awareness of the benefits of high-speed broadband.

Market provision will play a greater role

Whatever the outcome, open markets, with their decentralised decision-making, free exchange, scope for trial and error, and ability to rapidly exploit technological change, will have a key role to play in delivering consumer benefits – much more so than has been the case up to now.

In fact, where there is scope for more effective and dynamic markets, and a possible decline in importance of some of the old market failures, it would not seem sensible to be planning for any significant increase in PSB funding or provision. This is particularly true in the more extreme visions of the future – that of “radical transformation”, for example. In the longer term, existing commercial PSBs like ITV and Five are likely to have a more useful role to play in helping drive commercial market developments than in the delivery of narrowly defined public service goals.

In their thoughtful paper on public broadcasting in the digital age, Armstrong and Weeds argue that although PSB can be seen as a coherent response to market failures inherent in broadcasting that is funded by advertising, digital broadcasting is much less prone to traditional market failures, and will supply programming that viewers want to watch.¹⁶ For example, insofar as consumption moves towards non-linear technologies, the public good argument for PSB will diminish. Mechanisms already exist that allow charges to be made for broadcast content. There are sophisticated approaches to price differentiation which allow most users to access content they value at a price they can afford. The past few years have also suggested that

¹⁶ Mark Armstrong and Helen Weeds, “Public Service Broadcasting in the Digital World”, in Paul Seabright and Jürgen van Hagen (eds), *The Economic Regulation of Broadcasting Markets* (Cambridge: Cambridge University Press, 2007).

much of the content provided on the internet will be free at the point of use – either funded by advertising and transactions revenue, or simply provided by people who post for free. Although neither development entirely removes the public good rationale, they do suggest, given other calls on public funding, that public intervention to address the problem should be scrutinised ever more carefully.

The experience good problem will also reduce in significance, as the costs of finding good content will decrease. Increasingly, programmes will be consumed on demand, after they have been extensively reviewed. More and more information about the nature of available programmes is being provided. There are already many examples of peer-group recommendations on the web that help users to find content they will like and enjoy – these are likely to develop further. Content packagers will find it in their interest to guide customers to new and interesting content they will like – hoping they will come back for more. Programmes can be sampled and fast-forwarded by users, and quickly rejected if they are not suitable – the cost of making a wrong consumption choice is limited.

Enduring market failures

Armstrong and Weeds also note, however, that there will be a remaining rationale for PSB linked to externality and citizenship concerns.¹⁷ The scenario analysis helps us to identify what those enduring market failures are likely to be.

First, although more content with PSB characteristics will be provided by the market, some genres will still be under-provided and not available to all. The internet is likely to be good at providing access to a multitude of opinions and discussions about news stories and issues of importance. It is likely to be less good at investing in well-resourced newsgathering infrastructure, at investigative journalism

¹⁷ Ibid., 126.

and at helping users distinguish truth from prejudice. Impartial news provision is unlikely to be a key feature of the new world and internet content providers are likely to find it harder to fund high-quality narrative dramas and serious factual programming – and may not be interested in doing so.

Second, an argument can also be made for PSB as the main bulwark against declining investment and standards. This case is particularly strong in a “fragmented” world. International comparisons show that, in markets where PSBs produce original high-quality content, consumers’ tastes are conditioned and commercial competitors follow suit. And even if high-quality content is made, it may have to appeal to international rather than UK audiences.

Third, although media consumers are increasingly knowledgeable about what they watch and how they can choose it, there will remain some information asymmetries. Indeed, an increasingly significant problem may be less that high-quality content does not exist than that it will be difficult for people first to find it among the vast amount of content available and then to assess whether it is “trustworthy” or not.

Health of the creative economy

As commercial revenues fall and broadcasting markets become more international in their demands, investment in and production of UK content may suffer in some scenarios. The priority for public policy may need to shift from supporting UK content diversity to simply supporting UK content. Indeed, PSB interventions can have a significant effect – both positive and negative – on the health of the creative sector of the UK. Future policy should recognise this, and try to chart the difficult course between interventions that help markets develop (through, for example, support for training, R&D, conditioning consumer expectations for UK content) and those that crowd out private investment.

THE NATURE OF INTERVENTION

Given these broad parameters, what sort of delivery mechanisms would we design for 2018? Will we still need a major structural intervention like the BBC, or would public interest content be more effective if it were spread across a much wider range of suppliers and distributors, in line with what might be a much more fragmented consumption environment?

A public institution

Across many areas of public policy, recent years have seen an emphasis on introducing, designing and regulating markets to achieve public policy goals. In PSB, too, this is entirely appropriate and indeed we suggest, a greater potential in the future for the use of market mechanisms to deliver public goals than has been the case in the past. Nevertheless, we argue that at least one strong institution is needed as a primary conduit for public service content to address market failures and help condition the market, especially as competition increases.

We maintain that an institution with a culture and values that are closely aligned with overall public service objectives will more effectively deliver public service content. Some aspects of public service content are very difficult to define precisely – such as challenging and ambitious drama or factual programming. In this way, they are unsuited to detailed contractual specification and are more likely to be delivered by an institution in which public service values and aims are embedded than by one that is primarily delivering a public service contract for commercial gain.

Public institutions also avoid the potential conflict between commercial and public service objectives that may arise when contracts are used to fund the provision of public service content by private companies. In most scenarios, this conflict will get more rather than less intense.

Institutions, if their governance is properly designed, can be more flexible too. For example, within its overall remit, the BBC's priorities and approaches can change more easily over time than would be possible through a tightly specified contract with a commercial provider – which could only be significantly changed at the point of renewal.

Institutions, of course, have their disadvantages. There is always the risk that institutional interests may take precedence over public interests, and it may be hard to convince the public that those institutions are held to account effectively for what they do. They can become more interested in their own expansion or survival than in the general public interest. If not properly challenged they can become complacent and inefficient. Entrenched institutions may be less likely to innovate than new market entrants, although a PSB mandate can effectively encourage innovation (seen, for example, in the iPlayer).

Intervention of sufficient scale

Most importantly, perhaps, if they operate on a large enough scale, institutions can help to ensure that public service content continues to create an impact even when faced with powerful global competitors, and can help bring audiences together in those scenarios that see a much more fragmented market. A large PSB can:

- commission more and better-funded output, and can support more risk-taking and innovation;
- play a key role in “conditioning” the rest of the UK broadcasting market – for example, by setting benchmark quality standards and ensuring there is a high audience expectation for UK programming;
- provide a counter-balance to the market power of large integrated commercial broadcasters; and

- use its scale and scope to help secure audience attention for its output across a range of platforms and encourage viewers to sample different types of content.

It could be argued that, in a world that involves the most “radical transformation” of markets and media consumption – in which consumers choose content via search engines from a vast array of providers (and, to a lesser extent, from a small number of large global players) – it will be more effective to place public service content with a wide range of suppliers, each of which will be more in tune with its target customers and hence better placed to ensure that content reaches its intended audience. But even here there is a case for having at least one significant institution able to commission public service content and exploit it widely across different media, even if other approaches are adopted alongside it. Institutions can change, too. In 2018, one might envisage a new type of institution which is more open, diverse and decentralised in its approach to commissioning and distribution, and one which engages more actively and openly with content producers whoever they are – individuals or big firms.

Plurality of PSB provision

Plurality is almost always a good thing, and plurality of PSB providers has been at the centre of the UK model for many years. Plurality has been generally accepted to deliver benefits in three main ways, both for broadcasters and content creators:

- providing competition for different types of PSB content, hence improving quality, value and innovation;
- securing a broader reach for PSB content by employing a range of suppliers each with its own distinct audience; and
- ensuring there is a diversity of views and perspectives on screen, especially in news and current affairs.

The key question for PSB is whether public intervention will continue to be needed to secure the benefits of plurality. If the market itself provides plurality, then intervention to that end is no longer necessary. In our view, the arguments for a plurality of PSB providers are weakening, as we explain below. It should be noted, however, that this does not weaken the argument for public service broadcasting as a whole – the benefits, as described by Gavyn Davies and summarised in chapter 2, remain valid (although this does not mean that the scale of intervention should remain constant as markets develop).

In respect of the first benefit listed above, in all the scenarios we have examined except that of “gradual evolution”, the expectation is that significant competition, even for narrowly defined PSB-type content, will emerge in both traditional broadcasting and new media. Not all of it will be free, and not all will be available to everyone, but it will act as a competitive spur for the BBC to continue to deliver high-quality programming that attracts audiences. More generally, it should be remembered that the BBC is already open to the beneficial effects of market forces at various stages of the value chain – either through the commissioning process (in which independent producers compete against in-house producers within the new commissioning framework), or through its competition for audiences, without whose support its long-term prospects would look doubtful.

In terms of securing a broader reach for public service content, the importance of maintaining several public service content providers will also diminish under all scenarios. New media platforms and greater availability of on-demand services will ensure that viewers are able to access programming at their convenience and through the platforms and devices of their choice. In an increasingly competitive world, it is arguable that too much plurality of PSB provision risks fragmenting the impact of public service content and reducing its effectiveness. The future scenarios suggest a world in which UK public service content provision will have to compete for attention either with very

powerful and well-funded global players or with thousands of smaller and highly targeted content and service providers. In both worlds, although there is a case for supporting PSB plurality, we argue that a more important objective in a harsh media environment is to retain a PSB provider with the scale and scope to operate effectively. If a trade-off has to be made, we think, therefore, that it should be made in favour of reach per se, not plurality of PSB providers.

We are therefore left asking whether the third goal – that of ensuring that there is a diversity of perspectives – can only be provided by securing additional provision of public service content alongside the BBC. In the more radical scenarios, even this objective will be much reduced in importance, as new media developments will allow a much wider range of perspectives and opinions to be accessed by citizens than ever was possible in the old world of four large highly regulated PSBs.

If the real world is more in line with the “gradual evolution” or “consolidated transformation” futures, however, then plurality of supply may still be an important goal for some programming genres. Impartial news and current affairs, UK children’s content, and ambitious and challenging drama and factual programming are usually thought to be most at risk in a fully commercial market, but not all are equally important in terms of delivering the wider social goals associated with PSB. News and current affairs, at both national and regional level, would seem to be the most important here, as long as broadcast news remains an important source of news and information for most people.

Content standards

It is important to recognise that UK broadcasting policy is not simply focused on public service content and channels, but also seeks to ensure that all programming meets the standards expected by citizens,

in areas of harm and offence, fairness and privacy. This issue has received considerable public attention over the last year or so. Here the choice is whether to continue to design detailed rules and specifications for the type of intervention we want, or to set out broader principles which regulators or PSBs can interpret more flexibly as technology and society's tolerances change.

Although the former approach guarantees well-understood standards, it may become irrelevant to citizens' needs over time. And even if detailed rules can still be applied to traditional broadcast channels, it is likely to be difficult to design such rules for content delivered via the internet, and in any event, such rules could be hard to enforce.

The alternative approach would be for the regulator to set out some broad principles governing acceptable standards, and then ask broadcasters and new media players themselves to decide how best to act in a manner consistent with those principles. The latter approach is harder for a regulator to monitor, but will be more responsive as needs change.

The scenario analysis suggests that we are entering a period of great uncertainty and possible change – in how content is made and consumed, in the importance of different broadcasters and platforms, and in citizens' expectations regarding levels of protection from potentially harmful or offensive content. In such an environment, regulation needs to be more rather than less flexible, suggesting a need for general principles rather than hard and fast rules. Even in the most conservative “gradual evolution” view of 2018, arguments for a flexible approach will apply more strongly with time.

Returning to the question of plurality, this approach may be easier to pursue if some of the key broadcasters, like ITV and Five, remain as part of the “PSB family” and are signed up to certain broad goals. In this

way there could be value in a plurality of PSB provision as a way of securing wider support for maintaining acceptable editorial standards and investing in UK content over the long term, and thereby contributing to the overall health of the UK broadcasting sector.

THE ROLE OF CONTESTABLE CONTRACTS

If some public service programming is to be provided alongside the BBC, there is a range of ways of providing it. Policy-makers must seek the right balance of institutions, contracts and other compacts or arrangements. They need to choose whether to rely on tried and tested existing providers, or to encourage scope for new providers to emerge. They need to decide whether to allocate funding via competitive tender or via a process of assessment and negotiation.

A clear and obvious option would be to support an alternative, directly funded public service institution, likely to be Channel 4, with the aid of guaranteed public funding, to take on the responsibility. For the following reasons however, we do not think that public money to secure public service content on Channel 4 is the answer:

- it would compromise Channel 4's reputation for editorial independence and experimentation;
- it would raise difficult competition concerns;
- it would require a new and possibly counter-productive accountability mechanism to be put in place;
- it might not be sustainable in the longer term, given the likely continued commercial pressures facing the channel; and
- it is not clear why one would want to preserve an additional publicly funded institution alongside the BBC.

Another option would be to have an open and transparent process by which contracts are awarded to PSB providers, with a competitive process where appropriate, hence increasing efficiency and accountability at the point of allocation, and perhaps ensuring that the best ideas for delivering a defined aspect of public service content are discovered. Invitations to tender could be issued to both existing and new providers.

A hybrid option would be to extend today's regulatory compacts with ITV and Five, by which regulatory assets such as spectrum access and Electronic Programme Guide position are traded for agreed PSB obligations. This would have the advantage of building on the resources, public profile and expertise of existing bodies, but might be time-limited in its usefulness (as the value of those regulatory assets declines) and is arguably less transparent and fair than a competitive tender process open to all.

The disadvantages of some systems of contestability have also been much discussed, and are well summarised in Ofcom's previous PSB Review.¹⁸ If relatively modest amounts of PSB are to be funded alongside a strong institution, however, we believe that there is a case for using a contestable contract approach. While recognising the upfront costs in providing a service, it is not obvious, for example, why a contract for the provision of schools programmes or UK programming for older children could not be openly offered for tender every few years. Teachers' TV has shown that this can be done.

However, contestable contracts would not work well in two specific forms:

- 1 First, in securing more general and hard-to-specify public service objectives. These are difficult to write effectively into a contract and then hard to monitor during the course of the contract.

18 Ofcom, *First Review of Public Service Television Broadcasting* (London: Ofcom, 2003–5).

- 2 Second, in contracting on a case-by-case basis for individual PSB programmes. This would involve high transactions costs and high costs of securing transmission in peak-time commercial schedules (commercial broadcasters would expect to be compensated for the full opportunity cost of showing the PSB programme).

The hybrid approach – in essence, a continuation of the current model – may have value as a transitional arrangement, although it will be important to ensure that the full value of those regulatory assets is returned to the public in the form of clear PSB commitments.

FUNDING SOURCES

A range of mechanisms for how to fund the provision of PSB alongside the BBC has been posited. We argue that although some of these have some short-term tactical merit, they also share long-term drawbacks. Below we summarise the drawbacks of each method of funding.

Regulatory assets

Regulatory assets such as spectrum may be of value in the short to medium term. As the scenario analysis shows, they have uncertain long-term prospects. A fully broadband world would suggest little or no value in holding spectrum, for example, and the value of EPG positioning is likely to decline as consumption migrates to new platforms and becomes increasingly non-linear. Under the “gradual evolution” scenario, they will have more value for longer.

Industry levies

Levies look superficially attractive, and, if spread widely across the communications sector, could be kept reasonably low. But they may distort investment decisions over time, and could reduce profits at a

time of significant economic stress. This could adversely affect the commercial health and investment plans of the broadcasting and communications sector in the UK.

Direct grants out of general taxation

For pragmatic reasons, direct grants seem unlikely to be seriously on the agenda in the near to medium term for anything other than a small contribution at the margins. In any event, they may raise concerns about political independence.

BBC assets (such as a share in BBC Worldwide)

Transfer of BBC assets introduces new problems. For example, the assets are difficult to value, the process lacks transparency and it may lead to foreclosure of future options for BBC Worldwide.

Lottery funds

Again, we suggest that lottery funding could have some short-term tactical value, but this would be, at best, a marginal contribution to the broader funding challenges ahead.

Top-slicing the licence fee

In discussing the type of funding required, “top-slicing”, or sharing the licence fee among PSB providers, has been a highly controversial topic throughout Ofcom’s PSB reviews. We believe that licence fee “top-slicing” would almost certainly weaken the BBC, especially if it is the first step on a slippery slope to further cuts, and it does not make sense if we take a long-term view of PSB. Equally, a continually increasing licence fee is not, in our view, a sensible assumption in any of the scenarios outlined earlier – public support cannot be guaranteed in either evolutionary or transformational worlds, and if

economic times are bad, then scope for increases will be even more limited.

Moreover, top-slicing risks weakening support for PSB in general, not just at the BBC, for two reasons:

- 1 At present, public acceptance of the licence fee depends very much on the perception that it delivers value for money. Most licence-fee payers have at least a vague idea that the proceeds fund part or all of the BBC. If it were to be split in future between several or many providers of public service content, it would be much more difficult to demonstrate value and accountability, putting pressure on a mechanism that relies on public support.
- 2 Spreading the licence fee reduces the chances that a clear long-term strategy for its future evolution can be developed – if many broadcasters have a claim on the licence fee, the chances of reform will be much lower.

Rather than talking about sharing the licence fee, policy-makers should be working out now what its long-term future is and how it can be changed to respond to future public concerns – especially as we continue to move into a world in which consumers expect more choice and control over what they choose to consume and to pay for.

There are also good reasons to avoid models that involve a mix of commercial and public funding (some European PSBs receive both advertising income and a licence fee). Mixed funding raises difficult issues around incentives and accountability and also competition concerns. Indeed, we would argue that the UK broadcasting system has benefited so far by largely keeping competition for audiences separate from competition for funding



An important new issue is the extent to which part of the licence fee could be used to help fund the move to high-speed broadband – following the precedent set by digital switchover, or, given the BBC context, how the BBC might support the move to broadband. Another set of issues arise because of the changes in delivery and reception equipment being used in the market, which will make a licence for TV receiver ownership increasingly out of date.

5. POLICY IMPLICATIONS

Our final section sets out the policy implications of the discussion, first in terms of core policies and then with reference to the PSB institutions.

CORE POLICY IMPLICATIONS

Given the preceding discussion, we argue that there are several core components of policy that will stand us in good stead for all plausible eventualities, irrespective of which scenario transpires. These are discussed below.

Policy implication 1

High-speed broadband provision should be prioritised ahead of any new PSB interventions

Policies to promote widespread access to high-speed broadband should be a key part of any new policy mix. This is critical because there are many public benefits from ensuring that broadband does spread quickly. This being the case, exclusion of certain groups from the high-speed broadband world would be a bad outcome for both the industry and the consumer. As we have discussed, many of the aims of PSB can be more effectively delivered in a world with high broadband penetration and some can be delivered without investing as much public funding in content. The policy toolkit here is likely to involve a role for public broadcasters and for broadcasters more generally. For example:

- a role for the BBC and others in creating new content and services which will help drive broadband take-up;
- a role for PSBs in supporting media literacy initiatives to enhance consumer understanding of broadband and its capabilities;

- a possible role for using some of the licence fee to support broadband development programmes, as has been done with the switchover process.

Policy implication 2

There should be tight scrutiny of any new claims for increased funding of PSB

It is hard to see a case for significantly expanding funding of public service content in any of the scenarios we have assessed:

- in the more optimistic scenarios, the market will continue to increase provision of content and services with public service characteristics in many of the genres traditionally thought to be part of the core PSB remit;
- in the less optimistic scenarios, it is not obvious that the answer is to spend more public money on content; rather,
- the challenge will be to secure wider access to existing public interest content via broadband and mobile and to give commercial players more not less freedom to respond to commercial pressures and opportunities.

Government policy should therefore seek a new balance of markets and public intervention, with the presumption being that any new claim for direct funding of public service provision is very tightly scrutinised. In some of the more radical scenarios, there may be a case for reducing spending on public service content over time. Those decisions should be made as markets develop and we have a better understanding of where things are heading.

Policy implication 3

Commercial players should be given as much flexibility as possible in what is an increasingly competitive market

Given the competitive challenges ahead, and their potential importance to the long-term health of the UK media and production sector, key existing commercial players like ITV and Five should be given as much flexibility as possible to develop their commercial strategies, forge new alliances, and prepare for the world of high-speed broadband. Channel 4 faces similar competitive pressures. To help secure a dynamic domestic commercial media sector, one option would be to free all three broadcasters from their existing PSB obligations and allow them to play a full role as commercial players in the UK and world marketplace. Any continuing PSB obligations for these commercial firms should be designed to be affordable and consistent with their commercial strategies.

Policy implication 4

The BBC should be at the heart of any new system for 2018

There is a strong case for having a large public institution at the core of the system, with scale and scope to compete with big global players and condition the UK market, and a broad remit across different media and platforms to secure reach and impact. We therefore believe the BBC will continue to play a central role in public service broadcasting, but a role that will need to change significantly as it assumes probably greater prominence in the delivery of public service objectives than it has done hitherto.

Policy implication 5

A limited number of “market-tuning” and “market-changing” interventions should be considered to ensure plurality of PSB provision and maintain content standards

Although intervention to secure plurality is likely to be less important in some scenarios than in others, there are likely to be some elements of public service content that cannot be provided by the BBC alone. To address this, two types of PSB intervention might be merited over and above the BBC.

The first involves encouraging what we term “market-tuning” contributions from existing commercial PSBs – PSBs retain their public service status and privileges in exchange for limited obligations which go with the grain of their commercial programming strategies. Second, there may also be substantial public value in some carefully targeted “market-changing” PSB interventions in particular areas, at least in the medium term, such as the provision of regional news and support for a more diverse range of UK-originated content in, for example, serious factual or drama programmes. Without intervention, these are less likely to be offered up by commercial PSBs, given their cost and possible inconsistency with overall commercial programming strategies (although this could be put to the test in more detailed discussions with those broadcasters). In both cases (market-tuning and market-changing interventions), economic incentives should be given to the broadcasters or other providers concerned, possibly including direct payment.

In addition to direct commercial PSB-based intervention, we argue that additional components of the public service provision could be secured through a system of open tenders, contracts and, where appropriate, contestability. Contestable contracts could be applied to the commercial PSB interventions above, but not, we believe, to the

BBC. The BBC benefits from scale, from the dependability of its funding, and from the political independence which is a cornerstone of the PSB ecology. By contrast, contestable funding might be appropriate for ITV, Channel 4, Five and other (new) PSB providers.

Policy implication 6

A fair and transparent approach to awarding PSB contracts is needed, including an element of contestability in some cases

Across all scenarios, there may be increased concerns about the levels of funding available for UK-originated content. A range of policy approaches will need to be considered here, from securing a continuing significant role for the BBC, to ensuring that commercial PSBs have as much flexibility and big enough incentives to continue to invest in UK programming.

IMPLICATIONS FOR EXISTING PUBLIC SERVICE BROADCASTERS

In this final section, we propose roles for the main existing PSBs in 2018. It is against this background that we believe policy for the short to medium term should be formulated.

The BBC

Policy implication 7

The BBC's funding should continue to be provided by the licence fee, subject to periodic review

The BBC benefits from scale and from the dependability of its funding; its funding model also gives it a political independence which is vital for the central pillar of public service broadcasting. The scenario

analysis also suggests that, as broadcasting expands into new media, a weakening of the BBC would not be good for either PSB provision or the industry. The inference we draw is that top-slicing is not an appropriate model for the BBC.

The price of this privileged position is a demanding governance regime. Our analysis has important implications for the BBC Trust and management members, who must recognise that they will have an even more central role in PSB provision.

We suggest that the following changes would be needed:

- 1 The BBC should commit to a more open and pluralistic commissioning policy, perhaps with some commissioning functions organised entirely independently from the main part of the corporation, to ensure that it emits a diverse range of views and perspectives.
- 2 It should also accept willingly that, when undertaking any course of action, it needs both to take account of the legitimate interests of commercial entities and to be open about its planning and processes.
- 3 The BBC should pursue a more open and collaborative approach, including partnerships with other broadcasters (perhaps sharing access to its resources) in order to facilitate public service provision.
- 4 It should promote other public service content, providing promotional support and high-profile links to content of public value from a wide range of other suppliers.
- 5 It should be asked to be at the vanguard of the move to high-speed broadband in the UK, using its various media to improve

consumer awareness and understanding, and finding creative ways to help drive broadband demand and share distribution costs.

ITV and Five

We see two broad possible approaches for Five and ITV.

First, consistent with the “market-tuning” approach suggested above, ITV and Five’s PSB obligations should be realigned so that they are more consistent with new policy objectives and available resources. In effect, this means helping ITV and Five to do more of the things they would like to do, which are in the public interest, but which they cannot afford. PSB benefits and obligations are traded off by the two broadcasters in different ways, and Five has greater incentives to remain part of that contract. But for both, PSB in future would mean a commitment to a reasonable level of UK content, and to impartial news. In return, ITV and Five would be allowed discounted access to the digital terrestrial spectrum and other PSB privileges. Part of this deal, though, would need to be a more transparent “willing buyer, willing seller” process, to give full assurance that the public value of any obligations accepted by ITV and Five fully reflected the value of the privileges granted.

Alternatively, there is a second possible approach for commercial PSBs: if the biggest policy challenge for 2018 is to secure a dynamic commercial media sector, it might be best to free ITV and Five from their existing PSB obligations and allow them to play a full role as commercial players in the UK and world marketplace.

The choice between these two approaches is dependent on the view taken of the continued importance of retaining ITV and Five in the PSB family (for example, to further help condition the market), and the scale of the commercial challenges they face.

Policy implication 8

Additional sources of funding could come from regulatory assets or direct government funding

There may be scope in the short to medium term for using remaining regulatory asset value (for example, position on the EPG or access to spectrum) to secure some transitional PSB obligations outside the BBC, but it should be recognised that the value of these is likely to decline in the longer term. Small amounts of direct government funding may also be appropriate for some modest interventions outside the BBC – for example, to ensure plurality in news supply in the nations. Larger-scale interventions are unlikely to be either affordable or desirable.

Channel 4**Policy implication 9**

Channel 4 (as an entity) should not be in receipt of public funds

The future for Channel 4 is more uncertain than that of ITV and Five. Again, we think that there are two options:

- 1 Recognise that Channel 4's position as a publicly owned creator of public value may be time-limited and that privatisation, and the opportunity to operate on a much larger scale, may be a more effective solution.
- 2 Accept that Channel 4 should remain a not-for-profit publicly owned company and redesign its PSB contribution to match the value of the remaining public assets it benefits from

(spectrum, not-for-profit status), with the flexibility to change the shape of public value generated by these assets as market challenges become more acute. This approach is only tenable if Channel 4 has sufficient scale to penetrate in an increasingly crowded landscape. Extra help could be provided through, for example, partnerships and shared resources with the BBC, and a new approach to rights deals with its suppliers (such help might also be extended to ITV and Five). Scope to invest in or manage its own production might also be considered.

Under either option, Channel 4 (like ITV and Five – and, indeed, other broadcasters) could apply for either public funds or other regulatory assets to meet specific public service objectives. The choice between the options will be influenced by the view taken of the speed of external change, and the weight given to different policy priorities. A vibrant and less constrained private Channel 4 might be able to make a more effective contribution to the UK media economy than one reliant on ever-increasing amounts of public funding. In our view, the pivotal judgement that determines the best policy outcome will answer the question “What is the best route to resolving Channel 4’s commercial challenges?”

Governance issues for all PSBs

Material changes to the PSB system – whether to the BBC or to the commercial PSBs – also raise issues of governance. There are only two sensible contenders for this governance role: Ofcom and (the existing mechanism) the BBC Trust. Given the huge existing range of Ofcom’s duties and the central importance of the BBC, there is a legitimate doubt as to whether Ofcom has the necessary decision-making bandwidth. However, for the Trust to be a credible regulator, it must evolve; in particular, it needs to:

- delineate its “strategic” responsibility from that of the BBC management and in addition be clear on the processes that facilitate strategic decision-making;
- strengthen its regulatory role through being clearer on sanctions; and
- find ways to build transparency and accessibility.

In parallel, Ofcom’s role regarding PSB should be broadened to reflect wider public policy goals for the whole sector. For example, Ofcom could be asked to:

- maintain and strength the ability of the whole broadcasting industry to meet public policy objectives through a mix of competitive markets and PSB;
- replace the PSB review with a wider review of broadcasting as a whole, which should include radio and other media as well as television;
- appoint a steering group for this new review which would contain BBC and industry representation to ensure the review accommodates a range of opinions.

6. CONCLUDING REMARKS

The stable PSB ecology has gone forever. By 2018, we could be in a fully converged broadband world, with all the economic and social benefits that it might bring. Intervention to secure the public interest in that new world will need to be redesigned to remain effective. If we get it right, there is a real chance that a new balance of markets and intervention will deliver better outcomes than those we have today.

In the paper we have argued for a radical re-think of our policy in the UK towards public service broadcasting, informed by a much broader and longer-term perspective across the entire media and communications sector. New broadband developments can help unlock the potential of the UK media market to deliver more value for consumers and a stronger contribution to social aims. Alongside a redefined PSB, this will support a better-informed and educated public, engage citizens more actively in our democracy and community life, and help strengthen our national and regional cultures and values.

APPENDIX. SCENARIO ANALYSIS

For the scenario analysis, we considered the body of existing work which has attempted to draw a picture of how the UK broadcasting may change. Most notably we analysed, and make reference to, the scenarios discussed in the following works:

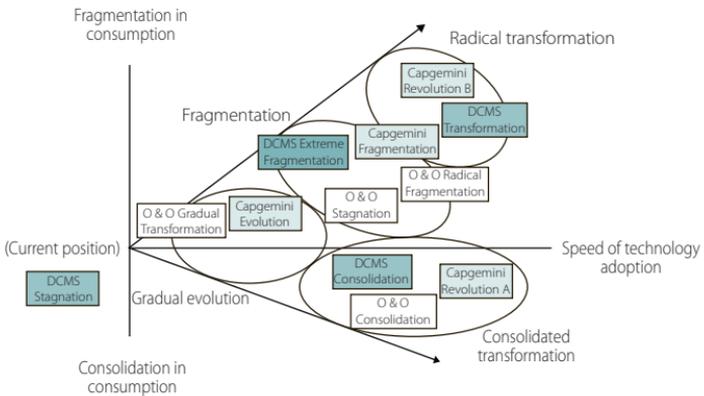
- Robin Foster, *Future of Broadcasting Regulation* (Department for Culture, Media and Sport, 2007).
- Oliver & Ohlbaum Associates Limited, *Synopsis of Oliver & Ohlbaum's Economic Modelling of Future Scenarios for Public Service Content, Phase One* (2008).
- Capgemini, *BBC response to Ofcom's Second Public Service Broadcasting Review, Phase 1: Summary of Market Modelling* (2008).

Although the results of each differ in detail, they are similar in their overall construction and hypotheses. We have therefore been able to cluster the scenarios into a small number of groups, which reflect four contrasting views of the future. In particular, the two key crucial drivers of change are:

- the speed at which new technologies are adopted by consumers (which, in itself, is a function of demand and availability of new technologies, infrastructure investment, etc.);
- the degree to which consumption of audiovisual content fragments amongst the increasing number of content providers (which is driven by a range of factors such as the extent to which the viability of traditional broadcasting economics are eroded, the ability of content providers to establish viable online business models and the degree to which consumers demand trusted, well-known brands to help navigation and search).

Figure 2 provides a stylized overview of the scenarios analysed against these two drivers of changes, and the broad views of the future discussed earlier in this report. Note that in the scenario analysis we excluded the view of “stagnation” described by DCMS (2007). We believe this scenario is now highly unlikely and argue that we have already progressed past this point. The “stagnation” scenario suggests that broadband infrastructure will, for example, remain at around 50% in the UK. According to PriceWaterhouseCoopers, broadband penetration in the UK in 2008 is already 64%.¹⁹

Figure 2: Scenario mapping



GRADUAL EVOLUTION²⁰

In the least revolutionary view of the future, “gradual evolution”, linear television remains the main conduit for consuming audiovisual content. Although there is some fragmentation in the industry as consumers discover more content online, the leading UK broadcasters remain the main gatekeepers and retain significant power.

¹⁹ PriceWaterhouseCoopers, *Global Entertainment and Media Outlook* (London: PWC, 2008).

²⁰ Described by Oliver & Ohlbaum (“gradual transformation” scenario) and by Capgemini (“evolution”).

Despite this, there is still pressure on UK commercial broadcasters. Overall share of broadcasters in the delivery of audiovisual content declines slightly, advertising stagnates and some technologies are adopted which allow advertising avoidance.

As a result, some degree of structural change amongst commercial broadcasters is required, costs are cut and there is some pressure to reduce the quality, breadth and type of content provided. In particular, pressure on commercial broadcasters with PSB obligations gradually increases.

FRAGMENTATION²¹

In a “fragmented” view of 2018, technology infrastructure is highly developed, but an extreme digital divide emerges.

For generally younger, more affluent groups, viewing behaviour migrates online as the internet becomes the most important platform for the distribution and consumption of audiovisual content. However, for a significant group of older and less affluent consumers, viewing remains predominantly through linear television, either because the modern network infrastructure has not been built out to their part of the UK, or because they cannot afford to connect to the new networks and pay for the content and services available.

In this scenario, with a large number of viewers migrating to a hugely fragmented online world and unsuccessful attempts to transfer their brands and business models online, operationally-g geared broadcasters become impoverished as advertising revenues decline. Spend in and quality of UK programming decreases.

21 Described by Oliver & Ohlbaum (to different extremes in their “stagnation” and “radical fragmentation” scenarios), Capgemini (“fragmentation”) and DCMS (“extreme fragmentation”).

CONSOLIDATED TRANSFORMATION²²

Under “consolidated transformation” there is a proliferation of new technology. However, unlike the “fragmented” future landscape there is no digital divide, adoption of these new technologies is wide and non-linear services broadly replace traditional linear consumption.

In this view of 2018, freedom from choice becomes as important as freedom of choice, and consumers look to trusted content providers to navigate the new market. This allows some incumbent broadcasters to transfer their power online, and maturity in online advertising enables the commercial players to adapt to the new business models. Alongside the incumbents, a few new players may also emerge. While choice increases, quality standards are broadly maintained and broadcasters continue to offer significant wider benefits to the market.

However, there is pressure for audiovisual content providers to become more vertically integrated and to consolidate their industry share across multiple platforms.

RADICAL TRANSFORMATION²³

Under the final and most extreme view of UK broadcasting in 2018, “radical transformation”, the rate of technology development and adoption increases considerably. In fact, the term “broadcasting” becomes essentially obsolete.

The maturing non-linear market successfully supports a wide range of new business models. Unlike the “consolidated transformation” scenario, consumer empowerment and the appetite to search for on-demand content themselves means that the market inexorably fragments.

22 Described by Oliver & Ohlbaum (“consolidation”), DCMS (“consolidation”) and Capgemini (“revolution A”).

23 This radical world of high technology adoption, fragmentation in consumption, changes in market structure and considerable power shifts is described by DCMS (“transformation”) and Capgemini (“revolution B”).



A future landscape characterised by “radical transformation” offers enormous consumer choice. Digital content will be widely distributed and all groups in the population benefit. Content will be designed to appeal to a wide range of niche audiences, alongside occasional high-quality, big impact shows.

However, value seeps away from many content owners to consumers and more niche providers (where quality gives way to quantity), and only those content providers that can obtain real scale can maintain viable business models. With pressure to reach scale, the prospect is again raised of a more concentrated UK market, albeit with powerful new players.

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What is the future of public service broadcasting? Historically, UK broadcasting has been characterised by a high degree of public intervention. But the transition to digital TV and the arrival of high-speed broadband, with its multitude of viewing options, are having a profound impact on the industry. These changes create the possibility of more effective delivery of content but also threaten to erode existing commercial and public broadcaster models and to fragment audiences and funding.

This paper, with a foreword by Gavyn Davies, explores what this changing context will mean for public service broadcasting in the UK some ten years from now. It does so by rearticulating the case for public service broadcasting and considering the extent to which market arguments, used in the past to justify public intervention, remain relevant in today's rapidly evolving broadcasting landscape.

It argues that the expansion of access to high-speed broadband will unlock the potential for the market to deliver much more public service content than in the old linear broadcasting world, and that a new balance of markets and public intervention will therefore be needed to secure key public policy objectives in the future. The authors explore the radical implications of this new balance for both existing public service broadcasters and wider broadcasting policy.

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