Airtime Sales Rules Review

Consultation

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Section 1

Executive Summary

1.1 We are consulting on the possible removal of the Airtime Sales Rules – two rules, which relate to how broadcasters sell TV advertising to media buyers and advertisers, referred to as the ‘withholding rule’ and the ‘conditional selling rule’.

1.2 The withholding rule means all of the airtime available on the commercial analogue channels – ITV1, C4 and Five - must be sold. In contrast, the conditional selling rule applies to all broadcasters, prohibiting them from ‘forcing’ media buyers – who want to buy airtime on one channel - to purchase airtime on additional channels.

1.3 The rules were intended to ensure fair and effective competition in relation to broadcasting and connected services and we have an obligation to review them periodically, to check whether they are still appropriate and fit for purpose. The rules were last reviewed in 2003 and we think it is now appropriate to assess whether they are still necessary.

1.4 We believe the rules need to be considered in light of key changes in the TV sector which we believe are likely to have enhanced competition in the supply of TV advertising airtime. The large increase in the number of TV channels and in digital TV take-up, along with a shift in viewing from PSBs toward digital channels, has provided more opportunities for buyers to secure advertising from non-PSBs. This trend towards greater competition is expected to continue with future sector developments.

1.5 We have also considered whether there are incentives for broadcasters to engage in behaviour prohibited by the rules. We believe there are limited incentives for withholding airtime, given evidence that, in the short run, it is unlikely to be a profitable strategy for C4 or Five and it would provide very little uplift for ITV1’s revenues. Moreover, we believe the way TV advertising is traded incentivises broadcasters to sell all their airtime in the long run.

1.6 Conditional selling is a form of bundling and bundling can yield benefits such as reduced costs. For bundling to have anti-competitive effects (for example reduced choice or higher prices) a sales house would need to have market power – and even then, any negative outcomes might be outweighed by beneficial welfare effects. We therefore believe it is more appropriate to treat possible conditional selling by broadcasters on a case by case basis, rather than through an industry-wide rule to prevent this behaviour.

1.7 Given these considerations, our preliminary view is therefore that the ASRs are no longer appropriate for ensuring fair and effective competition. Removing unnecessary regulation is important to enable sectors to develop and to give players more flexibility to run their businesses. This may then have positive impacts on innovation or investment.

1.8 If we conclude that it is appropriate to remove the rules, we will continue to monitor the development of the TV advertising sector and any effects of the removal. Continuing engagement from industry stakeholders will form an integral part of our ability to review the effects of lifting the rules.

Section 2

Summary

Introduction

2.1 Under s.318 of the Communications Act 2003 Ofcom is required to review from time to time any code made or approved by us under s.316 of the 2003 Act which has effect for a competition purpose.

2.2 Ofcom last conducted a review of a number of rules regarding advertising sales arrangements in 2003 (undertaken jointly with the ITC)[1]. At that time we considered that whilst the TV landscape was changing rapidly, it was necessary to retain prohibitions on withholding airtime and conditional selling for the purpose of ensuring fair and effective competition. These prohibitions are known as the Airtime Sales Rules ('ASRs' or 'the Rules').

2.3 We believe it is now both appropriate and timely to review the Rules again because:

i) There have been significant developments in the TV sector since the last review, which are likely to have had an impact on competitive constraints in the supply of TV advertising airtime;

ii) The withholding rule will, unless amended, automatically fall away when digital switchover completes as it only applies to analogue broadcasters; and

iii) In 2009, we stated that we would undertake this review as a necessary precursor to our other work reviewing rules which set limits on the amount and scheduling of minutage that broadcasters can carry (i.e. COSTA)[2]. This was also captured in Ofcom's draft Annual Plan 2010/11[3].

2.4 We are consulting on a proposal to remove both the withholding and conditional selling rules. In the event that they are removed, Ofcom will continue to monitor competition in the sector. We invite comments on this recommendation from interested parties.

The Airtime Sales Rules influence the way TV advertising airtime is sold

2.5 The Airtime Sales Rules, which place restrictions on the way broadcasters can sell their advertising airtime, are intended to ensure fair and effective competition in the TV advertising market. There are two rules:

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[1] Ofcom *Airtime Sales Rules* 2003 – these replaced the ITC's rules regarding Advertising Sales Arrangements (2001) and its Consolidated Statement Regarding Advertising Arrangements (1996). The Rules took effect from 1 December 2003 – see http://www.ofcom.org.uk/tv/ifi/guidance/ITV_airtime_sales/Airtime_sales_rules/

[2] 'Code on the scheduling of TV advertising – Rules on advertising minutage, breaks and teleshopping' 26th May 2009 http://www.ofcom.org.uk/consult/condocs/rada08/statement/costa.pdf

[3] http://www.ofcom.org.uk/consult/condocs/draftannplan1011/

- the withholding airtime rule: this prohibits the withholding of advertising airtime on analogue terrestrial channels namely GMTV, ITV1, C4/S4C and Five [4]; and
- the conditional selling rule: this prohibits the conditional selling of any channels, which occurs when a broadcaster requires that an advertiser or media buyer, who wishes to purchase airtime on one channel, must buy another of the broadcaster's products as a pre-condition of the sale.

2.6 While the withholding rule means that broadcasters of commercial analogue channels must sell all their available advertising time allowed under COSTA, the conditional selling prohibition is much broader as it applies to all broadcasters.

The Rules were intended to ensure fair and effective competition in the TV advertising sector

2.7 In the 1990s, the ITC identified the practices of conditional selling and withholding as prejudicial to fair and effective competition in the TV advertising market and hence incompatible with broadcasters' licence conditions not to engage in any practice or enter into any arrangement which is prejudicial to fair and effective competition.

2.8 In the 2003 review, the ITC/Ofcom found that the commercial analogue channels had the tightest restrictions on the amount of airtime they were able to sell and the highest levels of demand. As a result, the ITC/Ofcom concluded that these broadcasters had the potential to withhold airtime and increase profits. In contrast, it was concluded that digital channels did not have a sufficiently large market share, nor in relation to Sky was there a sufficiently strong case, to merit extension of the rule beyond commercial analogue channels.

2.9 The conditional selling rule applies to all broadcasters and so is not directly linked to the market power of individual broadcasters or sales houses[5]. The 2003 review noted concerns about the widespread nature of conditional selling, and its impact on the TV advertising sector in terms of reduced choice and artificially high prices for media buyers and advertisers. As a result all broadcasters were prohibited from conditionally selling airtime across their portfolio of channels.

There have been a number of developments in the TV sector since 2003 which we expect to have increased competition in the sale of advertising airtime

2.10 Since 2003, the TV sector in the UK has undergone significant changes, both in terms of television platforms and services, what viewers watch and the characteristics of players in the market. For example, digital television take-up has grown significantly[6] and there are now many more channels available to viewers. This has resulted in viewing becoming more fragmented with more people watching

[4] These are referred to as the 'commercial analogue channels' in the rest of this document – or as 'commercial PSBs'.
[5] We refer to broadcasters and sales houses interchangeably in this document given the latter represent broadcasters and sell their airtime to media buyers.
[6] In (Q3) 2003 only 47.8% of UK households had digital television and this rose to 89.5% by (Q3) 2009 – see Figure 1 in Section 4.

non-PSB[7] channels and hence being exposed to the greater amount of adverts on these channels.

2.11 Media buyers and advertisers have more choice about where to purchase airtime as a result of these changes. In addition the negotiating power of media buyers ought to have increased as a result of the consolidation of media buyers since 2003.

2.12 We consider that these developments are likely to have enhanced competition in the sale and acquisition of TV advertising airtime. In addition we believe that these trends, including that for greater consolidation, may continue in the future so as to further increase competition in the next 3-5 years.

We believe there are limited incentives for broadcasters to withhold airtime

2.13 We have considered whether, given the developments in the TV sector over the last few years and in the context of the trading model for TV advertising airtime, ITV, C4 and Five still have an incentive to withhold airtime on their commercial analogue channels.

2.14 Our preliminary conclusion is that there are now limited incentives, in both the short and long run, for ITV1, C4 and Five to withhold advertising minutes on their main channels. Our analysis of the incentives to restrict the supply of airtime, supported by findings from an econometric analysis we commissioned[8], suggests that in the short run the withholding of airtime is unlikely to be a profitable strategy for the broadcasters. The econometric data also suggests that the broadcasters would not have a clear incentive to act in concert to withhold airtime across all three commercial analogue channels.

2.15 Furthermore, we believe that the way advertising is traded should incentivise broadcasters to sell all their airtime in the longer run. This is because, under current circumstances, those broadcasters who increase their share of all commercial impacts[9] sold will find it easier to secure revenue commitments from media buyers and advertisers.

Bundling can deliver positive benefits to buyers and sellers of TV advertising

2.16 Bundling occurs in many industries and can have a positive impact on competition and welfare. In the context of TV advertising sales there may be positive effects from bundling such as greater efficiency or sales expansion. However in some circumstances bundling could have negative effects on competition, e.g. if it enables a broadcaster to reduce or exclude competition from the sector.

2.17 Conditional selling is a particular form of bundling and occurs when a broadcaster is able to impose bundling on a media buyer. However a broadcaster would only be able to force media buyers and advertisers to accept bundling which had substantial negative effects on them if the broadcaster has market power. Further, we note that

[7] PSB means public service broadcaster and includes all BBC channels, ITV1, GMTV, C4, Five and S4C - non-PSBs therefore refers to all other channels, except these.
[8] This will be published by the end of April on our website.
[9] A commercial impact is a single viewing of a TV advertisement by a member of the target audience.

even if a broadcaster has market power and engages in bundling, there may be positive outcomes from the behaviour and these might outweigh any negative effects.

2.18 Therefore, given that there are likely to be beneficial effects from bundling, we believe that a blanket prohibition on conditional selling could prevent broadcasters bundling airtime in ways which may deliver positive outcomes to advertisers and media buyers.

We believe that there is a strong case for considering any anti-competitive bundling on a case by case basis

2.19 When the Rules were last reviewed, the ITC/Ofcom concluded that it was necessary to retain the ASRs in order to prevent the widespread practice of conditional selling by broadcasters. However, since bundling can have positive effects, Ofcom does not consider that conditional selling should be treated as necessarily problematic. Further, given the incentives sales houses all face to obtain as high a share of commercial impacts (SOCI)[10] as possible, parallel behaviour is unlikely to be sustainable – small sales houses in particular would have strong incentives to engage in different (i.e. non-parallel) behaviour.

2.20 Accordingly, Ofcom believes that it may be appropriate to treat conditional selling by broadcasters in the same way as other types of bundling behaviour, namely on a case by case basis rather than by imposing ex ante prohibitions. As such if the ASRs were removed, the analysis of complaints of possible anti-competitive bundling by broadcasters would start with an assessment as to whether the firm in question had market power. It would then consider whether the behaviour could give rise to a restriction of competition which was not outweighed by any benefits it may deliver.

2.21 We also note that the Contracts Rights Renewal (CRR) undertakings require ITV plc to offer separate (and protected) contracts for airtime on ITV1 and its other digital channels. We believe this should prevent ITV's ability to use any market power to 'force' media buyers to purchase airtime on its digital channels in order to buy airtime on ITV1. Although we do not yet know the outcome of the Competition Commission's (CC) CRR Review, we do know that this undertaking is a feature of the existing undertakings and proposed new undertakings from ITV plc, which the CC is consulting on at this time[11].

There are potential benefits associated with simplifying and reducing regulation, where appropriate

2.22 Given our provisional view of the incentives to engage in the behaviour prohibited by the Rules, we are consulting on their removal on the grounds that the Rules are no longer appropriate to ensure fair and effective competition.

2.23 This fits with our wider commitment to reduce and simplify complex or unnecessary regulation and is in line with our general duties in s. 3(3) of the Communications Act 2003 to have regard to our regulatory principles, including targeted and proportionate

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[10] SOCI = the percentage share of the total viewings of TV advertisements.

[11] See Competition Commission website: *ITV Contract Rights Renewal – Provision Decision on Remedy Variations* http://www.competition-commission.org.uk/inquiries/ref2009/itv/provisional_decision_remedy.htm and also the *Notice of consultation on revised remedy proposal submitted by ITV* http://www.competition-commission.org.uk/inquiries/ref2009/itv/pdf/10-02-24_rpa_consultation_final.pdf

regulation and seeking the least intrusive regulatory mechanisms and, in s. 6, our duty to review regulatory burdens.

2.24 We believe there may be benefits from the removal of disproportionate regulation. For example, we consider that the withholding rule may no longer be appropriate given our analysis of the incentives for commercial analogue channels to restrict airtime, which is supported by our econometric evidence.

2.25 It is also possible that the blanket application of the conditional selling rule may be preventing individual firms achieving efficiencies. To the extent that the Rules may distort any decisions about the way airtime is sold, there is the possibility that their removal could give broadcasters more flexibility about how they operate. If this is the case, then removal of the Rules may enhance efficiency and encourage innovation which might have positive impacts for broadcasters, advertisers and viewers.

2.26 We note that TV (and specifically TV advertising) is a sector subject to considerable regulation with complex effects. Hence, we outlined several areas related to broadcasting in our draft Annual Plan[12] where we proposed considering the scope to simplify or reduce regulation. We noted that we would examine whether the requirement for certain broadcasters to sell all their advertising minutage is still appropriate (and this forms part of the ASR review).

2.27 We also indicated we would consider whether to amend the (COSTA) rules. These rules set the maximum amount of advertising minutes and determine break patterns for commercial PSBs and other channels – COSTA will be discussed in another consultation document, to be issued in the next few months. Whilst the review of COSTA also relates to the sale of TV advertising airtime, we note there are distinct differences in their scope and objectives. The ASRs address aspects of how airtime for TV advertising is sold and are intended to ensure fair and effective competition in the supply of advertising airtime - whilst COSTA sets limits on how much and how often TV advertising occurs on channels and is focused on consumer protection and limiting over-exposure to advertising.

We assess the impact of lifting the Rules in this review

2.28 The analysis in the following chapters which has led us to consult on the proposal of lifting the ASRs includes our assessment of the impact of doing so.

2.29 In line with our principal duty[13], we will keep under review the impact on competition in the market should we conclude that it is appropriate to lift the Rules after our consultation. We can achieve this by analysis of trends in the sector and regular discussions with stakeholders, including media buyers and advertisers and the Office of the Adjudicator (CRR).

2.30 If circumstances materially change in the sector in the future e.g. if the CRR remedy is removed or if there is further substantive consolidation in the sector, these changes to circumstances might change the incentives for broadcasters to engage in anti-competitive behaviour. In this case we would revisit whether it would be appropriate to reintroduce targeted ex ante rules where necessary to ensure fair and

[12] Ofcom *Draft Annual Plan 2010/11* http://www.ofcom.org.uk/consult/condocs/draftannplan1011/

[13] In carrying out our functions to further the interests of citizens in relation to communications matters and the interests of consumers in relevant markets, where appropriate by promoting competition.

effective competition or consider the application of other regulatory tools in the Competition Act 1998 and the Enterprise Act 2002 which are available to us.

Our consultation process

2.31 We have provided a 10 week consultation period in order to allow stakeholders to take account of an econometric study of the TV advertising market that we intend to publish by the end of April. It will be available on our website alongside existing research on TV advertising at http://www.ofcom.org.uk/research/tv/reports/.

2.32 The econometric study looks at the responsiveness of the demand for TV advertising in response to changes in the amount of advertising minutage. The results of this study are relevant to the work on ASRs in that it provides an additional piece of evidence when we are considering the incentives on the ITV1, C4 and Five – in an unconstrained world - to restrict the supply of advertising airtime.

2.33 We invite responses to our consultation questions and recommendation by **7 June 2010.** We will aim to publish a statement by September. Our aim is to provide certainty for broadcasters and media buyers about the status of these Rules in time for the next round of their yearly contract negotiations.

Section 3

Introduction and background

3.1 Under s.318 of the Communications Act 2003, Ofcom has a duty to review whether regulation we have imposed remains appropriate for ensuring fair and effective competition. The purpose of this review therefore is to assess whether the Airtime Sales Rules remain fit for purpose or whether they should be amended or removed.

3.2 This Section outlines what the Rules are, why they were developed and the legal framework for assessing whether they are still required.

The Airtime Sales Rules restrict the way TV advertising airtime is sold

3.3 The ASRs were imposed to protect fair and effective competition in the supply of TV advertising airtime and prohibit:

- the withholding of advertising airtime by the commercial analogue channels; and
- conditional selling of any channel, which occurs when a broadcaster requires that an advertiser or media buyer, who wishes to purchase airtime on one channel, must buy another of the broadcaster's products as a pre-condition of the sale.

3.4 The withholding rule means the Channel 3, Channel 4 and Channel Five licensees[14] must sell all available advertising time allowed under COSTA on their analogue channels, i.e. ITV1[15], C4, and Five[16]. It does not strictly apply to digital versions of these channels. However we note that in effect the rule has been applied to the simulcast digital versions of the analogue channels, since we believe the same content and advertising is carried on analogue and digital versions of the same channel.

3.5 In contrast, the conditional selling prohibition applies to all broadcasters, not just those with commercial analogue channels. This prohibition only refers to some bundling activities; bundling of products is not prohibited per se, only that bundling which can be described as conditional selling. We describe what activities comprise conditional selling in more detail in Section 6.

The Airtime Sales Rule have force under s.316

3.6 The Rules took effect on 1 December 2003. This followed a joint consultation by the ITC and Ofcom (published in May 2003) as to whether specific ex ante rules on

[14] See Annex 5 for more details on Channel 3, Channel 4 and Channel 5 licensees.
[15] We refer to Channel 3 as ITV1 in the rest of this document for simplicity – this definition includes GMTV (which is now owned outright by ITV plc) and all the regional and national television services broadcast on the analogue Channel 3. However, we recognise that Channel 3 is known as STV in central and north Scotland and UTV in Northern Ireland – and moreover, that there are 15 regional TV broadcasting licences, of which four are not owned by ITV Broadcasting Ltd (ITV plc) – 2 are held by STV plc and one by UTV plc and Channel TV Ltd respectively.
[16] The withholding rule will no longer apply to S4C as it will cease to be an analogue channel after March 2010.

advertising sales arrangements were required[17]. At that time, the functions of the ITC under the Broadcasting Act 1990 had not yet transferred to Ofcom, as the relevant provisions of the Communications Act 2003 ("the 2003 Act") had not yet come into force. The relevant legislative provision under which the Rules were made was s.2(2)(a) of the Broadcasting Act 1990, which required the ITC to ensure "fair and effective competition" in the provision of licensed broadcasting services and services connected with them.

3.7 S.2(2)(a) of the Broadcasting Act 1990 was repealed on 29 December 2003 by s.406(7) and Schedule 19 to the 2003 Act. The status of the Rules following that repeal is addressed by the transitional arrangements in paragraphs 1(1)(b) and (2)(a) of Schedule 18 to the 2003 Act, which provides that anything done by a legacy regulator for the purposes of, or in connection with, the carrying out of functions transferred to Ofcom is to have effect as if it had been made or done by or in relation to Ofcom. The Rules were made in connection with functions of the ITC transferred to Ofcom under Schedule 1 to the 2003 Act, namely its functions in relation to Broadcasting Act licences.

3.8 S.316(1) of the 2003 Act provides that Ofcom should include conditions in the regulatory regime for each licensed service which it considers appropriate for ensuring fair and effective competition. The relevant condition in television broadcast licences includes a provision (in accordance with s.316(3) of the 2003 Act) requiring the licensee to comply with any code approved by Ofcom for the purpose of ensuring fair and effective competition.

3.9 By virtue of the transitional provisions set out in paragraph 3.7 above, the Rules have effect as if they were a code approved by Ofcom for the purposes of a licence condition imposed under s.316 of the 2003 Act.

The Rules were intended to ensure effective competition in the TV advertising sector

3.10 The precursors to the Rules[18] were statements made by the ITC in the 1990s. At that time, the TV advertising sector was characterised by monopoly provision of TV advertising airtime. For instance, in two statements in 1994[19], the ITC identified withholding and conditional selling as practices which were prejudicial to fair and effective competition and therefore not compatible with broadcasters' licence conditions.

3.11 At the time of the last review in 2003, it was considered that a withholding prohibition was still appropriate since the commercial analogue channels had the ability to withhold airtime in order to drive up prices and increase their profits.

3.12 The 2003 review also noted that there was concern about the widespread nature of conditional selling and its impact on the TV advertising sector in terms of reduced choice and artificially high prices for media buyers and advertisers. The conditional selling rule was applied to all broadcasters and, as such, was not related specifically

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[17] ITC/Ofcom *Joint Consultation on ITC rules regarding Advertising Sales Arrangements* http://www.ofcom.org.uk/consult/condocs/adsalesarangements/

[18] The prohibitions were reformulated into 2 explicit ex ante rules by Ofcom in the review of the prohibitions in 2003.

[19] ITC *Policy statement regarding advertising sales arrangements* 22nd March 1994 and *Further statement on advertising sales arrangement* 27th April 1994.

to the individual market power of broadcasters. As a result all broadcasters were prohibited from conditionally selling airtime across their channels.

Ofcom has an obligation to review regulation

3.13 S.318 requires Ofcom to review from time to time any code made or approved by them for the purposes of s.316 which has effect for a competition purpose. A provision having effect for a competition purpose is defined in s.318(4) of the 2003 Act as a provision, the only or main purpose of which "is to secure that the holder of a Broadcasting Act licence does not: (a) enter into or maintain arrangements, or (b) engage in a practice, which Ofcom considers or would consider to be prejudicial to fair and effective competition in the licensed services or connected services." This applies to the Rules. Moreover Ofcom is required to consult before modifying or revoking the ASRs.

3.14 Accordingly, in reviewing the Rules, we have considered whether they continue to be appropriate for the purpose of securing that providers do not enter into arrangements or engage in practices which we would consider prejudicial to fair and effective competition in the licensed services.

We last reviewed the Airtime Sales Rules in 2003

3.15 Ofcom's last Review of the Airtime Sales Rules was in 2003. At that time we concluded that whilst the media landscape was changing rapidly, it was appropriate to retain prohibitions on withholding airtime and conditional selling for the purposes of ensuring fair and effective competition[20].

We believe it is now appropriate to review the ASRs

3.16 Since 2003 there have been a number of developments in the TV sector which are likely to have affected the TV advertising market, including significant growth in digital TV penetration, a large increase in the number of channels available to viewers and substantial shifts in viewing towards new channels.

3.17 We believe these changes, which we discuss in more detail later in the document, mean that it is appropriate to review the ASRs in order to assess whether the underlying rationale for the Rules remains valid and whether the Rules themselves are a proportionate response to any potential competition problems in the supply of TV advertising.

3.18 In addition, as we approach digital switchover some of the regulation will automatically fall away given the way the Rules are defined. For example, the withholding rule strictly only applies to commercial analogue channels and it will shortly cease to apply to one broadcaster, SC4, which is to move to a digital only service[21]. Unless amended, the withholding prohibition would expire completely by 2012 when digital switchover completes.

[20] Two prohibitions were removed in the last review - (1) the prohibition on 'share for ITV deals'; (2) All ex ante rules in relation to the joint selling of airtime by competitors were removed but it was noted that all parties in the market must ensure their sales arrangements complied with the Competition Act.
[21] Digital switchover in Wales was scheduled to complete in March 2010.

Our review will precede a distinct consultation on the amount and frequency of TV advertising

3.19 Furthermore, we stated that we would undertake a review of the ASRs in our 2009 statement on COSTA. COSTA rules determine the maximum amount of TV advertising for channels and non-PSBs are currently allowed to broadcast more minutes of advertising than commercial PSBs. We intend to issue a consultation on COSTA rules in the coming months which will consider the case for the harmonisation of advertising airtime across PSBs and non-PSBs and if so, whether any changes to the existing COSTA rules would be required.

3.20 It is useful for the ASR review to precede a review of COSTA. This is because the position as to whether PSBs are still required to sell all their airtime may be a relevant consideration in deciding whether an increase in the allowance for advertising minutage is viable for ITV1, C4 and Five.

3.21 Further, given there are different frameworks applying to the two sets of rules, we believe that it is appropriate to undertake their reviews separately although we do of course recognise that there are linkages between the two. As we have already noted in our consultation document we consider that, under current circumstances, the trading mechanism incentivises broadcasters to sell all their airtime and we would assume that this is likely to continue to be the case even under potential changes to the rules on the amount of advertising. We also do not consider that there are any particular linkages between the rules on the amount of advertising and the conditional selling rules.

We will continue to take account of the CRR Review in this Review of the ASRs

3.22 We recognise the importance of taking account of the status of the CRR undertakings, i.e. the remedy which determines how ITV sells its advertising airtime on ITV1, within our consultation on the ASRs.

3.23 The CC is currently reviewing the CRR undertakings. Whilst the CC's final report on CRR has yet to be published, we believe it is still appropriate to begin our review of the ASRs because:

- There have been a number of changes in the broad TV sector which are likely to have affected the overall level of competition in the supply of TV advertising airtime;

- We believe that, irrespective of CRR, under current circumstances the underlying trading mechanism in TV advertising incentivises broadcasters to sell out airtime in the long run, and this is unlikely to change as a result of the CRR review; and

- Our review of ASRs has a wider scope than CRR; it is much broader given that the Rules are intended to influence how all broadcasters sell TV advertising airtime, not just how ITV plc sells airtime on ITV1.

3.24 The CRR undertakings currently require ITV plc to offer separate i.e. standalone (and protected) contracts on ITV1 compared with ITV's other digital channels. We believe this should prevent ITV plc's ability to use any market power in ITV1 to engage in conditional selling i.e. 'forcing' media buyers to buy airtime on its digital channels.

3.25 Further, the current CRR Automatic Ratchet Mechanism (ARM) allows buyers to withdraw revenue in proportion to a fall in ITV1's SOCI, thereby reducing incentives to withhold.

3.26 We also note that the CC has consulted on various amendments to the CRR undertakings, all of which would continue to discourage ITV1 from withholding airtime or engaging in conditional selling[22].

The focus of this review is the appropriateness of ASRs for the purpose of ensuring fair and effective competition in the supply of TV advertising

3.27 The ASRs apply to the supply of TV advertising airtime in the UK. Therefore, this forms the focus of our review. Our assessment of developments in the sector since 2003 (see Section 4) has not suggested that a narrower focus would be appropriate, although in considering the withholding rule, we have regard to the fact that it only applies to a subset of suppliers, namely the broadcasters of commercial analogue channels.

3.28 We note that, at the time of the last review of the ASRs, the ITC/Ofcom implicitly adopted the market definition used by the CC in its report on the Carlton/Granada merger[23], namely the supply of TV advertising in the UK.

3.29 Continuing to use the market for the supply of TV advertising in the UK as the appropriate starting point for our review is also consistent with the position adopted in the CC's recent provisional report on the review of the CRR undertakings. In this report, the CC reiterated the view that there is a single market for TV advertising in the UK and that internet advertising is still not a sufficiently close substitute to act as a constraint on pricing.[24]

3.30 We agree that forms of internet advertising are unlikely to currently constrain the pricing of TV advertising. This is based on a number of observations, including the substantial difference in the amount of internet display advertising compared with TV advertising[25]. However, as we note in the next chapter, there may be scope in the future for internet display advertising to begin to impose some form of competitive constraint on behaviour in the UK TV advertising sector.

Overview of the document

3.31 The rest of the document is laid out as follows:

[22] See Competition Commission *ITV Contracts Right Renewal – Provisional Decision at* http://www.competition-commission.org.uk/inquiries/ref2009/itv/pdf/provisional_decision_remedy.pdf
[23] This was published in 2003 i.e. the same year as the ASRs.
[24] Competition Commission *Carlton Communications Plc / Granada Plc: A Report on the Proposed Merger,* http://www.competition-commission.org.uk/rep_pub/reports/2003/482carlton.htm#summary
[25] Internet advertising has risen rapidly. However, as we discuss in Section 4, the majority of advertising on the internet is actually classified advertising whereas TV advertising is a form of display advertising. The internet is therefore not yet a significant medium for display advertising and - in relative terms - internet display advertising is just under a fifth of the size of TV advertising.

- **Section 4** – presents the major developments that have taken place in the TV sector generally, since the last review of the ASRs, and highlights their potential implications for competition in the supply of TV advertising. Looking at wider changes in the sector's landscape is useful in considering whether the underlying rationale for the ASRs is still relevant;

- **Section 5** – sets out our analysis of the incentives for the channels to withhold airtime from the market and considers what may happen if we were to remove the withholding rule;

- **Section 6** – sets out our analysis of the incentives for broadcasters to bundle airtime across several channels and considers what may happen if we were to remove the conditional selling rule; and finally

- **Section 7** – sets out our recommendation: the proposal to lift the ASRs.

Section 4

The Changing Landscape: TV Advertising

Introduction

4.1 We explained in the previous Section that the current ASRs were reviewed and amended in 2003 in order to ensure fair and effective competition in the supply of TV advertising airtime.

4.2 In this Section we examine how the sector has changed in recent years to help us assess whether the underlying rationale for ASRs is still relevant.

4.3 We do this by:

- Setting out the developments that have taken place in the TV sector generally since 2003;
- Discussing the potential effects of these developments on TV advertising and competition in the sale and purchase of TV advertising; and
- Considering likely future competitive developments, as this can help us understand whether specific competition problems in the supply of TV advertising are expected to emerge in the future, and whether these would have to be addressed with ex ante rules.

There have been several key developments in the TV market since 2003

4.4 The TV landscape in 2010 is very different to that of the mid 1990s when the ITC identified the practices of conditional selling and withholding as prejudicial to fair and effective competition[26]. Moreover, a large part of that change has taken place since the ASRs were last reviewed. The key developments in the last 6 years have been the rapid increase in digital TV uptake and a corresponding shift in TV viewing from PSBs toward digital channels. This has helped to produce greater opportunities for media buyers to purchase impacts (i.e. advertising) from non-PSBs and suggests that there should now be greater competition in the supply of TV advertising airtime.

4.5 While overall TV viewing has remained broadly the same since 2003[27], a number of key developments have taken place since then, including:

- A major increase in the number of (digital) TV channels available to viewers - about 200 more channels exist and there are now around 500 in total;

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[26] In the mid 1990s, there was no digital terrestrial television, no Channel Five and much lower satellite TV take-up.
[27] Ofcom *Communications Market Report 2009 (August)* http://www.ofcom.org.uk/research/cm/cmr09/cmr09.pdf -
Viewing per head, per day in all homes was 3.44 hours in 2003 and 3.45 hours in 2008 – it fluctuated very little over the past 6 years.

- An almost doubling of digital TV uptake in the UK, with almost 90% of UK households now having access to digital TV services;
- A much more fragmented viewing pattern for TV, with a clear shift in viewing from the PSBs (who have lost around a fifth of their audience share) to the digital channels – although we note that some of the losses in viewing have been offset by gains to the PSBs' digital 'family' of channels;
- An increase in the volume of commercial impacts by almost one-third - driven by the increase in digital TV take-up and viewing of the digital channels.
- A narrowing of the gap between the shares of commercial impacts for the largest and smaller sales houses; and
- Consolidation of media buyers.

4.6 These developments may have resulted in increasing levels of competition in the TV advertising market.

4.7 Furthermore, it is anticipated that future developments may further increase competition in the sale of TV advertising. For example, we expect digital penetration to increase until the completion of Digital Switchover (DSO) in 2012 and, as a result, viewer fragmentation is likely to rise further.

4.8 In the remainder of this Section, we elaborate and discuss the evidence on the various developments which have either already taken place in the TV sector - or are likely to affect the sector in the future - and highlight their potential implications for competition in the provision of TV advertising. We start with the major growth in digital television.

Digital platform take-up has grown significantly the last review of ASRs

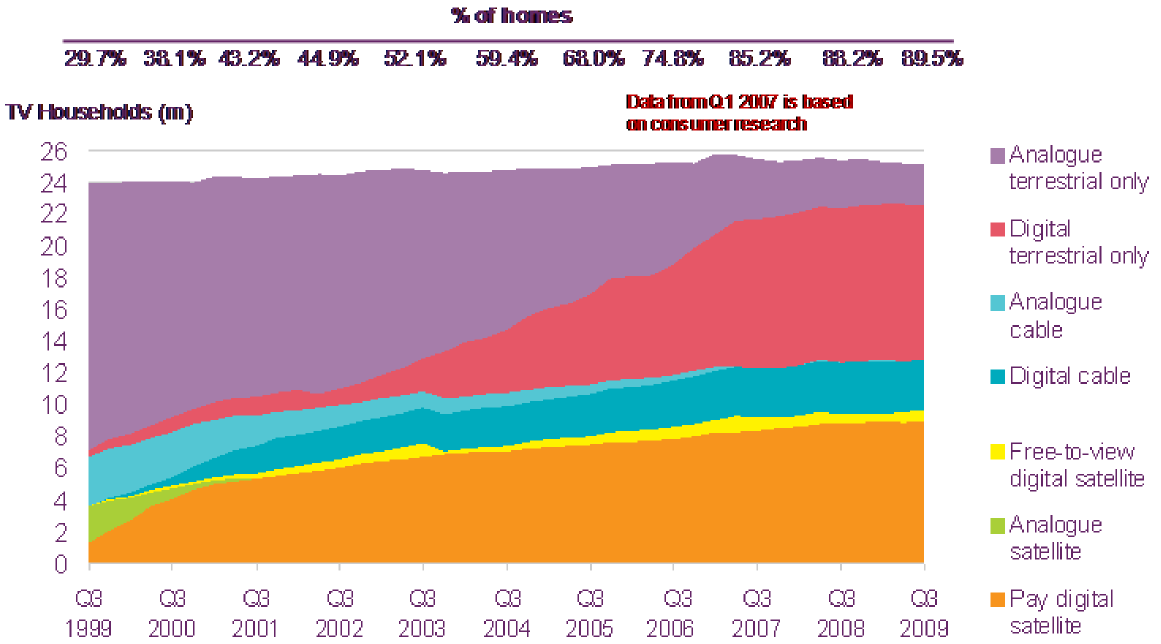
4.9 In the last 6 years, we have witnessed a major shift towards increased take-up of digital television. Major changes have taken place on two fronts. There has been:

- A substantial increase in the proportion of UK households who have access to digital TV services; and
- A material increase in the number of channels broadcasting in the UK and a subsequent shift in viewing towards these new digital channels.

4.10 The development of digital broadcasting and different digital platforms has enabled a significant increase in the number and range of channels available to TV viewers. According to our 2009 Communications Market Report (CMR), the number of channels broadcasting in the UK increased from 294 in 2003 to 495 at the end of 2008.[27]

Moreover, since 2003 we have seen a huge growth in the penetration of digital TV. Consumers now access a much wider range of content across a variety of digital platforms, compared to 2003 when most people watched analogue TV channels. For example in 2003, 47.8% of UK households had digital television[28] and this rose to 89.2% in 2009 - see Figure 1 below.

Figure 1: Multichannel television take-up



Note: Digital terrestrial relates to DTT-only homes.

Source: Ofcom, GfK, Sky, Virgin Media

4.11 The proportion of homes with digital television will continue to increase until DSO is completed in 2012. It is estimated that by the end of March 2010, 24% of total UK households will be in areas 'switched' to digital terrestrial transmission (i.e. where there is now no analogue TV signal) and this figure will reach around 98.5% of the population over the next two years as Digital Switchover completes. As the 10% of UK households, which still only access analogue TV services, take up digital television during this period, they are likely (as we explain below) to follow previous DTV adopters and shift some of their viewing to non-PSB channels.

TV viewing is more fragmented than in 2003

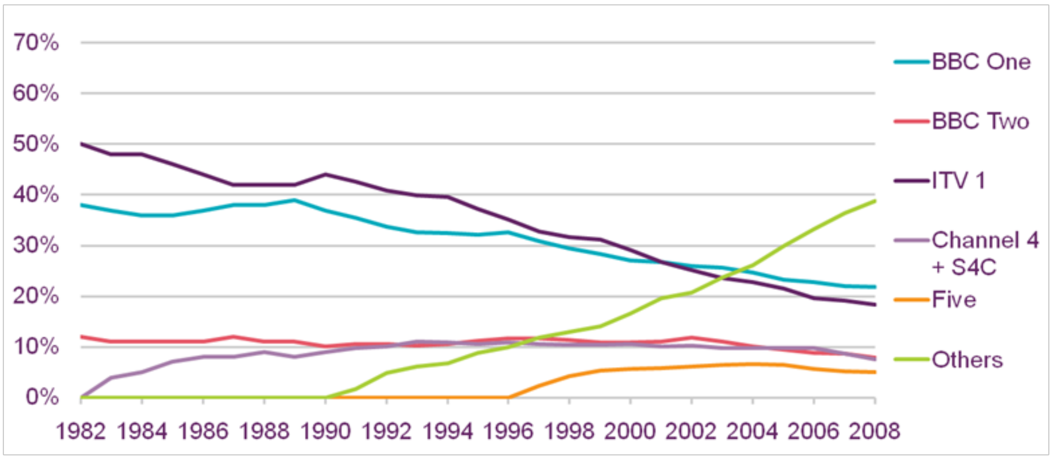
4.12 Since 2003, the growth in the number of digital TV channels and the increasing take-up of multichannel TV has resulted in increasingly fragmented viewing. More viewers watch content delivered over a wider range of digital channels and viewing of analogue channels and their simulcast digital versions has declined.

4.13 As Figure 2 below shows, multichannel viewing as a proportion of television viewing in all homes, all day, has grown to 39% in 2008, a rise of almost two-thirds since 2003.

[28] Figures for digital TV take-up include figures for digital terrestrial TV, digital cable, free to view digital satellite and pay digital satellite.

4.14 As a result, the five main PSB channels (BBC1, BBC2, ITV1, C4/S4C and Five) all experienced reductions in viewing share over the same period. The collective share of these channels has fallen by one-fifth since 2003 to just less than 61% in 2008.

Figure 2: Channel shares in all UK homes, 1982 to 2008

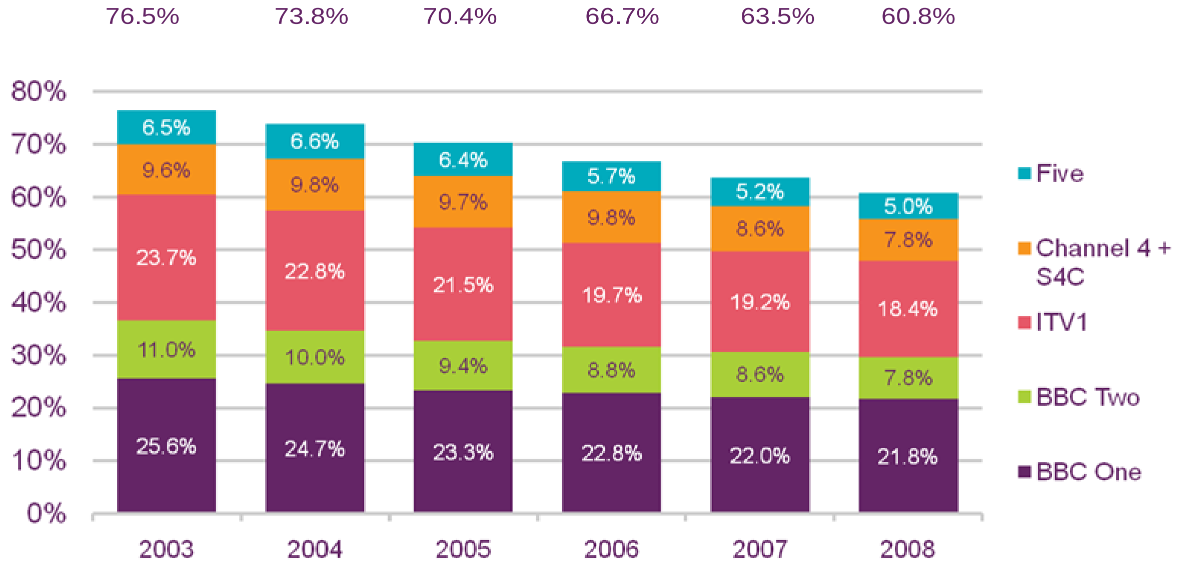


Source: Ofcom

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

4.16 However, since 2003, the key difference is that all five main PSB channels have shown a decline in their respective audience shares. This is illustrated in Figure 3 below which shows both the individual as well as collective percentage audience share of the five main networks in all UK homes over the period 2003-2008. The combined share of the commercial analogue channels - ITV1, C4 and Five – fell more than a fifth from 39.8% to 31.2% over 2003-2008.

Figure 3: Five main networks' audience share, all homes[29]



Source: BARB

Fragmented viewing has had an effect on the sale of TV advertising

4.17 The key change in the TV landscape – i.e. more fragmented viewing patterns - is likely to have affected the market for TV advertising airtime. There appear to be three key effects:

a) A greater volume of commercial impacts;

b) Changing shares of commercial impacts (SOCI) amongst broadcasters/sales houses; and ultimately

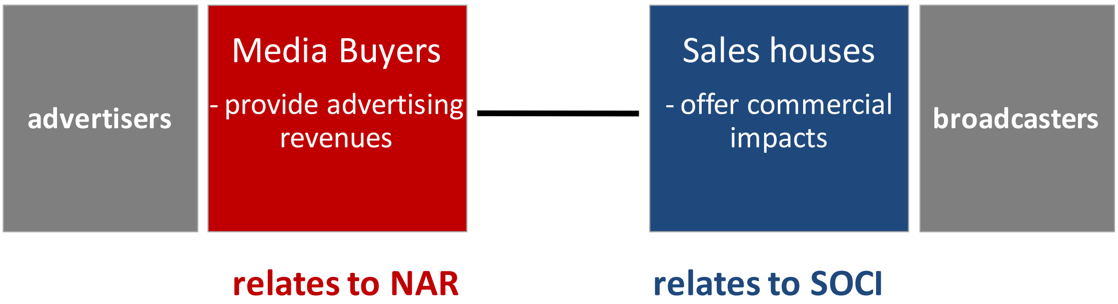
c) Changes in the share of net advertising revenues (NAR)[30].

4.18 In order to understand how competition operates in this sector and what these changes may indicate, it is useful to consider how advertising airtime is traded – see Figure 4. This is explained fully in Annex 6 but, in simple terms, sales houses sell, not minutes of advertising airtime but commercial impacts associated with viewing on commercial TV channels to advertisers and media buyers, who represent advertisers. Commercial impacts[31] are defined by reference to the exposure of viewers to advertising – each occasion when a standard length advertisement is seen by a viewer counts as one commercial impact. In return, media buyers and advertisers pay broadcasters advertising revenues. Prices for advertising are

[29] ITV1 figures include GMTV1.
Figures for C4 include S4C. S4C is a Welsh TV channel and the analogue service on will not exist after March as Wales will have completed DSO. That service incorporated English-language programming broadcast by C4 (as analogue reception of C4 was, until recently, unavailable in most of Wales). Going forward in time, we will decouple data on C4 and S4C e.g. on channel share, given both channels are available separately in Wales on digital TV and there will no longer be any other overlap e.g. in terms of their content (and also in terms of their sales of advertising).
[30] Net advertising revenue is aggregate total advertising revenue net of all agency fees, production costs and commissions
[31] Note, we distinguish between 'commercial impacts', which relate to viewing on commercial channels and 'channel shares' which include viewing figures for BBC channels.

normally described in terms of costs per thousand impacts (CPT) or as the Station Average Price (SAP)[32], either for a general audience, or for a particular demographic group.

Figure 4: Simple view of trade in TV Advertising



4.19 During contract negotiations[33], broadcasters and media buyers will negotiate the share of the buyer's total expenditure on TV advertising for the forthcoming year ("share of broadcast" or SOB) which will be given to that broadcaster, in return for discounts off that broadcaster's price and a number of terms and conditions which relate to how advertising is scheduled.

4.20 We understand that a **key factor in these contract negotiations is a broadcaster's SOCI** from the previous year as a predictor of future success. That is, if a broadcaster has been able to increase their SOCI over the previous year, then their sales house will use that to try to encourage media buyers to commit a greater share of broadcast expenditure to them for the following year. Equally, media buyers will be more interested in committing expenditure to broadcasters that have increased their SOCI because that would tend to demonstrate an ability to attract audiences which are of interest to advertisers.

4.21 Broadly, we would expect that broadcasters which achieve greater SOCI should be able to secure greater spend commitments from media buyers, which will then be reflected in broadcasters' net advertising revenues. Looking at these two measures – NAR and SOCI – can therefore provide evidence of relative changes in the supply of TV advertising and help us form a view of changes in competition[34]. For example, if the leading broadcasters' shares of SOCI and NAR were declining over time, then this ought to be consistent with increasing competition in the sector.

The volume of commercial impacts has increased

4.22 Before examining trends in SOCI and NAR, it is useful to consider why there has been an increase in the volume of commercial impacts.

4.23 As we outlined earlier, the fragmentation in TV viewing has occurred because of two developments: the availability of more channels and greater adoption of digital TV (see Figure 5) resulting in a shift in viewing from the BBC and commercial PSB channels towards commercial non-PSB channels.

[32] SAP is the average price per impact across a channel (or sometimes a range of channels).
[33] Contracts for TV advertising are typically negotiated on an annual basis, towards the end of the preceding calendar year.
[34] However, care needs to be taken when interpreting changes in shares of NAR as ITV1's NAR is influenced by its CRR regulation.

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

4.25 Further, current advertising minutage regulations allow the commercial non-PSB channels to broadcast more advertising minutes than commercial PSB channels. For PSBs, the time devoted to television advertising (and teleshopping spots) must not exceed:

(i) an average of 7 minutes per hour for every hour of transmission time across the broadcasting day; and

ii) subject to (i) above, an average of 8 minutes an hour between 6pm and 11pm.

4.26 In contrast, non-PSBs can devote up to an average of 12 minutes of television advertising and teleshopping spots for every hour of transmission across the broadcasting day, of which no more than 9 minutes may be television advertising.

4.27 Therefore any shift in viewing from the commercial PSB to non-PSB channels will also increase the overall viewing of TV adverts (and, hence, increase the number of impacts available).

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

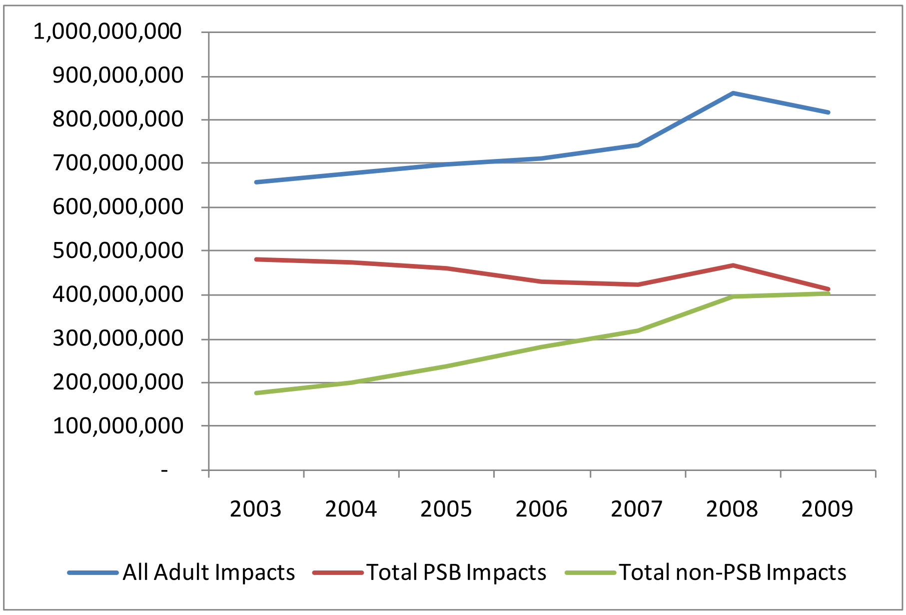
Figure 5: Summary of increases in commercial impacts (on non-PSBs)

<table>
<tr><th>Development</th><th>Result</th><th>Effects on market</th></tr>
<tr><td>More digital TV channels (which have more ad minutage than PSBs)</td><td>More TV adverts on non-PSB ‘group’</td><td rowspan="2">• More impacts available
• Change in market shares for SOCI</td></tr>
<tr><td>Greater take-up of DTV and viewing of non-PSB channels</td><td>Increase in TV adverts viewed on non-PSBs</td></tr>
</table>

4.29 In aggregate terms, the overall volume of Adult commercial impacts increased by 24% from 655 million to 815 million between 2003-2009. This is shown in Figure 6 below. This overall growth is essentially attributable to the 129% increase in commercial impacts from non-PSB channels whilst the total number of commercial PSB impacts has fallen relative to the 2003 level. As can be seen in the figure below, the proportion of Adult commercial impacts delivered by PSBs and non-PSBs are now almost equal[35].

[35] The PSB figures include ITV1, C4, Five, GMTV and S4C – S4C comprises the smallest proportion of Adult Impacts in this combined figure and now provides 0.24% of total commercial PSB Adult Impacts.

Figure 6: Total adult commercial impacts over time



Source: BARB

4.30 Given that the increase in the volume of commercial impacts has been driven by increasing access to and viewing of digital television, it is likely that the number of impacts will continue to rise until digital switchover is complete in 2012. There is one caveat here – and that relates to potential changes to rules governing the amount of TV advertising. A separate consultation document which we aim to publish in the next few months will seek views on whether or not we should move towards more harmonised rules on the amount and frequency of advertising on PSB and other channels. Changes to the amount of minutage allowed for TV advertising will obviously have an impact on the volume of commercial impacts and could also affect the mix of commercial impacts delivered by PSBs and non-PSBs.

The gap between sales houses' (and channels') SOCI has also narrowed

4.31 The growth in commercial impacts supplied by non-PSBs has also led to a shift in the distribution of SOCI between the channels and sales houses. It is relevant to consider SOCI changes both at a channel and sales house level.

4.32 Changes in SOCI on an individual channel basis are important, given that the withholding rule applies to specific (commercial analogue) channels.

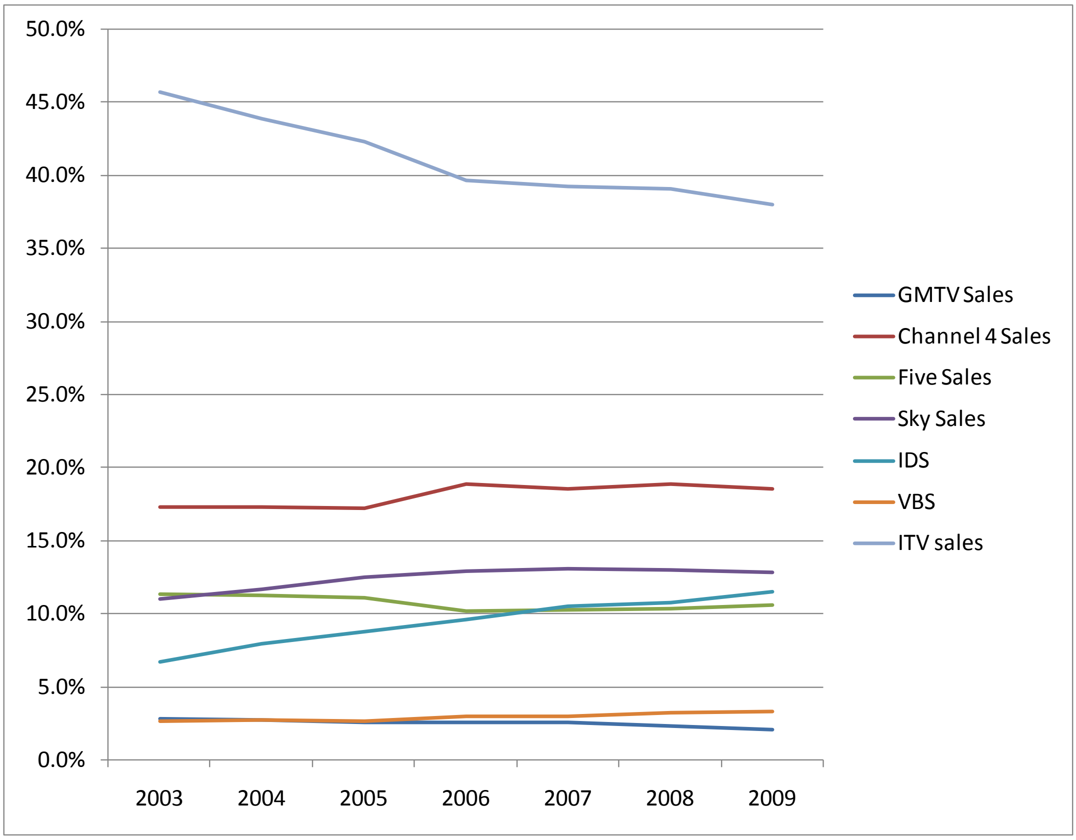
4.33 It is useful to consider changes in SOCI amongst sales houses with regard to the conditional selling rule. Sales houses generally sell airtime for a number of channels – for their affiliated channels and/or third party channels on behalf of other broadcasters. For example, ITV Sales sells airtime for ITV plc's whole portfolio of channels: ITV1 plc licensees, ITV2, ITV3, ITV4, Men and Motors and CITV but it also sells airtime for third party licensees: STV Central, STV North, UTV and Channel TV. We consider the changes in the distribution of SOCI across sales houses first, and then consider changes to channel SOCI.

Sales houses' SOCI

4.34 Figure 7 below shows changes in SOCI in the Adult demographic for each of the major sales houses. It shows that the SOCI of ITV's sales house has declined from almost 48% in 2003 to 38% in 2009[36].

4.35 Over the same period, there have been some increases in the SOCI delivered by other sales houses, such as IDS and Sky. Furthermore, Sky's relative share of SOCI is likely to increase further as it has recently won the contract to sell airtime on Viacom's portfolio of channels[37].

Figure 7: Adult SOCI by sales house from 2003-2009



Source: BARB

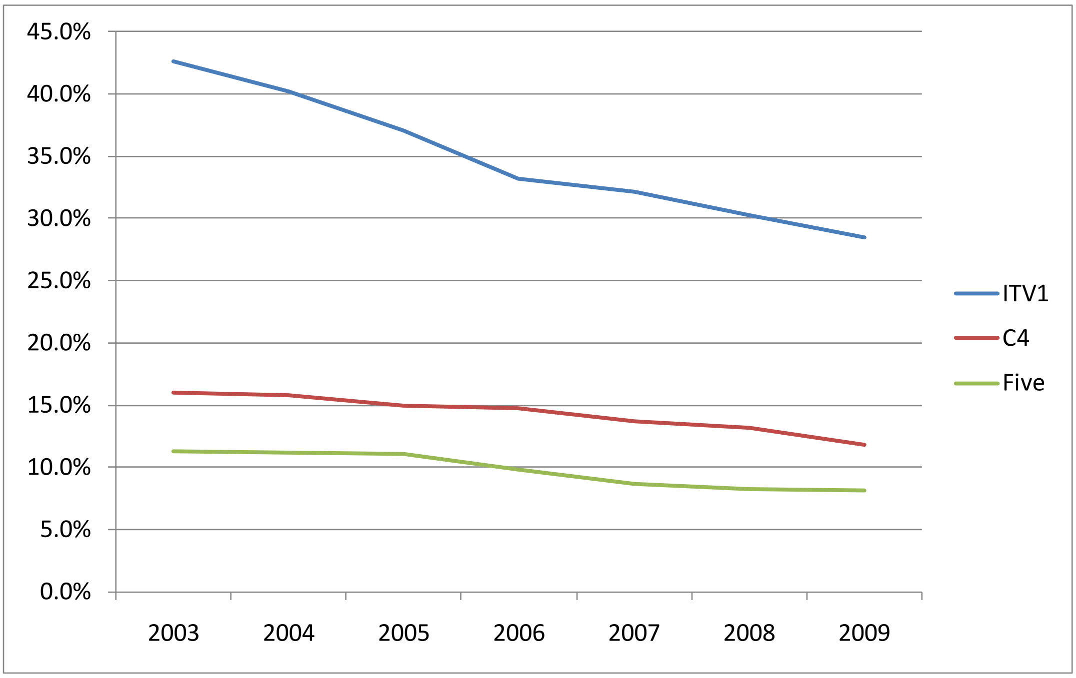
Channels' SOCI

4.36 Figure 8 below illustrates how the share of Adult SOCI for each of the main commercial analogue channels has fallen.

[36] The chart also shows historical figures for GMTV's sales house. Given GMTV is now owned outright by ITV, we would expect, going forward, to add its SOCI on to the figures of ITV's sales house – and to do the same for figures on NAR (net advertising revenue).

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

Figure 8: Adult SOCI for Channels ITV1, C4 and Five from 2003-2009



Source: BARB

4.37 Lower SOCI would be expected to lower the negotiating power of any channel and ultimately lower their respective share of TV advertising revenues.

4.38 The lower shares of Adult SOCI for commercial analogue channels reflect the shift in viewing to non-PSB channels. Between 2003 and 2009, ITV1, C4 and Five's combined share of Adult SOCI fell from circa 70% to 48%[38] - with the gains going to the non-PSB channels. The non-PSB channels increased their combined share of Adult SOCI from around 27% to 49% over the same period[39].

4.39 The decline in Adult SOCI for individual channels and increased viewing fragmentation are further illustrated by comparing Figure 9 and Figure 10 below:

- Whilst ITV1's Adult SOCI is still more than double the size of C4, this gap has narrowed; and

- the gap between C4 or Five and non-PSB channels (such as ITV2, E4 and Dave[40]) has also reduced.

[38] These figures do not include GMTV or S4C – however both of these channels also experienced significant declines in their channel SOCI over 2003-2009.
[39] However, note that the increase in non-PSBs' SOCI includes gains achieved in SOCI by PSBs' digital 'family' channels.
[40] Formerly called UK Gold Classics, then UKG2 and UKTV G2 and re-launched as Dave in late 2007.

Figure 9: Top 15 commercial channels based on Adult SOCI in 2003

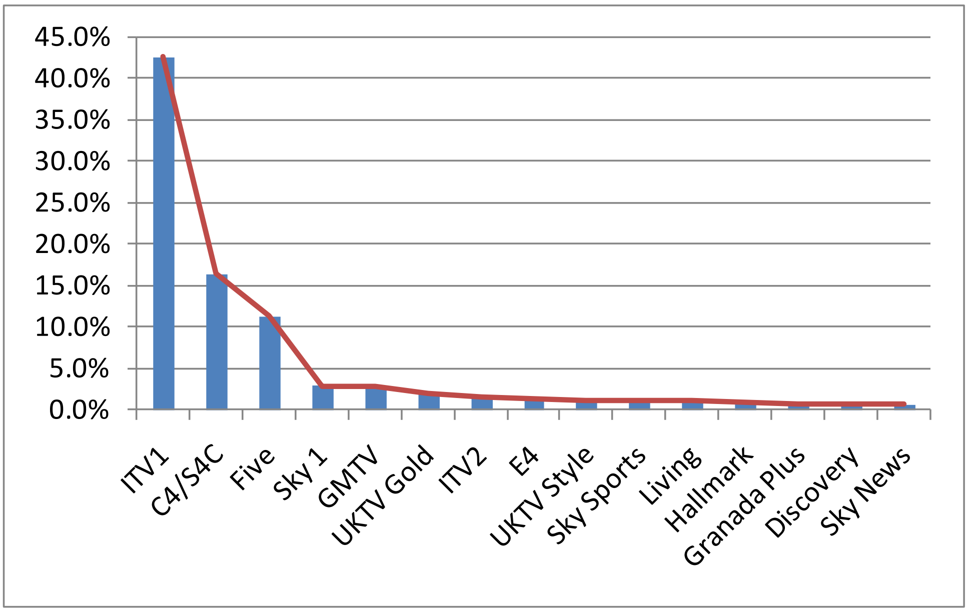
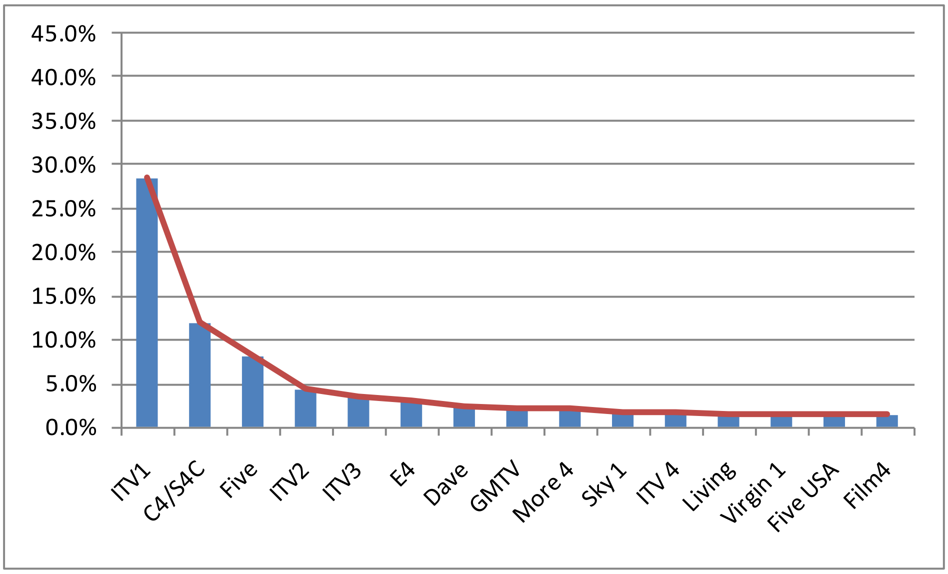


Figure 10: Top 15 commercial channels based on Adult SOCI in 2009



Source: BARB

4.40 Whilst ITV1, C4 and Five have lost SOCI, it is important to recognise that the ITV and Five sales houses have not experienced as large a decline in SOCI as their main channels – and in the case of the C4 sales house, there has actually been a slight increase relative to 2003. This is because the ITV plc, C4 and Five digital 'family' channels have captured some of the loss in viewing on their main channel.

There has also been a consolidation of media buyers

4.41 Alongside the changes in SOCI, we have witnessed continuing change on the other side of the market i.e. amongst media buyers. There has been a long term trend towards consolidation amongst media buyers. This has continued in the years since 2003, with many media buying points now owned by larger groups or negotiating on a group basis. This has led to the development of more powerful media buyers (e.g. WPP/GroupM), which purchase advertising across a wide range of media and on behalf of a number of advertisers[41].

4.42 Buyer power refers to the ability of buyers to constrain the power of any particular sales house. We may expect buyer power to exist if there were very few media buyers and each comprised a large proportion of any sales houses' revenue. In this scenario, even if the supply side contained a few sales houses, they may be unable to charge high prices for fear of losing a significant proportion of revenue.

4.43 Between 2003 to 2009, the share of TV advertising expenditure from media buyers provided by the largest six buying groups rose from 69.1% to 81.4% - see Figure 11. Given this increased concentration, we might expect buyer power to have increased since 2003.

Figure 11: Largest 6 media buyers - by % of TV expenditure from all buyers

2003 Media Buyers	Their % TV expenditure across all media buyers	2009 Media Buyers	Their % TV expenditure across all media buyers
Magna	13.6%	Group M	28.9%
Starcom	12.9%	Vivaki	16.1%
Group M	12%	Aegis	14.4%
Aegis	11.8%	Opera	14.2%
OMD	10.1%	Magna	4.3%
Zenith Optimedia	8.8%	Walker Media	3.4%
Total for top 6	**69.1%**	**-**	**81.4%**

Source: Ofcom, calculated from Nielsen data

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

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

result, we might expect these large buyers to have greater negotiating power, as the loss of some business from such buyers will represent a high level of absolute revenues to individual broadcasters.

4.45 Furthermore, given there are many small TV channels in the market and a large number of new impacts across a variety of TV channels, media buyers should be more able to credibly threaten to transfer spending from one sales house to another. However, we note that in the review of CRR, the CC considered that buyers may have a limited ability to walk away from ITV1 because of their reliance on ITV1 to deliver mass audiences.

4.46 Across the sector as a whole though, these market changes are likely to have strengthened buyers' negotiation position vis-à-vis broadcasters' sales houses, potentially helping them to secure a lower price for advertising.

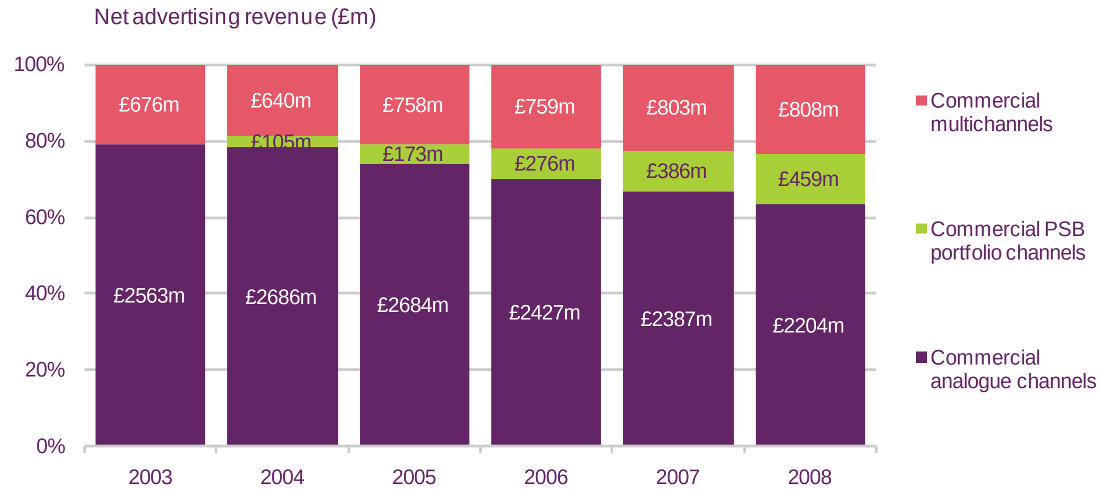
The potential effects of sector developments since 2003

4.47 The shifts in viewing and SOCI noted above may have impacted the revenues of broadcasters – and possibly also had some bearing on advertising prices.

TV advertising revenues are more fragmented

4.48 Figure 12 shows the breakdown of NAR by type of channel between 2003 and 2008. Non-PSB channels experienced a growth in advertising revenues at the expense of the commercial analogue channels. ITV1, C4 and Five lost a total of £362m in revenues, which represents a decline of 14% (although, as previously noted, some care needs to be taken when interpreting changes in NAR for ITV1 as it is influenced in part by the CRR remedy[42]).

Figure 12: NAR over 2004-2008 by channel type



Source: Ofcom/broadcasters.
Notes: Figures expressed are in nominal terms and replace previous data published by Ofcom. Commercial PSB portfolio channels include ITV2, 3, 4, Men & Motors, CiTV, ITV News Channel, E4, More 4, Film 4, 4Music, Five US and Fiver (plus their '+1' channels). Sponsorship revenues are not included. Totals may not equal the sum of the components due to rounding. Commercial multichannels are effectively the digital channels not owned by ITV plc, C4 and Five (and S4C which is also a PSB).

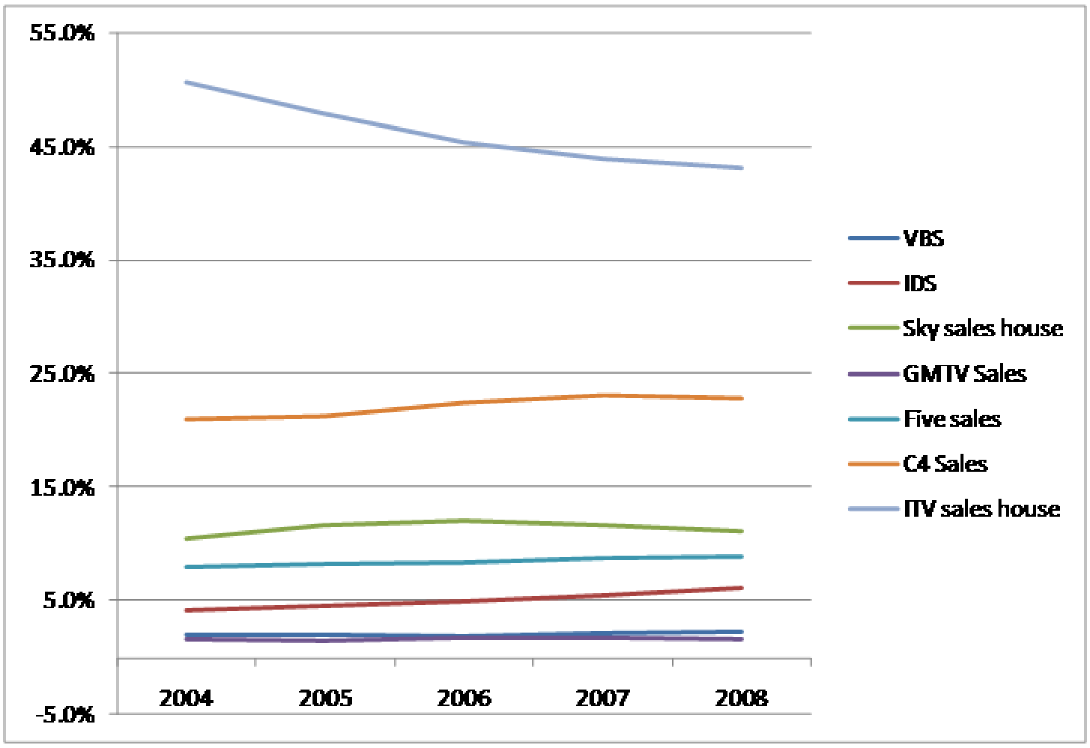
[42] The CRR ratchet allows media buyers to withdraw revenue from ITV1 in proportion to the fall in ITV1's SOCI so part of ITV's decline in share of NAR can be attributed to the CRR remedy itself.

4.49 Digital channels have increased their combined share of advertising revenues over the period 2004-2008, However, the majority of the recent revenue gains to digital channels as a whole have actually gone to the commercial PSB portfolio channels, (shown in green in the diagram above) – these channels had negligible revenues in 2003 but by 2008 comprised over 13% of total sector NAR.

4.50 This reflects the fact that PSBs launched more 'family' channels after 2003[43] and these and their existing digital channels have been successful in attracting an increasing share of viewing, commercial impacts and advertising revenues. This growth in NAR for the PSBs' wider portfolio channels has helped ITV plc, C4 and Five to offset, to varying degrees, the decline in revenues from their main channels.

4.51 For ITV plc, the growth of its family channels has only partially offset the decline in ITV1's share of TV advertising revenues; whilst for C4, it has actually helped to deliver a slight increase in its sales house's share of revenue relative to the position 5-6 years ago – this is illustrated in Figure 13 below.

Figure 13: Share of NAR over 2004-2008 by sales house



Source: Ofcom

Advertising prices have fallen

4.52 It is possible that market developments may also have affected the price of TV advertising. A number of stakeholders have told us that there has been a widespread fall in the price of commercial impacts in recent years. The large growth in the number of commercial impacts, as well as the stronger negotiating position of media buyers, may have contributed to this.

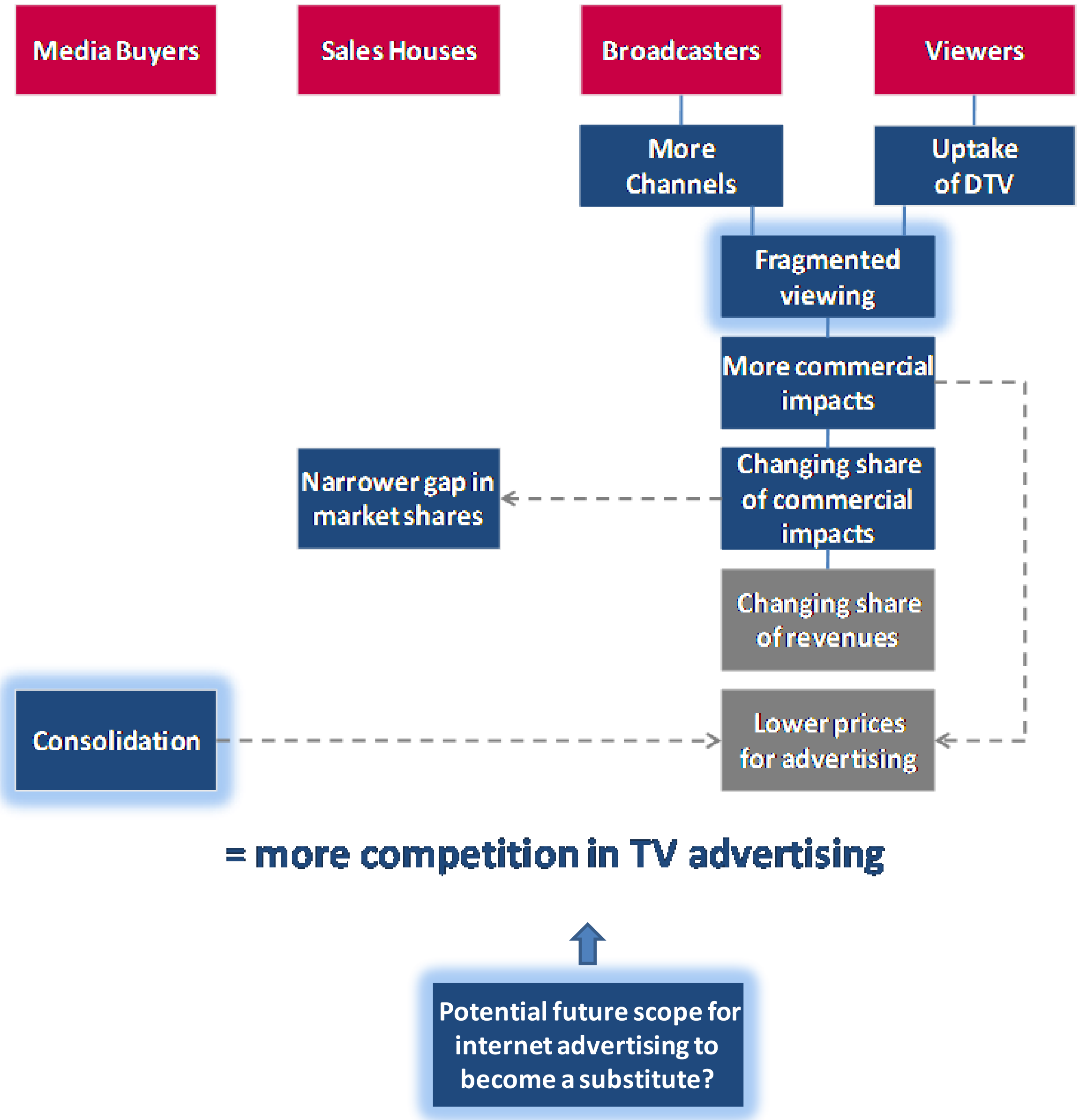
[43] For example, ITV3 was launched in 2004, ITV4 in 2005, More4 in 2005 and Five USA in 2006.

4.53 However, while a fall in prices for media buyers may provide some indication of increasing competition in the sale of TV advertising, it is difficult to establish causation, particularly given that a number of other factors - which are unrelated to the competition in the market - can also influence price, such as the effect of the CRR remedy on ITV1's pricing and wider cyclical factors in the economy.

We believe that these sector developments are likely to have increased competition

4.54 Throughout this Section, we have set out the developments affecting the TV landscape and the results on the market for TV advertising airtime. Figure 14 tries to summarise the developments and how they link across aspects of the supply chain.

Figure 14: Changes potentially affecting competition in TV advertising



4.55 We have shown that there have been key changes at each level of the TV advertising supply chain (which are indicated in the top - red - boxes) and multiple developments below (in blue). The potential effects of these changes are noted (in grey boxes) i.e. the changing share of advertising revenues for broadcasters and the effect on advertising prices.

4.56 The key shift in the last six years has been the rapid increase in digital channels and digital TV uptake and a corresponding shift in TV viewing from PSBs toward digital channels. This has helped to produce a number of developments with implications for the competitive position relative to 2003:

- **More fragmented viewing** - the PSB channels do not dominate viewing in the way they once did – consumers have access to a greater choice of channels suggesting the PSB channels have to compete more actively for their viewing;
- **More commercial impacts** – The shift in viewing to digital channels has increased the volume of impacts available (i.e. advertising) from non-PSBs, and, in general terms, may mean a reduced reliance on ITV1, C4 and Five; and
- **The changed shares (and narrowed gap) in SOCI between sales houses and channels** – Lower SOCI should lower the negotiating power of any individual channel and ultimately lower its respective share of future TV advertising revenues. Although there are still gaps between the commercial analogue channels and non-PSBs, the fact that commercial analogue channels are losing SOCI (and share of NAR) whilst smaller channels are increasing their shares, may signal the effects of increasing competition – although we recognise that some of the gains in revenues are being captured by the digital 'family' channels of the PSBs.

4.57 In addition, there has been continuing media buyer consolidation. This may also have had implications for competition as it may imply an increase in buyer power which, alongside other factors such as the development of more commercial impacts, may have contributed to a reduction in advertising prices.

4.58 All of these factors indicate less advertiser reliance on commercial analogue channels for impacts and advertising airtime. They also suggest that media buyers may be more able to secure better deals on the advertising they purchase from competing sales houses. In short, they indicate there could be a greater amount of competition in today's TV advertising market than in 2003.

4.59 Furthermore, there are three potential developments - 'marked' in the highlighted blue boxes in the diagram above – which may, in future, contribute to extending a potential trend of increasing competition in the TV advertising market. These are:

- The scope for internet display advertising to eventually become a competitive constraint on TV advertising;
- Further fragmentation in TV viewing; and
- Finally, possibly more consolidation amongst media buyers or even amongst smaller sales houses.

4.60 We discuss the latter potential developments in some more detail below.

There is potential for internet display advertising to constrain pricing of TV advertising but not in the near future

4.61 An important development in recent years has been the shift from traditional to digital media. Internet advertising has grown rapidly – going from 3% as a proportion of all advertising in 2003 to 20% by 2008. It now attracts, in overall terms, similar levels of revenue to that of TV advertising.

4.62 However, the majority of advertising on the internet is classified advertising whereas TV advertising is a form of display advertising. In 2008, while total annual expenditure on internet advertising reached £3.3 billion, paid-for search advertising accounted for almost 60% of this total - it has grown rapidly since 2000. Data from the same year also suggests internet display advertising comprised around 19% of all internet advertising[44].

4.63 The internet is therefore not yet a significant medium for display advertising and - in relative terms - internet display advertising is just under a fifth of the size of TV advertising.

4.64 Another important issue for advertisers is likely to be the fact that the internet does not yet offer the mass, broad demographic appeal to the same extent as television. Whilst television is in virtually every home in the UK – TV penetration is around 98% - internet penetration had reached around 70% of homes last year[27]. In addition whilst those with a home internet connection are increasingly representative of the UK population as a whole, it remains more prevalent among particular demographic groups - for example 85% of AB households have the internet at home but only 49% of DE households[45].

4.65 As such, advertisers seeking to build mass awareness across a broad range of audiences quickly are not likely to view the internet as a close substitute for television at this time.

4.66 We show the differences in the top 20 advertisers who use the internet and top 20 advertisers who use television advertising in Figure 15 and Figure 16 below. It is noticeable that the list of internet advertisers is dominated by communications/technology companies (e.g. ebay, websites and mobile operators). In contrast the list of TV advertisers is dominated by firms supplying fast moving consumer goods e.g. Procter & Gamble, Kelloggs, Tesco, Marks & Spencer etc. Only BT, BSkyB and the COI appear in the top 20 on both lists.

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[44] The *Advertising Association's Advertising Statistics Yearbook* June 2009.
[45] Ofcom *Tech Tracker Q1 2009* http://www.ofcom.org.uk/research/stats/Q1_Tech_Tracker_2009.pdf

Figure 15: Top 20 TV advertisers in 2008

TV Advertiser	Total Ad Spend £,000	% of Total
Procter and Gamble	126,521	3.6
Unilever	90,723	2.6
Reckitt Benckiser	87,554	2.5
COI	75,066	2.2
Kelloggs	62,831	1.8
L'Oreal Paris	50,185	1.4
Nestle	38,264	1.1
Direct Line Insurance	36,047	1.0
Tesco	35,718	1.0
Sainsbury's Supermarkets	35,527	1.0
DFS Furniture	33,105	1.0
Marks and Spencer	31,387	0.9
Asda Stores	28,332	0.8
Wm Morrison Supermarkets	27,979	0.8
News International Newspapers	27,098	0.8
Ford Motor company	27,062	0.8
BSkyB	26,042	0.8
BT	25,053	0.7
Argos	24,304	0.7
Mars	24,032	0.7

Figure 16: Top 20 internet advertisers in 2008

Internet Advertiser	Total Ad Spend £,000	% of Total
Ebay	21,199	0.6
O2	12,368	0.4
BT	8,756	0.3
Kayak.com	8,001	0.2
Dating Direct	7,524	0.2
COI	7,138	0.2
BSkyB	6,956	0.2
T-Mobile	6,420	0.2
Orange	6,124	0.2
Microsoft	5,563	0.2
William Hill Bookmakers	4,766	0.1
Midas Player.com	3,905	0.1
Xtend	3,653	0.1
MX Financial Services	3,109	0.1
Dell Computer Corporation	2,966	0.1
Thomson Tour Operators	2,959	0.1
ING Direct	2,838	0.1
PC World	2,822	0.1
Virgin Media	2,769	0.1
Vodafone	2,610	0.1

Source: Advertising Association

4.67 It is also noticeable that, not only are the amounts spent on internet advertising much smaller than the amounts spent on TV advertising, but also that the top internet advertiser accounts for less than 1% of total internet advertising whereas the top TV advertiser accounts for more than 3% of TV advertising expenditure in its own right. This perhaps suggests that a more diffuse range of firms are using the internet compared to TV.

4.68 As a result, we do not believe that sufficient advertisers would currently switch spending to the internet so as to provide an effective constraint on price increases for TV advertising airtime.

4.69 We may only expect this to change if the scale and coverage of internet display advertising grows – for example if household internet uptake increases nearer to the level of television penetration or it is able to build mass awareness quickly across a broad range of audiences. We will continue to monitor market developments to establish more clearly the scope for internet display advertising to develop as a future substitute for TV advertising.

In the future, the trends since 2003 in the sector are likely to continue

4.70 Having said that, as already mentioned, the recent developments which may have led to increased competition in TV advertising are likely to continue in the future. In other words, digital TV penetration and fragmentation of viewing will increase further which is likely to create more commercial impacts and potentially reduce the differences between the broadcasters' SOCI even more.

4.71 Finally, given the recent advertising downturn, we might also expect to see more consolidation amongst media buyers and sales houses. For example, Sky's sales house recently won the contract to sell advertising time on Viacom's portfolio of channels[46]. This would have had the effect of increasing Sky's (sale house) share of Adult SOCI from 12.8% in 2003 to 16.1% in 2009 and could increase competition between sales houses.

4.72 Overall, these shifts could create greater competitive constraints on the pricing of TV advertising in the future.

Conclusion

4.73 In this Section, we have shown how there have been key shifts in the TV sector since 2003 and how these are likely to have increased competition in the supply of TV advertising airtime.

4.74 In short, there has been a shift in TV viewing from PSBs toward digital channels and this has produced greater opportunities for (the increasingly large) media buyers to purchase impacts from non-PSBs. While we have not assessed whether individual broadcasters or sales houses have market power, the shifts in this sector do suggest that the commercial PSB channels are likely to be subject to greater competitive constraints.

4.75 Furthermore, we believe that the trend towards greater competition in TV advertising may continue in future.

[46] Including MTV, Viva, Nickelodeon, VH1 and Comedy Central.

4.76 The shifts in the competitive landscape discussed in this Section are useful in considering whether the underlying rationale for ASRs is still relevant (given the Rules were retained in 2003 to ensure fair and effective competition in the supply of TV advertising).

4.77 In the following Sections, we move beyond a discussion of high-level competitive changes and present our economic analysis and assessment as to whether broadcasters have incentives to restrict the amount of airtime they sell or to provide it on a conditional basis. We also consider the possible effect of any such behaviour.

Question 1: Do you agree with our description of the key developments in the TV advertising market since 2003?

Question 2: Do you think we have missed any other recent market developments or trends relevant to competition in the advertising sector?

Question 3: Do you agree that SOCI is a key determinant during contract negotiations - that media buyers are more interested in committing expenditure to broadcasters which have increased their SOCI?

Question 4: Do you believe internet display advertising could increasingly act as a constraint on TV advertising (i.e. become a closer substitute) in the next 3-5 years?

Section 5

Assessment: Appropriateness of withholding prohibition

Introduction

5.1 The previous Sections outlined the legal background to the ASRs and described the changes which have taken place in recent years to the competitive landscape of the TV advertising market. The next two Sections consider the question of whether it is appropriate to retain the ASRs for the purpose of ensuring fair and effective competition. This Section examines that question in relation to the withholding rule which applies to the commercial analogue channels; the next considers it in relation to the conditional selling rule which applies to all broadcasters.

5.2 To the extent that the Rules may distort any decisions about the way airtime is sold, their removal could possibly give broadcasters greater flexibility to run their businesses – and if so, it could then have a positive impact on innovation and investment which may, in turn improve programming and deliver benefits to viewers and advertisers.

5.3 A table summarising the possible benefits and drawbacks of lifting the Rules is outlined in Section 7. We note that the key potential benefit from lifting the withholding rule is likely to be the removal of disproportionate regulation on the commercial analogue broadcasters – given that our analysis suggests that they have low incentives to engage in this behaviour.

5.4 Hence, we do not expect that removal of the withholding rule will materially change the behaviour of commercial analogue channels nor affect market outcomes.

ASRs prohibit the restriction of the supply of advertising airtime

5.5 As described in Section 3, in 2003 the ITC/Ofcom retained the prohibition on the withholding of airtime by the commercial analogue broadcasters as they believed that such behaviour could be prejudicial to fair and effective competition. Their view was that the commercial analogue channels 'with the tightest restrictions on the amounts of airtime they can sell and the highest levels of demand, have the potential to withhold airtime and increase profits'[47]. Therefore the commercial analogue channels are currently required to sell all their airtime, subject to the requirements of the COSTA.

5.6 Hence, the concern that led to the introduction of the withholding rule in 2003, was that ITV1, C4 and Five had a degree of market power and the ability to reduce the level of airtime minutes that they broadcast on their main channels, so increasing price and their profit levels. In this Section, we consider whether we continue to be concerned about this behaviour.

[47] Para 36 - Ofcom *Airtime sales rules* 2003
http://www.ofcom.org.uk/tv/ifi/guidance/ITV_airtime_sales/Airtime_sales_rules/

Our analysis takes account of the two-sided nature of the TV advertising market and its trading mechanism

5.7 In order to assess whether broadcasters have an incentive to withhold advertising airtime we consider whether such a strategy would be profitable either in the short run or over the long run. To analyse this we take into account both the two-sided nature of the TV advertising market and the incentives placed on sales houses due to the nature of the TV advertising trading mechanism.

5.8 We analyse TV advertising as a two-sided market because broadcasters sell impacts to advertisers on one side of the market and supply programmes to viewers on the other side of the market. In other words, advertisers want access to airtime in order to advertise to viewers. Broadcasters attract viewers to their channel by broadcasting programmes. When viewers watch these programmes on a commercial channel, they will also watch advertising (thereby providing the impacts for the broadcaster to sell to advertisers).

5.9 The relevance of the two-sided nature of the market is that changes on one side may have knock-on effects to the other side of the market. Therefore any examination of a change in profitability as a result of changing the supply of advertising airtime should consider the reactions of both sides of the market.

5.10 The remainder of this Section analyses, conceptually, the effects on both viewers and advertisers of a broadcaster restricting the supply of advertising airtime, in order to assess whether withholding could be theoretically profitable. It then discusses the nature of the trading mechanism and how this might affect sales houses' incentives in the short and the long run. We also provide an overview of econometric and other evidence to assess the incentives that broadcasters actually face to withhold supply of advertising airtime.

Whether it is theoretically possible to profit from a withholding policy depends on the reactions of viewers and advertisers

5.11 When considering the theoretical ability to profit from a withholding policy in a two-sided market such as TV advertising, it is useful to consider the effects of such a policy in a sequential manner. Therefore we first discuss the effects of such a policy on the viewer side of the market and then on the advertiser side of the market.

5.12 For viewers, a fall in the quantity of minutes of advertising broadcast could be regarded as a fall in the 'price' or cost of watching the content. This is because advertising may be regarded as a nuisance or inconvenience when watching programmes on a commercial channel[48]. If minutes of advertising (the cost of viewing) fall, viewers may find the channel more attractive, which may lead to increased viewing. If viewing increases this would raise the supply of impacts from the remaining minutes of advertising broadcast.

5.13 If viewers particularly dislike advertising, a restriction in advertising minutes could lead to a significant increase in viewing and a large increase in impacts from the remaining minutes of advertising broadcast. This would offset to at least some degree the loss of impacts represented by the lost advertising minutes. Hence, whilst advertising minutes may fall, impacts may not fall or may not fall to the same extent.

[48] Obviously for pay-TV content the price is made up of both the subscription paid to access services and the advertising watched by viewers.

Therefore, we need to understand the reactions of viewers to a fall in advertising minutes in order to assess whether a policy of withholding minutes would be a feasible way of reducing the volume of advertising impacts.

5.14 If a restriction in advertising minutes does lead to a fall in the volume of impacts, we next need to consider whether this would be profitable for broadcasters. Economic theory suggests that if a broadcaster reduced its impacts it would only be able to raise prices and profits if advertisers did not switch their demand to other channels' impacts to any great extent. Therefore we need to understand the nature of advertisers' demand before we can conclude whether, even if it were feasible to reduce impacts by reducing minutes, this would actually be a profitable policy.

5.15 Annex 7 explores the theory of the two sided market, and the potential effects of a fall in advertising minutes on the viewer and advertiser sides of the market, in more detail.

The TV advertising trading model may limit the extent to which short run reductions in impacts result in higher revenues and profits for broadcasters

5.16 We have described the possible theoretical effects of withholding advertising airtime, noting that the profitability of such a strategy will depend on the response of both viewers and advertisers. However, it is also important to consider incentives to withhold advertising minutes and impacts in the context of the TV advertising trading model - the mechanism for short run and long run 'price' setting in the UK TV advertising market. This sub-section examines the short run effects of the trading model i.e. within the trading year.

5.17 In the short run i.e. during the trading year, media buyers book advertising campaigns with broadcasters to deliver a set amount of impacts over the course of the campaign. The price of those impacts (or SAP) is determined ex post by dividing the broadcaster's total revenue by the number of impacts delivered over a period[49].

5.18 If the number of impacts fell (perhaps via a withholding policy or because the broadcaster's programming became less popular with viewers), then an amount of revenue booked to that channel prior to campaign broadcast would purchase fewer impacts than forecast. However, whilst the price may have risen, this may not lead to higher revenues for the broadcaster because broadcasters' revenues are largely determined in the deal season. This is when agencies agree the share of future TV expenditure to be delivered to the sales house over the next year in return for discounts. All other things being equal, if the price of impacts rose, but advertisers did not increase their marketing budgets for subsequent campaigns that year (i.e. they accepted purchase of a lower volume of impacts from the channel), then the total amount of revenues in the market place would be constant.

5.19 Therefore in this scenario, whilst a broadcaster has lowered impacts and raised short run prices, it would not gain in absolute revenue terms from the rise in price. This is because it would receive the same share of TV expenditure from the constant level of TV advertising spend.

5.20 In contrast, total expenditure in the marketplace could rise in the short run if the increase in the price of the channel's impacts led to increases in marketing budgets

[49] This is described in more detail in Annex 6.

within the advertising year. This might occur if advertisers attempted to purchase a given number of impacts from a channel no matter the price.

5.21 However, if total advertising expenditure rose, all broadcasters would benefit. This is because each media buyer must ensure that its total spend is allocated across the broadcasters as per the agreements signed in the deal season. Hence, each broadcaster's share of advertising revenue agreed in the deal season will now translate into higher absolute revenues. However, it may be difficult for a broadcaster considering engaging in a withholding policy to estimate the likelihood of advertisers increasing their budgets and to calculate any resultant increases in absolute revenues with any certainty.

5.22 Therefore we consider that there are likely to be low incentives for the channels to withhold in the short run.

Longer run incentives to withhold

5.23 This discussion has focussed on the short run incentives for a broadcaster to withhold advertising minutes i.e. within the trading year. However, it is also important to consider whether there would be any longer term incentives to engage in such behaviour. Changes in the delivery of impacts could have different effects on advertiser demand in the short and long run. Furthermore, short run changes in revenues and profits due to a withholding policy may be used to increase future viewing levels (and so impacts) for the channel via programme investment.

5.24 We consider two main areas in relation to the long run incentives to reduce advertising minutes. The first is the way advertising is traded and the second is the effect of any changes in programme quality on levels of viewing (and impacts).

Revenue commitments agreed in the deal season are the main driver of broadcasters' revenues

5.25 As explained in Annex 6, in the annual deals between media agencies and sales houses, agencies commit to spend a certain proportion of TV advertising spend (also known as 'share of broadcast' and abbreviated to SOB) on a particular sales house in return for discounts from SAP (higher discounts from SAP result in a higher share of future impacts). These deals appear to have emerged due to the inherent uncertainty on both sides of the market place i.e. agencies will not be certain exactly how much their advertisers will spend during the next year (their spend depends on future marketing campaigns) and broadcasters will be uncertain as to how many impacts they will deliver (which will depend on the success of their future programming).

5.26 One of several key performance indicators used by agencies when deciding how much revenue to commit to a sales house is the sales house's SOCI. In other words, the 'relative impact delivery performance' of the sales house in the previous period is seen as a key indicator of its ability to deliver future impacts. Therefore, whilst there is no formal link between SOCI and NAR (except for ITV1, see below), a sales house which delivers higher SOCI is likely to obtain higher revenue commitments from media buyers the next year. Similarly, if a broadcaster withheld minutes and impacts fell significantly, this may negatively affect a channel's SOCI and therefore damage its negotiating position in the next deal season.

5.27 In the case of ITV1, this effect has been codified into the CRR remedy. CRR links ITV1's SOB commitments directly in a 1to1 relationship to its SOCI performance through the Automatic Ratchet Mechanism (ARM). Therefore if ITV1 reduced impacts by withholding minutage this would affect its SOCI and via the CRR ARM directly reduce the media buyer's SOB commitments for the next deal season.

5.28 It is also possible that CRR, by formalising a relationship between ITV1's SOCI and its SOB commitments, has 'formalised' a similar relationship (which existed to some extent prior to CRR) for the other sales houses. In other words, it is possible that CRR has resulted in more focus being placed on SOCI/SOB across all sales houses not just ITV. It would appear that most media agencies chose to take the adjustment in their SOB commitment to ITV1 allowed each year via CRR. Other sales houses then negotiate with the media agencies about the proportion of spend removed from ITV1 which their sales house can receive. If this is the case many of the sales houses are also likely to have an incentive to maximise their SOCI as a way of achieving the highest proportion of the released spend as possible.

Programme quality may also affect impacts and revenues

5.29 If broadcasters could increase short run revenues by lowering advertising minutes, and these revenues were reinvested into programming, there may be other long run effects of a withholding policy. For instance, if investment in programming increased the quality/attractiveness of programmes on the channel, this may raise levels of viewing and so increase future impacts and SOCI.

5.30 Changes to programming and scheduling of programming can take up to 18 months to occur. When considering a tactic such as withholding, a broadcaster would have to weigh up the likely effect on revenues in the short run (whether the tactic would actually raise revenues) and the effects on SOCI as a performance indicator influencing future demand. As discussed above, we think that the workings of the trading model mean that it would be difficult for channels to gain revenues in the short run through a withholding policy. We also consider that such a policy may damage longer run profitability by damaging SOCI performance, unless the changes in programming led quickly to viewing increases.

There is evidence to support the view that the channels are not incentivised to withhold

Evidence from econometric studies

5.31 We have been able to assess whether advertiser and viewer demand is likely be responsive to changes in advertising minutage by analysing the results of econometric studies. This helps us assess whether a withholding strategy is likely to be profitable and so whether ITV1, C4 and Five are likely to withhold airtime if we removed the prohibition.

5.32 To date there have only been a limited number of econometric studies on price elasticity in the TV advertising market. Due to data constraints, the analysis has tended to be at an aggregate level (demand for all channels). Thus, a study by Hendry in 1992 estimated the price elasticity of demand for TV advertising as a whole and the PwC study for Ofcom in 2004 estimated price elasticity for PSBs and non-PSBs but did not disaggregate the results by individual channels. However, the results of these two studies were consistent in that both found that demand for TV advertising was elastic (or responsive)[50] to changes in the volume of impacts.

5.33 Ofcom recently commissioned an econometric study to derive estimates of both own and cross elasticity effects of changes in the amount of advertising minutage on individual PSBs.[51] It uses data on actual prices paid by a media buyer to different broadcasters and uses up-to-date data i.e. data for the period 2002-2009. The econometric study also explicitly factors in the viewer side of the market i.e. it explicitly uses a two-sided market framework.

5.34 The results of the model enable us to derive estimates of the responsiveness of the prices (measured in CPT) for commercial impacts delivered by PSBs in response to changes in the volume of minutage. We are also able to derive estimates of the cross-effects for individual PSBs e.g. the impact on Five's prices of changes to the advertising minutage on ITV1.

5.35 This econometric analysis found that viewers' demand for C4 and Five is very inelastic[52] – that is, for a change in the volume of advertising minutes, audiences would not change very much at all. Hence if these channels attempted to reduce advertising minutes this would reduce their impacts. However, on the advertiser side of the market, the study found demand was elastic – so that for a given percentage reduction in the volume of these channels' impacts, there would be a less than proportionate increase in price and revenue would be likely to decrease. These results therefore imply that neither C4 nor Five would have an obvious commercial incentive to withhold their airtime i.e. it would not be profitable for these two channels to unilaterally withhold their advertising minutes in the short run.

5.36 Where ITV1 is concerned, viewer demand was again estimated to be very inelastic. Hence, withholding would be a feasible strategy to reduce impacts. The study also found that on the advertiser side of the market, for a given percentage reduction in the volume of impacts, there would be a more than proportionate increase in price and as a result we would expect revenue to increase. However, the increase in price and revenues would be slight, so the incentive to withhold could at best be described as very weak. The econometric data also suggests all three commercial analogue channels together would not have a clear incentive to act in concert to withhold airtime.

5.37 Our intention is to publish this study during our consultation period so that stakeholders can review the model approach and results.

Other factors influencing incentives to withhold – the changing market

5.38 Section 4 outlined the changes which have taken place since 2003 in the TV sector and competitive landscape of the TV advertising market. It outlined how there has been a substantial increase in digital penetration since 2003 and an increase in the number of channels broadcasting in the UK. These have both contributed to a change in viewer behaviour, with viewing becoming more fragmented, which suggests greater competition on the viewing side of the market. By definition as

[50] Hendry, David F, *An Econometric Analysis of TV Advertising Expenditure in the United Kingdom* Journal of Policy Analysis, 1992, 14 (3), 281–311
and PricewaterhouseCoopers *Economic Analysis of the TV Advertising Market* December 2004 http://www.ofcom.org.uk/research/tv/reports/tvadvmarket.pdf .
[51] We intend to publish this report on our website by the end of April.
[52] An explanation of these terms is outlined in Annex 7.

advertisers want access to viewer impacts, this should also imply that there is more competition on the advertiser side of the TV advertising market too.

5.39 Ofcom recognises that advertisers' ability to switch away from ITV1 may still be more limited than would be the case for other channels. However, compared to 2003, it is now probably easier for advertisers to substitute impacts from non-PSB channels for impacts from the commercial analogue channels. We also note that, under current circumstances, there are longer run incentives for all channels and sales houses to maximise their SOCI. This would suggest that even if advertisers had slightly less ability to switch away from any particular channel, the channel would still be unlikely to engage in withholding behaviour. This is discussed in more detail in the earlier sub-section on longer run incentives.

5.40 We also believe that any shift in advertisers' demand away from the commercial analogue channels would have only a relatively small effect on the prices of other commercial channels' impacts. As described in Section 4, non-PSB channels now comprise a large proportion of impacts in the current market place (around 49% of all Adult commercial impacts). Even if there were a shift of demand and so advertising spend to the non-PSB channels, the increase in revenues in the numerator of the price equation (see Annex 6) would be spread over a large number of impacts (in the denominator). Therefore it would take large shifts in revenues to increase prices significantly on the non-PSB channels.

5.41 It is also useful to consider the reaction of the non-PSB channels to a reduction in advertising minutes broadcast by the commercial analogue channels. If the commercial analogue channels reduced the volume of their advertising airtime through a withholding policy, this could provide an opportunity for non-PSBs to offer more airtime to advertisers who were using the PSB channels. The PSBs would also have become relatively more expensive which could also make the non-PSBs more attractive to advertisers.

5.42 Any increases in the advertising minutes broadcast on non-PSB channels are likely to increase their supply of impacts and as noted above, these impacts are likely to be less expensive than those from the PSBs. If advertisers switch to these channels in response, this switch in revenues may help to offset any increase in prices on PSBs. The extent to which other channels could undertake an increase in advertising minutes depends on a number of factors but in particular whether they are close to their advertising caps.

5.43 Finally we note that any attempt by the three channels to reduce supply of minutes and impacts via some sort of coordinated activity would only be achievable if there were limited substitutes and limited incentives to cheat on such an agreement. Whilst advertisers probably have less ability to switch away from ITV1, we believe that there are sufficient alternatives to the other two channels for such a policy to be unsustainable. We note that we could always pursue such behaviour under the Competition Act 1998.

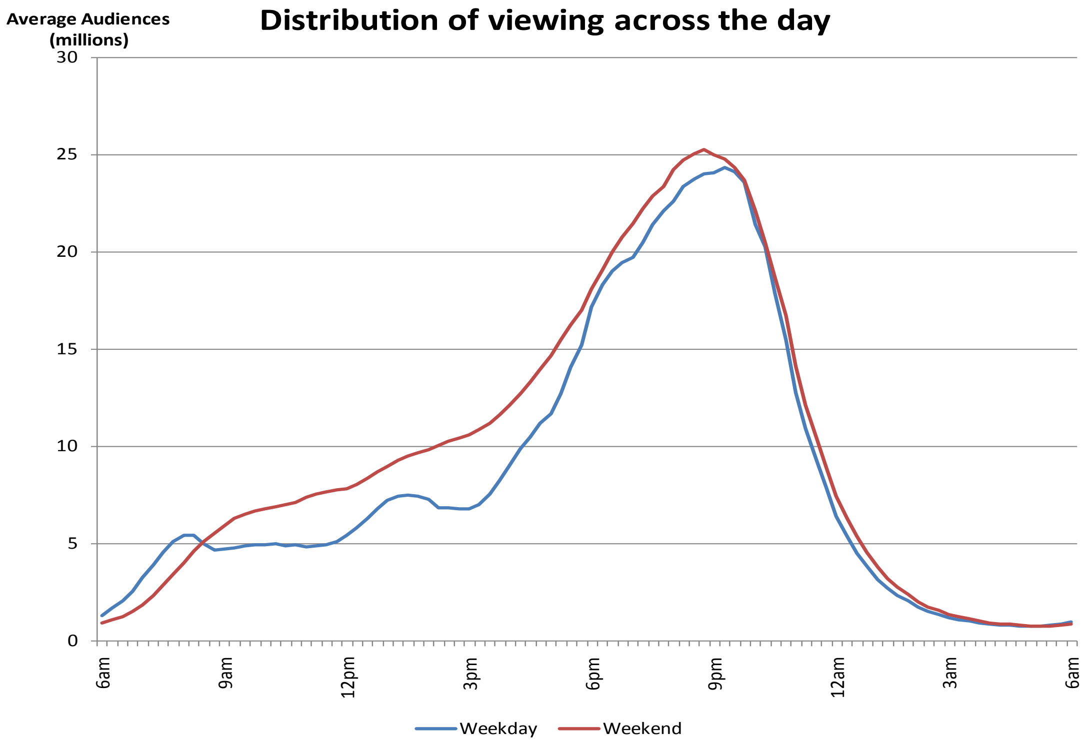
5.44 The above discussion suggests that – in theory – it is unlikely that the commercial analogue channels have an incentive to withhold airtime in either the short or long run. We also consider below some examples which suggest that this is born out in practice.

Broadcasters do not currently appear to withhold airtime

5.45 It is possible that the commercial analogue channels have the scope to manipulate the distribution of their advertising minutes across the day in order to manipulate their overall supply of impacts. In other words, they could effectively by-pass the withholding regulation by maintaining the level of minutes supplied but effectively withholding impacts. They could do this and still remain within the COSTA requirements (the COSTA requirements for peak time minutage are ‘maximum averages’ so reducing the minutage in this time period would be unlikely to run the risk of breaching the COSTA code).

5.46 The ability to manipulate the timing of advertising minutage and so the supply of impacts arises because viewing is not distributed evenly across the day – see Figure 17 below:

Figure 17: Distribution of TV viewing across the day in 2008



Source: BARB

5.47 Most viewing takes place during the evening and on weekends (peak time) whilst during the day viewing is considerably lower. As one might expect, there are very low viewing levels during the night

5.48 However, we note that there has been no evidence that the commercial analogue channels have attempted to alter the distribution of advertising minutes in order to reduce impacts. The current distribution of advertising minutes across the day for each of the commercial analogue channels is shown in Figure 18, Figure 19 and Figure 20 below.

Figure 18: Hourly distribution of Advertising for ITV1 in 2009

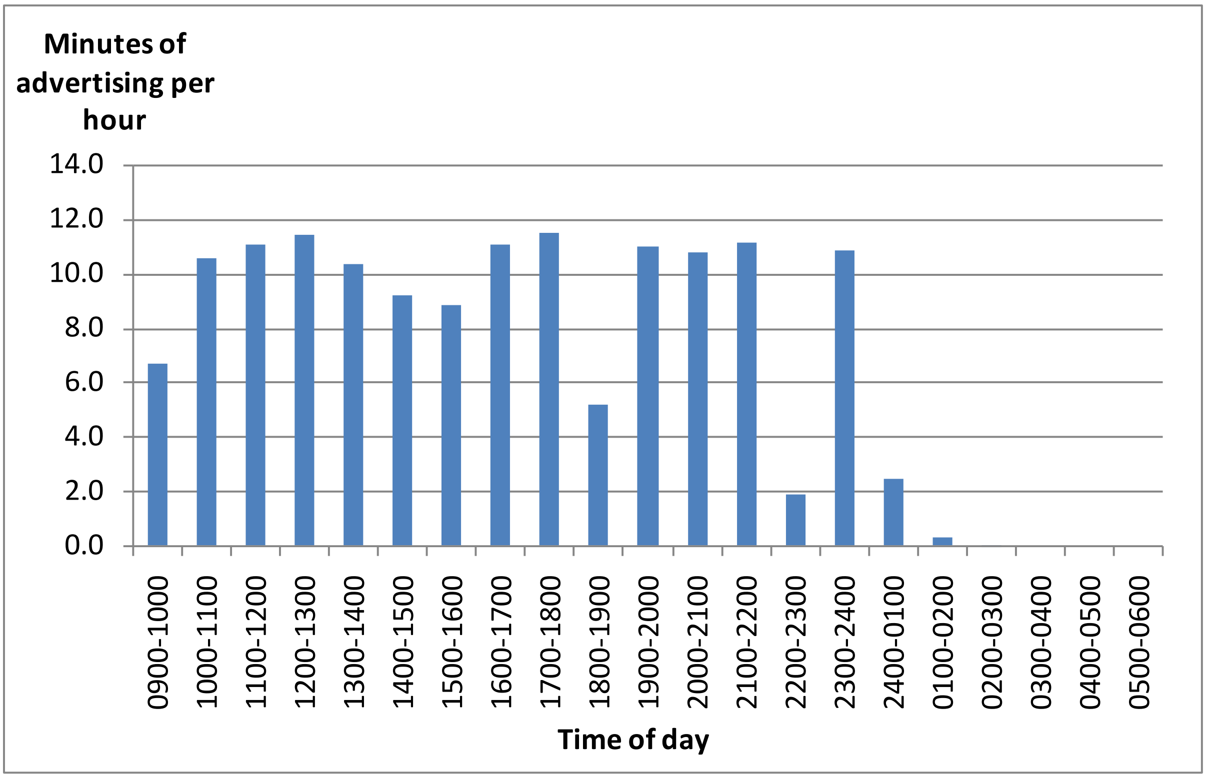


Figure 19: Hourly distribution of Advertising for C4 in 2009

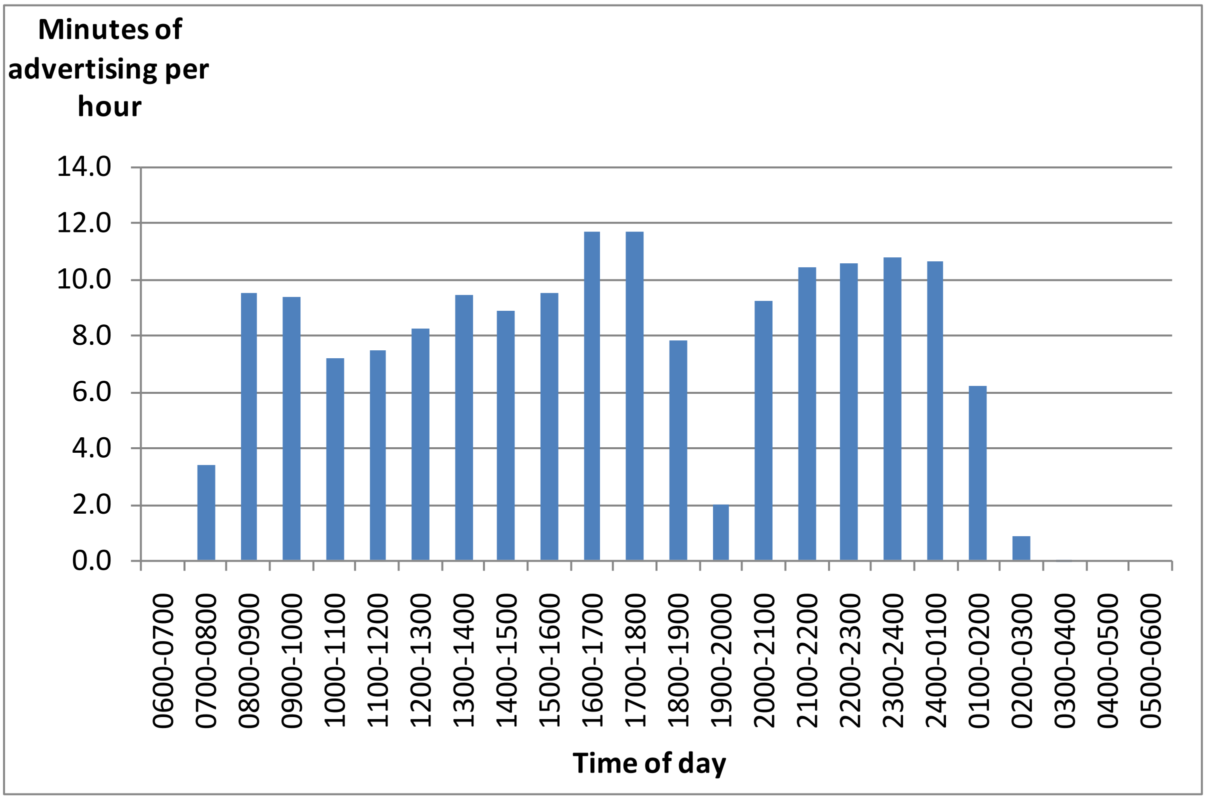
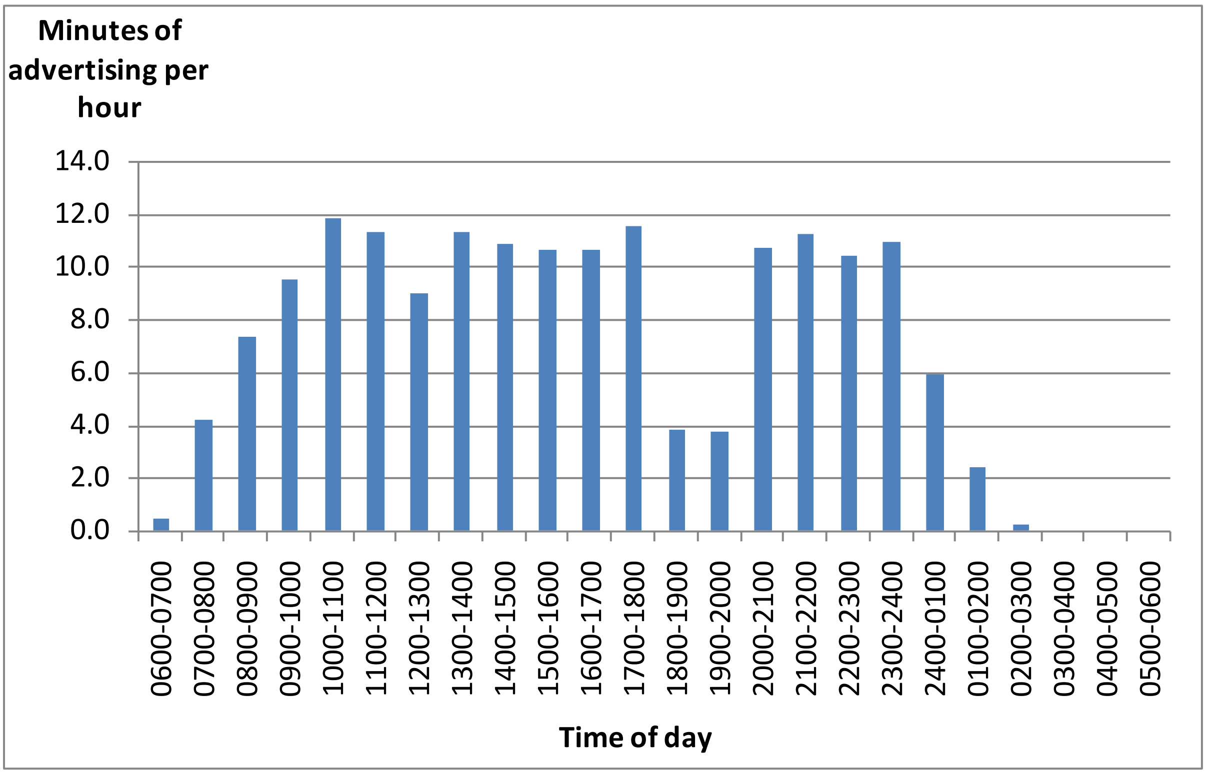


Figure 20: Hourly distribution of advertising for Five in 2009



Source: BARB

5.49 As can be seen, each of the channels concentrates the bulk of its advertising minute allocation during day time and in peak. There are very few minutes of advertising broadcast during the middle of the night when viewing (and so potential impacts) is at its lowest. Hence the behaviour of the channels suggests that they have not sought to manipulate advertising minutes between peak and off-peak. This would tend to reinforce the hypothesis that broadcasters are incentivised above all to maximise SOCI.

5.50 Further, we note that whenever ITV plc, C4 or Five launched a 'family channel', these channels (which are not required under COSTA to sell all their minutes), have tended - when first launched - to sell a low number of advertising minutes but then increase the amounts of advertising minutes sold over time as viewing increased. This also suggests that there may be limited incentives for these sales houses to reduce minutage and impacts.

Overall conclusion on withholding

5.51 Ofcom considers that there are likely to be limited incentives in both the short and long run for ITV1, C4 and Five to withhold minutage and so withhold impacts.

5.52 A broadcaster will only withhold minutage if this would lead to an increase in its revenues and profits.

5.53 In the short run, theory suggests that revenues will only increase if the withholding policy results in a drop in impacts, which in turn leads to a greater than proportionate rise in price. However, any analysis of a change in volumes of impacts on prices and profits is complicated by the effect of the TV advertising trading model. It is likely that a broadcaster facing responsive demand from advertisers (or elastic demand) would not be certain that any changes in impact levels would lead to higher revenues within the trading year i.e. the short run.

5.54 Since 2003, there have been various developments in the TV advertising sector which suggest that competition has increased. Hence if the volume of the commercial analogue channels' impacts fell, it is unclear that this would be profitable in the short run as advertisers today may be more prepared to switch away from the commercial analogue channels' impacts to those of other non-PSB channels. This is supported by evidence from a recent econometric study which suggests that C4 and Five are unlikely to find it profitable to unilaterally withhold airtime and that such a policy would only deliver small gains to ITV1. It is also supported by the fact that there is no evidence of the three broadcasters manipulating the distribution of minutage across the day in order to reduce available impacts.

5.55 Longer run incentives are also likely to be an important influence on a decision by broadcasters to withhold. Each year, during the deal season, broadcasters agree discounts off SAP in return for a share of future TV advertising expenditure, or share of broadcast expenditure, from media buyers. This share of broadcast has a direct effect on their future TV advertising revenues. Media buyers will allocate a greater share of broadcast expenditure to channels and sales houses which have proven their ability to deliver impacts i.e. to those channels and sales houses with the highest levels of SOCI or where SOCI has increased. As viewing appears to be relatively insensitive to levels of advertising minutes, any attempt by broadcasters to reduce minutes could reduce impacts but therefore also damage SOCI performance and so future revenues.

Question 5: Is there any other relevant evidence we should consider in order to examine the ongoing need for the withholding rule?

Question 6: Do you agree with our conclusions that the commercial analogue broadcasters do not appear to have strong incentives to withhold airtime? If not, why?

Section 6

Assessment: Appropriateness of conditional selling rule

Introduction

6.1 This Section considers the appropriateness of the conditional selling rule for the purpose of ensuring fair and effective competition.

ASRs prohibit the conditional selling of airtime

6.2 The ASRs explicitly state that a sales house must not make ‘sale of Channel A conditional on the advertiser/buyer taking Channel B or vice versa’[1]. However, it was also made clear that this rule did not prohibit a sales house from bundling products[53].

6.3 Unlike the prohibition on withholding, this rule applies to all broadcasters licensed by Ofcom. Therefore all broadcasters are required to ensure that they abide by the prohibition.

Outline of the rest of this Section

6.4 This Section first discusses the type of bundling/conditional selling behaviour which occurs in UK television markets and compares this to behaviour in other communications markets. We go on to discuss current economic thinking about the nature of bundling/conditional selling and explain how conditional selling is a form of bundling. We then consider the incentives there may be to bundle/conditionally sell and the fact that in certain circumstances this type of behaviour can be welfare enhancing. We note that many of the positive welfare effects can benefit buyers as well as sellers.

6.5 Next we examine the particular circumstances in the TV advertising market in which bundling may be problematic and in contrast the circumstances in which it may be welfare enhancing.

6.6 Finally we discuss whether a policy which imposes a blanket prohibition on one type of bundling continues to be necessary given the changes which have occurred in the TV advertising market. We discuss whether another approach to the regulation of this type of bundling might ensure that behaviour detrimental to overall economic welfare was prohibited, whilst enabling behaviours which are welfare enhancing can take place.

6.7 In the rest of this Section, we use the term ‘bundling’ to describe bundling in general. There are several different types of bundling covered by this general description, including that which has been termed conditional selling.

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[53] The 2003 ASR document stated that ‘As such, to the extent that a sales house wishes to offer a price for Channel A, a price for Channel B and a price for a bundled product of Channel A and Channel B, this would be acceptable providing that the price of any such bundled product was not in itself predatory and in breach of the Chapter II prohibition’.

Bundling is widespread in the UK television industry and other communications markets

6.8 Before examining bundling in theoretical terms, it is useful to describe the nature of this behaviour in the television and broadcasting markets and compare it to that which occurs in other communications industries.

6.9 Bundling is widespread across different parts of the broadcasting industry. A general entertainment channel is itself a bundle of different programmes, such as documentaries, comedies, news etc and viewers choose between television platform providers (such as Sky, Freeview or Virgin Media) which offer a variety of different bundles of channels in the form of channel packages.

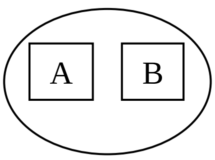
6.10 Similarly, when broadcasters or sales houses sell advertising airtime in the UK, they do not sell a single impact from a particular channel but instead sell a bundle of different impacts to fulfil advertisers' campaign needs. Even if an advertiser contracts for impacts for a single campaign on a single channel, the impacts will be delivered across different times of day, on different days of the week, in breaks in different programmes and in breaks in different positions (such as before a programme starts, breaks during programmes etc). Sales houses representing a number of channels, sell bundles of impacts across those channels.

6.11 Bundling also occurs across a variety of different communication markets and is a common feature of sales strategies. For instance, within retail mobile markets, mobile phones are bundled with inclusive calls and texts. Similarly, many communications providers currently offer bundles of a variety of communications services. For instance, Sky and BT (amongst others) offer a variety of different bundles comprising broadband, fixed telephony and television services and Virgin Media offers bundles of broadband, fixed telephony, mobile telephony and television services.

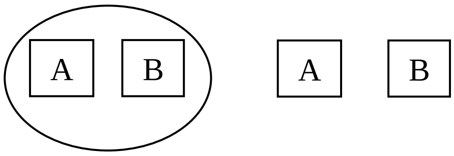
There are three theoretical types of bundling

6.12 Bundling can encompass various types of behaviour including various pricing practices. However, it can be categorised into three main types: pure bundling, mixed bundling and tying. In the descriptions below we assume that there are two products, A and B, within the bundle.

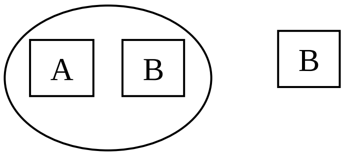
6.13 Pure bundling occurs when products A and B are only sold as part of a package or bundle and in fixed proportions. This is shown in the diagram below where the two products are enclosed within a circle, which represents the bundle.



6.14 Mixed bundling occurs when a buyer can buy A and B together in a bundled package <u>or</u> can purchase A and B separately. However, the package of A and B together is sold at a discount to the combined price of purchasing each product separately. This is shown in the diagram below, where the two products are available in the bundle (enclosed by the circle), but also available outside the bundle as separate products. The price of the bundle (P_{AB}) is less than the price of the two goods if they were purchased separately (P_A and P_B). Hence, $P_{AB}<P_A+P_B$.



6.15 Tying occurs when the purchaser of one product (the ‘home’ product) e.g. A, is required to purchase another product B, (the ‘tied’ product). It is possible to purchase the ‘tied’ product separately but not the ‘home’ product. In other words, the buyer could buy B on its own or A and B together but not A on its own. Tying can sometimes occur through the mechanism of a ‘buy through’ i.e. you must first buy one product before you can get access to the next product. Tying is shown below in the diagram.



6.16 It might be concluded that conditional selling encompasses behaviour which could be defined as pure bundling and tying[54]. For the sake of clarity, the rest of this Section will only use the terms used above (i.e. mixed bundling, pure bundling and tying) and not refer to conditional selling.

There are a variety of incentives to bundle

6.17 There may be a variety of incentives for a firm to bundle and these can have different effects on economic welfare. Some, for example those which expand output or lead to savings in transactions costs, can increase economic welfare. Others on the other hand, such as those aimed at limiting competition, will if successful, reduce welfare. Examples of incentives which may be relevant to the sale of TV advertising are discussed below.

Bundling to obtain cost savings

6.18 Firms may engage in bundling in order to reduce the costs that they face. For instance, if firms supply a number of goods and services to particular customers, then bundling may enable them to reduce the number of negotiations which take place and the number of legal contracts which need to be agreed between the parties. Hence, if a sales house represents a number of channels, it may be more efficient for them to negotiate once with an agency and have a single contract, rather than negotiating separately for the supply of each particular channel with separate legal contracts for the supply of impacts related to each channel. It should be noted that in this situation we would expect media buyers also to benefit from lower negotiation costs. These savings in transactions costs may be passed on to advertisers if the market for TV advertising is competitive.

[54] However, the effects of one form of bundling (e.g. tying) could be replicated by a version of another form of bundling. For instance, if a sales house were prevented from tying, it might instead allow buyers to purchase A separately from B but the price of A outside the bundle is so high that essentially the sales house is undertaking a tying policy.

6.19 There may be other forms of cost savings and efficiency gains available to sales houses when they bundle together impacts from a number of different channels. In the trading regime, broadcasters sell bundles of impacts to agencies and choose the slots for the advertisements when advertisers book campaigns. This choice enables broadcasters to ‘optimise’ i.e. place advertising in the most effective slots possible and ensures that the maximum amount of impacts are available to the market place.

6.20 This will not only maximise the amount that can be sold on the part of the sales house but also yield benefits to media buyers and advertisers. First, with more impacts available, more campaigns can be broadcast. Second, it is likely that optimisation will reduce levels of ‘wastage’. Wastage occurs when there are ‘excessive’ multiple viewings of an advertisement. If adverts were placed sub-optimally (i.e. in slots where they did not reach the maximum possible amount of the target demographic), then to achieve campaign objectives, the advert will have to be placed in more slots and this may lead to more people seeing the advert an ‘excessive’ amount of time.

Bundling to deliver value enhancements

6.21 Firms may engage in bundling in order to more easily deliver ‘value enhancements’ to end customers. This may also be a rationale for bundling in broadcasting e.g. it may enable sales houses to deliver impacts in related programmes across a number of its channels. For instance, the C4 sales house might be able to deliver for a particular advertiser campaign, impacts from Big Brother on C4 and then impacts from Big Brother’s Little Brother on E4. This may be beneficial to advertisers who want to obtain frequency amongst a particular demographic or be associated with a particular set of programmes.

Bundling to enable price discrimination

6.22 Price discrimination, where the same service is sold at different prices to different sets of consumers, may yield economic benefits or may be used by the firm in ways which reduce welfare for customers.

6.23 Bundling to enable price discrimination can be beneficial if this behaviour expands sales, the customer base and consumer surplus[55] for the services in question. An example of how bundling and price discrimination can be used together to increase sales and how this may lead to a number of benefits is outlined below.

6.24 Suppose there are three buyers of a product: X, Y and Z, have the following valuations for a hundred units from two suppliers A and B (the valuation represents the amount that they would be prepared to pay to purchase the units of the product):

	X	Y	Z
100 units of A	£7.00	£3.25	£1.50
100 units of B	£1.50	£4.25	£6.75
Total value	£8.50	£7.50	£8.25

[55] Consumer surplus is the difference between the price paid for the service and the valuation the buyer places on the service.

6.25 Assume that A and B are both sold by C. C does not know the buyers' valuations for the products, cannot bundle them together and cannot price discriminate. We assume that in this case, it estimates that it could obtain the highest revenues (and profits) if it charges £6.75 for one hundred units of A and £6.75 for one hundred units of B.

6.26 In this scenario, C will sell two hundred units and obtain revenues of £13.50. Buyer X will purchase one hundred units of A and Z will purchase one hundred units of B. Y will not purchase any units of A or B as its valuations are below the price charged.

6.27 It is useful to consider whether the buyers have benefitted relative to their valuations for the products. The valuations table tells us that X would have paid up to £7.00 for one hundred units of A. As it actually paid £6.75, it gained £0.25 consumer surplus per purchase of one hundred units. Z gained no consumer surplus as the price it paid equalled its valuation for the product.

6.28 We now assume that C can bundle the two products together when selling to buyers. Once again, C does not know the buyers' true valuation for the bundle. It chooses to price the bundle at £7.50 and this time it sells three bundles, one to each buyer.

6.29 In this scenario, C will sell six hundred units and gain revenues of £22.50. Sales and revenues have therefore increased compared to the scenario where no bundling occurs.

6.30 Total consumer surplus has also increased through the bundling of the products. Whilst Y's valuation is equal to the price paid (it gains no consumer surplus as it has paid its full valuation for the service), in contrast X would have paid up to £8.50 for the bundle but has actually paid less than this. It therefore gains £1 of consumer surplus. Similarly, Z would have paid up to £8.25 for the bundle and therefore gains £0.75 consumer surplus.

6.31 The example shows how bundling can enable sales to expand, increasing revenues for the seller but also increasing consumer surplus for buyers. Both sides of the market have gained from the bundling policy. It is also important to note that whilst the case shown uses pure bundling to show how price discrimination can lead to an increase in output and consumer surplus, we could also construct a case showing how tying could lead to an expansion of output and consumer surplus.

6.32 There may be further benefits of price discrimination through an expansion of output such as a reduction in the risk associated with innovation. This is because firms with high fixed and sunk costs (such as in broadcasting) may be able to recover these costs more easily over the larger output.

6.33 However, bundling and price discrimination can also have negative effects. For instance, consumers may have to purchase services in which they have no interest (effectively raising the price they pay for the good in which they are interested) and the price discrimination may act to obscure prices (which may inhibit consumer switching and so competition).

Bundling to engage in anti-competitive behaviour

6.34 Bundling can be anti-competitive if it results in the exclusion or foreclosure of rival companies. If a firm bundles a series of products together and refuses to sell these separately, this may deter entry by other providers. This is because by tying the products together, an entrant would need to provide all the products within the bundle or, if it only provides one of the products, it must be able to make a profit on a relatively low level of demand; some current purchasers would not give up the bundle they currently purchase if they also value the other products within the bundle.

6.35 Furthermore, if the firm commits to selling products as a bundle, potential entrants will be aware that for every sale they take away from the incumbent, they will have an effect on its profits. The incumbent may therefore respond aggressively to entry, making entry more risky and less profitable.

6.36 It is not clear whether bundling is significantly reducing entry into the sale of TV advertising airtime. Many of the current sales houses, such as ITV, C4, Five and Sky, are vertically integrated i.e. selling channels' impacts which belong to their parent company. If a new sales house entered the market, it would have to attract smaller channels which were not owned by the large sales houses. Hence, entry and growth in the sales house market may already be difficult whether or not bundling takes place. It is possible that bundling worsens the situation by making the proportions of SOB available to new entrants even smaller. However, this may also reflect the nature of the 'SOB commitment for discount' trading system whereby sales houses attempt to maximise the amount of SOB commitments they can achieve in the yearly trading season.

The effect of bundling on market outcomes will vary case-by-case

6.37 We note that there has been some consolidation on both the media buyer and sales house sides of the TV advertising market. Such consolidation may result in more opportunities and incentives to bundle and we would expect that bundling on both sides will continue to exist.

6.38 However, as discussed above, there are a variety of reasons firms may choose to bundle - some of these may be beneficial to market players e.g. those which reduce costs, expand output or offer value enhancements. Others may be more negative i.e. aimed at reducing competition by excluding rivals or obscuring prices to customers. However, a key point is that it is not possible, without investigating the details of the particular case in question to assume that bundling is inherently 'good' or 'bad' for customers.

6.39 For bundling to result in any negative welfare effects through a reduction in competition and choice, the sales house must have sufficient market power[56] such that the bundling policy could be used to exclude rivals.

6.40 In general, as discussed in Section 4 and above, Ofcom considers that competition has increased in the TV advertising market since 2003 and this should reduce the ability of sales houses to successfully engage in such anti-competitive bundling activity.

6.41 Furthermore, even though market power is a necessary condition for bundling to be problematic, bundling behaviour by a sales house with a high degree of market

[56] TV advertising is a differentiated market in the sense that the services sold by the sales houses are somewhat different to each other and they will have differing attractions to buyers. This is the case even for the smallest sales house. In a scenario of a differentiated market, all players have some degree of market power and it is this degree of market power which enables them to bundle. However, we would only be concerned about the effects of that bundling behaviour if the sales house in question had a significant amount of market power, such that the bundling policy could distort competition in the market place.

power is not automatically problematic. As noted above, there can be incentives to bundle which are welfare enhancing. For instance it might:

- Expand demand (via price discrimination) so enabling more advertisers to advertise on TV;
- Lead to lower negotiation costs – these gains would be on the buyer side as well as the seller side;
- Make it easier for a broadcaster to optimise – therefore more impacts are supplied overall which may enable more campaigns to be broadcast which potentially lowers prices; and
- Enable advertising across linked programming – therefore making it easier for advertisers to meet particular campaign goals.

6.42 Hence, even if a sales house with market power was bundling to exclude rivals and this had anti-competitive effects on the market place, these may be outweighed by any welfare enhancing effects.

6.43 In addition, if bundling were prohibited for all firms in a market place then there is the risk that beneficial welfare effects would not be realised. Ideally, rather than have a blanket prohibition, it would be better to take a case by case approach, first analysing the nature of the firms undertaking this behaviour (i.e. whether they have a significant amount of market power) and then if they do, assessing whether this behaviour has an overall negative effect on the market place.

6.44 In 2003 the ITC/Ofcom believed that pure bundling or tying behaviour was widespread amongst broadcasters/sales houses and that the very widespread nature of this behaviour effectively reduced choice and raised prices to media buyers. We consider that this refers to ‘parallel’ bundling behaviour i.e. whereby all sales houses in the market would attempt to conditionally sell, no matter what their size.

6.45 Ofcom believes that this is unlikely to remain the case across all sales houses. All sales houses have deals with media buyers whereby they offer ‘discounts’ (increased share of future impacts), in return for a commitment to spend a proportion of future TV advertising spend on that sales house. Smaller sales houses in particular, would find it difficult to engage in anti-competitive bundling behaviour as media buyers would find it easier to threaten to reduce future spend commitments in response. This would make parallel bundling behaviour less likely to be sustainable.

Conclusion

6.46 Bundling (of which pure bundling and tying are forms) occurs in many industries and – depending on the circumstances - it can have a positive or negative impact on competition and welfare. It is not possible to be categorical as to whether it yields overall benefits or costs to the industry participants and ultimately consumers/viewers. However, negative effects are only likely to arise if a firm has market power and acts in way that is likely to have an exclusionary effect. In this situation, a blanket prohibition on particular types of bundling may prevent welfare optimising behaviour by individual firms.

6.47 Therefore Ofcom believes that it would be better to treat all types of bundling on a case by case basis. This would start with an assessment as to whether the firm in question has market power and then investigate the positive and negative implications of its behaviour. The Competition Act 1998 allows Ofcom to investigate the positive and negative effects of bundling behaviour on a case by case basis and, in principle, is more likely to be used for this type of analysis than the ASRs. This is because s.317 of the 2003 Act prevents Ofcom from exercising its powers to enforce licence conditions under s.316 of the 2003 Act (such as broadcasters' licence condition to comply with the ASRs) if it considers that action under the Competition Act 1998 would be more appropriate.

6.48 We also doubt whether given the changes in market conditions that have taken place over the past few years, it would be feasible for firms to undertake parallel anti-competitive bundling behaviour i.e. it would be difficult for sales houses to maintain this behaviour given that they are all eager to obtain higher levels of SOCI and engage in considerable price and quality discrimination.

Question 7: Is there any other relevant evidence we should consider in order to examine the ongoing need for the conditional selling rule?

Question 8: Do you agree with our view that there can be both positive and negative effects from bundling (including conditional selling), which means there should not be a blanket ban on conditional selling?

Section 7

Recommendation: To lift the Rules

7.1 The underlying rationale for the ASRs was to ensure "fair and effective competition" in the provision of licensed broadcasting services and services connected with them. In assessing whether the ASRs continue to be appropriate for that purpose, we have considered whether, absent regulation, there would be a realistic prospect of a broadcaster engaging in the prohibited practices.

7.2 We believe a broadcaster is only likely to be able to engage in withholding or conditional selling to the detriment of its customers and the workings of the market if it has both the ability (i.e. is in a position of market power) and incentives to engage in this behavior (i.e. it would be profitable in some way).

7.3 We have not made an assessment of market power in our review. However, in Section 4 we illustrated how recent market developments suggest greater overall competition in the supply of TV advertising, which would imply that the ability of broadcasters to engage in this behaviour is likely to have eroded since 2003.

7.4 Furthermore, in the preceding two Sections, we set out our analysis of the appropriateness of each of the Rules:

- Our analysis indicates there are limited incentives to restrict advertising minutes. This is supported by econometric evidence which suggests that, in the short run, the withholding of airtime is unlikely to be unilaterally profitable for C4 or Five and that it would have a negligible impact on ITV1's revenues. Also, under current circumstances, the trading mechanism incentivises broadcasters to sell all their airtime in the long run;

- We also explained how conditional selling is a form of bundling and that bundling can potentially yield benefits to market participants. Even where conditional selling might restrict competition i.e. where the sales house has market power – any adverse effects could still be outweighed by the benefits.

7.5 We have thus provisionally concluded the Rules may no longer be appropriate for ensuring fair and effective competition. In the light of our analysis we also consider that there are a number of potential benefits of lifting the ASRs, as highlighted below:

	Possible Results from Lifting the Rules
Benefits from removing both rules	• Reduces regulatory complexity and burden in the TV sector • May provide more flexibility, allowing broadcasters to operate more efficiently – which could have positive effects on investment and innovation and in turn might deliver benefits for viewers e.g. through improved programming and thus for advertisers wishing to reach consumers
Benefit from removing withholding rule	• Removes disproportionate regulation (given evidence that there are low incentives for commercial analogue channels to withhold airtime)
Benefit from removing conditional selling rule	• Encourages the achievement of efficiencies and welfare benefits from this bundling behaviour
Potential drawback	• Residual risk of broadcasters in engaging in withholding and conditional selling to the detriment of customers

Our proposals

7.6 We are proposing to:

- Lift the withholding rule for all the commercial analogue channels – this means removing the prohibition on the broadcasters of ITV1, C4 and Five. It also means we do not propose to apply this rule to any other broadcasters or channels.

- Lift the conditional selling rule in relation to all channels.

7.7 This fits with our wider commitment to reduce and simplify complex or unnecessary regulation and is in line with our general duties.

7.8 We intend to keep the impact on competition in the market from lifting of the Rules under review should we remove them following our consultation. This would take place through analysis of key trends in the sector and regular discussions with stakeholders, including the buyer-side of the market and the Office of the Adjudicator (CRR).

7.9 Moreover if circumstances materially change in the sector – e.g. if the CRR remedy is removed or if there is substantive consolidation in the sector – which then indicated it was more likely that broadcasters would engage anti-competitive behaviour, it may become necessary to consider whether it would be appropriate to reintroduce targeted ex ante rules.

7.10 In this context, it should be noted that we also have other regulatory tools which we could use to address any potential competition issues, which may arise following the removal of the ASRs, namely:

- the prohibitions in the Competition Act 1998 (and the equivalents in the Treaty on the Functioning of the European Union) which apply, respectively, to agreements and arrangements between two or more undertakings and which have as their object or effect the prevention, restriction or distortion of competition within the UK; and to conduct by one or more undertakings which amounts to an abuse of a dominant position;

- Ofcom's concurrent powers to make a reference to the Competition Commission under the Enterprise Act 2002 if, in relation to commercial activities connected with communications matters, it has reasonable grounds for suspecting that any feature or combination of features in a market in the UK prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or in a part of the UK.

Question 9: Do you agree with our proposals to lift both the withholding rule and the conditional selling rule?

Question 10: Alternatively, if you think the ASRs should be retained in their current or an amended form, what is your reasoning for this view and, if relevant, how should they be amended?

Annex 1

Responding to this consultation

How to respond

A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 7 June 2010**.

A1.2 Ofcom strongly prefers to receive responses using the online web form at https://www.ofcom.org.uk/consult/condocs/asr/howtorespond/form, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.

A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email airtimesalesrules@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.

A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Siobhan Walsh
Floor 4
Competition Group, Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA

Fax: 020 7981 3333

A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.

A1.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex X. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Zahid Deen on 020 7981 3832.

Confidentiality

A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.

A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at http://www.ofcom.org.uk/about/accoun/disclaimer/

Next steps

A1.11 Following the end of the consultation period, Ofcom aims to publish a statement by September 2010.

A1.12 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see: http://www.ofcom.org.uk/static/subscribe/select_list.htm

Ofcom's consultation processes

A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.

A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.

A1.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash
Ofcom
Sutherland House
149 St. Vincent Street
Glasgow G2 5NW

Tel: 0141 229 7401
Fax: 0141 229 7433

Email vicki.nash@ofcom.org.uk

Annex 2

Ofcom’s consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

A2.3 We will be clear about who we are consulting, why, on what questions and for how long.

A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A2.5 We will consult for up to 10 weeks depending on the potential impact of our proposals.

A2.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom’s ‘Consultation Champion’ will also be the main person to contact with views on the way we run our consultations.

A2.7 If we are not able to follow one of these principles, we will explain why.

After the consultation

A2.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 3

Consultation response cover sheet

A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, www.ofcom.org.uk.

A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.

A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.

A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at www.ofcom.org.uk/consult/.

A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

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

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

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

DECLARATION

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

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

Name | Signed (if hard copy)

Annex 4

Consultation questions

A4.1 There are 10 questions in this consultation document, as follows:

Question 1: Do you agree with our description of the key developments in the TV advertising market since 2003?

Question 2: Do you think we have missed any other recent market developments or trends relevant to competition in the advertising sector?

Question 3: Do you agree that SOCI is a key determinant during contract negotiations - that media buyers are more interested in committing expenditure to broadcasters which have increased their SOCI?

Question 4: Do you believe internet display advertising could increasingly act as a constraint on TV advertising (i.e. become a closer substitute) in the next 3-5 years?

Question 5: Is there any other relevant evidence we should consider in order to examine the ongoing need for the withholding rule?

Question 6: Do you agree with our conclusions that the commercial analogue broadcasters do not appear to have strong incentives to withhold airtime? If not, why?

Question 7: Is there any other relevant evidence we should consider in order to examine the ongoing need for the conditional selling rule?

Question 8: Do you agree with our view that there can be both positive and negative effects from bundling (including conditional selling), which means there should not be a blanket ban on conditional selling?

Question 9: Do you agree with our proposals to lift both the withholding rule and the conditional selling rule?

Question 10: Alternatively, if you think the ASRs should be retained in their current or an amended form, what is your reasoning for this view and, if relevant, how should they be amended?

Annex 5

Broadcasting Licences and the ASRs

A5.1 The ASRs constitute a code in relation to the sale of television advertising airtime. Licensed broadcasters[57] are required to comply (to the extent applicable) with this code as a condition of their licences, whether they sell airtime on their channels directly or through a third party sales house. They are enforceable by Ofcom via broadcasters' licence conditions.

Analogue Terrestrial Channels - Licensees

A5.2 The withholding rule applies to commercial analogue channels – which means Channel 3, Channel 4 and Channel 5.

Channel 3

A5.3 Channel 3 is the statutory name for a free-to-air, commercially funded national television broadcast channel. Channel 3 is made up of 15 regional licensed areas, plus a national breakfast-time service – see Figure A5.2 below.

A5.4 In October 2002, Carlton Communications Plc (Carlton) and Granada plc (Granada) announced an agreed merger to form ITV plc (ITV). ITV plc owns 11 of the 15 Channel 3 broadcasting licences via its wholly owned subsidiary ITV broadcasting limited – see Figure A5.1 below.

A5.5 ITV broadcasting limited also now fully owns the company which holds the national licence for the Channel 3 national breakfast-time service (known as GMTV)[58].

A5.6 The two companies which hold regional licences in Scotland (central Scotland and the North of Scotland) are owned and controlled by STV plc. The regional licence for Northern Ireland is held by Ulster Television plc**.** The regional licence for the Channel Islands is held by Channel Television Limited.

A5.7 The current Channel 3 licences are normally referred to as the digital replacement licences (DRLs) and require the Channel 3 service to be broadcast via digital terrestrial TV and a corresponding analogue service to be provided until DSO.

A5.8 There are currently no obligations for the Channel 3 service to be broadcast on other platforms. However, the Channel 3 licensees choose to broadcast simulcast versions of the Channel 3 services on satellite, cable and IPTV platforms. (The satellite and cable broadcasts of the Channel 3 services are operated under 16 separate TLCS licences (15 for the ITV1 services and 1 for the GMTV service).

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[57] A television service will be licensable if it falls within one of the statutory licence definitions in the Communications Act 2003.

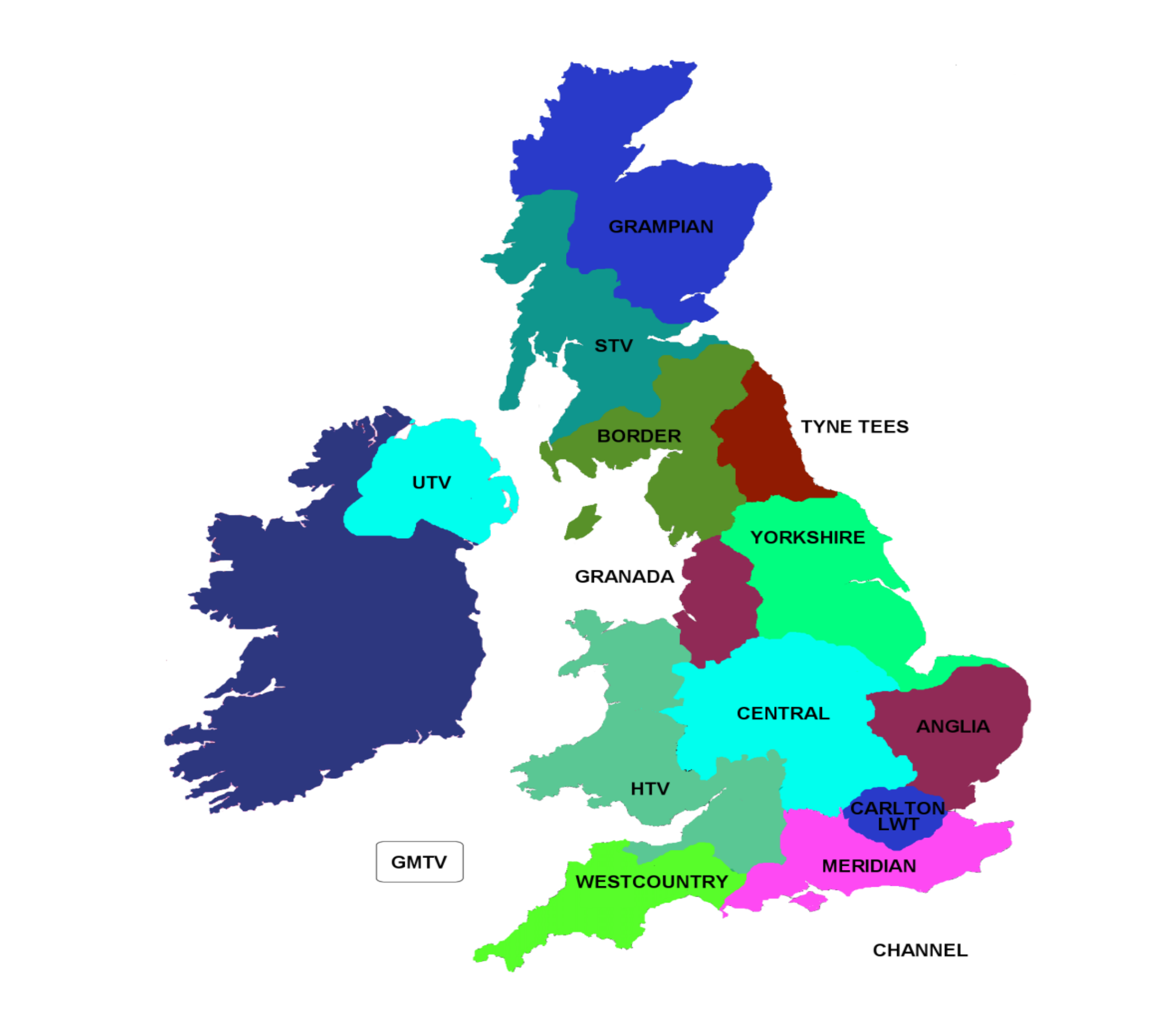
[58] In November 2009, ITV Broadcasting Limited secured full ownership of GMTV Limited ("GMTV"), the national breakfast-time Channel 3 licensee, having acquired the remaining 25% equity stake in the business from The Walt Disney Company Limited and one of its subsidiaries ("Disney"). See http://www.itv.com/presscentre/pressreleases/corporatepressreleases/itvplcsecuresfullownershipofgmtv/default.html

Figure A5.1: Channel 3 DRL Holders - regional and national franchises

Region/Service	Licence holder
Anglia ITV: East of England	**ITV Broadcasting Ltd** (formerly Anglia Television Limited) a wholly owned subsidiary of ITV plc
Border ITV: Borders and the Isle of Man	**ITV Broadcasting Ltd** (formerly ITV Border Limited) a wholly owned subsidiary of ITV plc
Central ITV: East, West and South Midlands	**ITV Broadcasting Ltd** (formerly ITV Central Limited) a wholly owned subsidiary of ITV plc
Channel Television: Channel Islands	Channel Television Limited
STV: North of Scotland (previously known as Grampian)	STV North Limited (owned by STV plc)
Granada ITV: North-West England	**ITV Broadcasting Ltd** (formerly Granada Television Limited) a wholly owned subsidiary of ITV plc
Wales ITV and West ITV: Wales and West	**ITV Broadcasting Ltd** (formerly ITV Wales and West Limited and HTV Group Limited) a wholly owned subsidiary of ITV plc)
London ITV: London Weekday	**ITV Broadcasting Ltd (formerly** ITV Carlton Broadcasting Limited) a wholly owned subsidiary of ITV plc
London ITV: London Weekend	**ITV Broadcasting Ltd** (formerly London Weekend Television Limited) a wholly owned subsidiary of ITV plc
Meridian ITV: South and South-East England	**ITV Broadcasting Ltd** (formerly ITV Meridian Limited) a wholly owned subsidiary of ITV plc
STV: Central Scotland	STV Central Limited (owned by STV plc)
Tyne Tees ITV: North-East England	**ITV Broadcasting Ltd** (formerly Tyne Tees Television Limited) a wholly owned subsidiary of ITV plc
UTV: Northern Ireland	UTV plc
Westcountry ITV: South-West England	**ITV Broadcasting Ltd** (formerly West Country Television Limited) a wholly owned subsidiary of ITV plc
Yorkshire ITV: Yorkshire	**ITV Broadcasting Ltd** (formerly Yorkshire Television Limited) a wholly owned subsidiary of ITV plc
GMTV: National Breakfast-time (UK)	GMTV Limited – **now fully owned by ITV Broadcasting Ltd**, a wholly owned subsidiary of ITV plc

Source: Ofcom

Figure A5.2: Map of Channel 3 Regions



Source: Ofcom

Note: The map is historic - HTV is now known as ITV Wales & ITV West; Carlton and LWT now as ITV London; Grampian now known as STV.

Channel 4

A5.9 The channel 4 licence is held by Channel Four Television Corporation.

Channel 5

A5.10 The Channel 5 licence is held by Channel 5 Broadcasting Ltd.

Other Channels - Licensees

A5.11 Television services require different licences depending on the delivery platform. Put simply, Television Licensable Content Service (TLCS) licences are for services made available using either satellite or an electronic communications network (such as cable). Services made available on a television multiplex (digital terrestrial television) are licensed as Digital Television Programme Service (DTPS) or Digital

Television Additional Service (DTAS) licences. For more information on Television Broadcast Licensing, please visit our website at http://www.ofcom.org.uk/tv/ifi/tvlicensing/ .

Annex 6

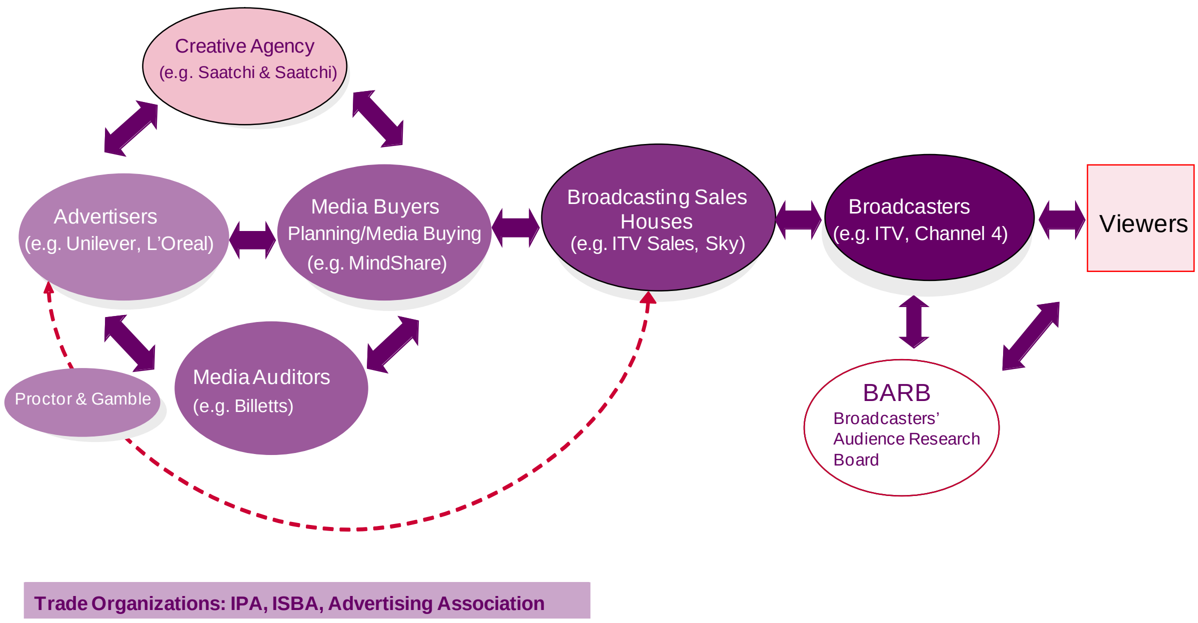
The TV Advertising supply chain and sales process

A6.1 This Annex explains the following:

- The key players in the TV advertising supply chain
- Measurement of TV audiences
- The TV advertising sales process
- The Pricing of Advertising

A6.2 Figure A6.2 below provides an overview of the various players and their roles in the TV advertising supply chain.

Figure A6.2: The TV Advertising Supply Chain



Source: Ofcom

Advertisers

A6.3 The advertising process is initiated by an advertiser. The advertiser may launch or run a campaign for a variety of reasons: for example, the organisation may wish to raise a product's profile, launch a new product or increase brand awareness. Working together with the creative agency/media buyer, the advertiser decides which advertising medium(s) it will use for a given campaign, and the length and scope of the campaign.

Creative Agencies

A6.4 Creative Agencies are employed by advertisers to provide consumer insight and to develop brand strategies. They are also responsible for designing the advertising campaign and the adverts. At times, some (or all) of the services provided by creative agencies may alternatively be provided by media buyers, specialist companies (e.g. communications planning companies), or in-house by the advertiser itself.

Media Buyers

A6.5 Media buyers (or media agencies) are employed by advertisers to act as a central point for negotiating the terms on which advertising is purchased from broadcasters. The majority of advertisers tend to use media buyers to buy TV airtime on their behalf rather than negotiate directly with broadcasters. Advertisers will often have a multi-year contract with their media buyer.

A6.6 As well as negotiating terms with the sales houses, media buyers plan and implement individual campaigns on behalf of advertisers. They collaborate with broadcaster sales houses on a daily basis, implementing campaigns and where necessary agreeing where specific advertisements will be placed on the programme schedule. Media buyers deal with all sales houses and other media providers – they do not limit their negotiations just to one sales house (or medium) for the delivery of all of its clients advertising needs.

Broadcasting Sales Houses

A6.7 Television advertising airtime is generally sold on behalf of broadcasters by broadcasting sales houses. Sales houses are responsible for managing the media buyer relationship, negotiating contracts and terms and conditions. The larger broadcasters have their own sales houses i.e. ITV, GMTV, C4, Five and BSkyB. Smaller broadcasters often contract to sell some or all of their airtime through the larger sales houses.

Broadcasters

A6.8 The broadcaster broadcasts the adverts. Working with the broadcasting sales house, the broadcaster will determine their schedule, where to include advert breaks and the length and number of those advert breaks. The broadcasting sales house will then assist the broadcaster to determine where best to broadcast the adverts within this schedule. Broadcasters also face a number of rules on the amount and type of advertising they can air throughout the viewing day[59].

Media auditors

A6.9 Media auditors are employed by advertisers to assess the effectiveness of advertising campaigns, and the performance of the media buyer. They assess a

[59] For example, the number of advertising minutes in an hour, advertising food during children's programming etc.
For more information see:
Broadcast Committee of Advertising Practice *Broadcast Codes* http://bcap.org.uk/The-Codes/BCAP-Code.aspx; and Ofcom *Broadcast Codes* http://www.ofcom.org.uk/tv/ifi/codes/ .

number of areas including but not limited to: the price paid per impact; coverage; frequency; and other quality elements of the campaign.

BARB

A6.10 BARB (Broadcasters' Audience Research Board) is the primary provider of television audience measurement in the UK. It covers all channels broadcasting across all platforms - terrestrial, satellite and cable in both analogue and digital[60].

Targeting and measurement of TV audiences

A6.11 Television audiences typically comprise a range of different demographic groups which can be differentiated according to three main characteristics i.e. age, sex, and socio-economic status. For example, a distinction can be made between broad categories such as 'Adults', 'Men', 'Children' etc. The 'Adults' demographic could then be further divided into (say) ABC1 Adults or Adult males, 16-34 etc. Different demographic groupings are not necessarily mutually exclusive e.g. the 16-34 Men demographic is a subset of Adult Men and also a subset of 16-34 Adults.

A6.12 Advertisers obviously want to target those demographic groups that are most likely to purchase their goods or services. For example, a manufacturer of soap powder will be most interested in targeting the person in the household that makes purchasing decisions. It will seek to reach the 'Housewives' demographic group, comprising those most likely to make decisions about which brand of soap powder should be purchased[61]. Some advertisers may be interested in ensuring that a range of different demographics see their advert, but will buy against their 'key' demographic. For example, a chocolate manufacturer may buy ' 16-34 Women' as they represent a higher proportion of their customer base, but will also be interested in selling its product to other demographics such as 'Men'. On the other hand, an advertiser may be interested in targeting a smaller, niche set of customers (e.g. pet owners) and may be able to vary the demographic (or group of demographics) they choose to buy against[62].

A6.13 The audiences for most TV programmes will cross all demographic groups – though the composition of the demographics may well vary considerably. A broadcaster can therefore sell the advertising airtime around its programmes against different demographics. As a result, within the same advertising break in a peak-time programme on ITV1, there may be adverts for a range of different products (e.g., a car, a shampoo product, a brand of beer and confectionery products) aimed at different demographics (although the advert will be viewed by a variety of different people when aired). Advertisers will be interested in ensuring that their advertising is targeted appropriately and that both (i) the number of people viewing the advert who are unlikely to be interested in the product is minimised; and (ii) the appropriate number of people within the selected demographic view the advert an optimum number of times. Equally, broadcasters will want to ensure that products are not advertised in airtime which could be used to target another demographic more

[60] BARB is jointly owned by ITV, BBC, C4, Five, BSkyB, and the IPA. More detail is available on BARB's website at http://www.barb.co.uk/.
[61] BARB defines a Housewife as 'The member of the household who is solely or mainly responsible for the household duties. A housewife may be male or female. There is only one housewife per household.'
[62] For some advertisers/products buying against a particular demographic may be more efficient than for other advertisers/products. The more niche a product or target market, the more difficult it may become to efficiently target customers.

efficiently. Therefore, broadcasters and advertisers both have an interest in ensuring that advertising is placed as efficiently as possible.

A6.14 The demographic profile of television audiences for particular programmes is measured by BARB. BARB statistics are based on television viewing by a panel of over 5,000 households, selected to be fully representative of all television households across the whole of the UK. This enables broadcasters and advertisers to identify what proportion of a particular demographic group is watching a programme. Experience of audience viewing habits enables broadcasters to predict what type of audience a programme will appeal to, and how many from each demographic group are likely to see it.

A6.15 The exposure of a particular demographic to an advertisement is measured in terms of ‘commercial impacts’ (or impacts). Each occasion an advert is seen by a viewer counts as one impact. The effectiveness of advertising in reaching a target demographic group is measured in television ratings, or TVRs. For a particular campaign, one TVR equates to reaching 1% of the target group with one 30 second advert[63]. Thus, an advert in a programme that reaches 25% of a particular demographic group delivers 25 TVRs. These commercial impacts or TVRs provide the ‘currency’ in which broadcasters and advertisers deal i.e. broadcasters and advertisers contract with one another for the delivery of a given volume of TVRs from a particular demographic group.

A6.16 Advertisers will have a number of objectives when planning a campaign. Often these are expressed in terms of coverage and frequency. Coverage, or ‘reach’, refers to the percentage of the target audience seeing the advert a minimum number of times. For example, if a campaign’s Adult coverage is said to be 80 or 80% then the advert was seen by 38.5 million of the 48.1 million Adults in the UK TV viewing population. Frequency is a method of describing the extent to which an advert in a campaign has been seen by the same person more than once. For example, if viewers have seen an advert 4 or more times, this is referred to ’4+’. As a result, ’4+ cover’ refers to the percentage of the target audience seeing the advert at least four times. The effective or optimal frequency will vary depending on the type of product being advertised and the objective of the campaign (e.g., product launch, brand building, promotion etc).

A6.17 Advertisers may also be interested in the positioning of their adverts, for instance, whether the advert is broadcast during peak or off-peak viewing hours, during a programme or between programmes, and position in a break period (e.g. first, second or last in break). They may also be interested in broadcasting their adverts during particular programmes, for example, ‘event’ programmes such as the rugby or football World Cups, or programmes which have a perceived link to their product such as beauty products during a TV makeover programme.

The buying and selling of TV airtime

A6.18 Below we discuss the process which underlies the negotiations between media buyers and the ITV sales house for sale of advertising airtime. While the CRR remedy effectively requires ITV to follow this negotiation process, this need not be the case for other sales houses. However, in general, most sales houses have tended to adopt a similar process to that of ITV.

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

Negotiation of annual contracts

A6.19 Contracts for the sale of television advertising airtime are typically negotiated between sales houses and media buyers on an annual basis. Historically, negotiations have taken place between the October to December (the 'deal season') prior to the commencement of the new advertising year in January[64]. Core terms are normally agreed by December, however, negotiations over other terms may continue throughout January and February.

A6.20 At the negotiation stage, both the media buyers and sales houses will only have an indicative idea of the number of commercial impacts likely to be delivered on each channel and the amount of TV advertising which will be demanded by advertisers (i.e. how much advertisers will choose to spend on campaigns) in the coming year. It is due to this uncertainty that negotiations have traditionally tended to focus on a given SOB commitment, rather than a specific 'price' for advertising (discussed further below).

Types of deals

A6.21 The main types of deals agreed during the deal season in order to satisfy the requirements of advertisers are:

- 'Agency Deal': an umbrella deal between sales houses and media buyers that encompasses their expected portfolio of advertisers: media buyers do not negotiate separate contracts for each of their clients. Most media buyers prefer these types of deals as they provide them with flexibility over the advertisers' terms and conditions.

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

A6.22 In some instances, media buyers' agency deals may also include an element of line-by-line deals for particular advertisers, and this will be negotiated under the overall umbrella of the agency deal.

Negotiation of SOB and discounts

A6.23 Given the uncertain future demand and supply of impacts, media buyers and sales houses do not negotiate on an absolute price to be paid per impact. Rather, when a media buyer commits to a campaign with a broadcaster it actually commits a level of expenditure with the broadcaster in the expectation that it will achieve a certain level of impacts for that expenditure. It is not until the end of the campaign that the actual price (referred to as Station Average Price and abbreviated as SAP[65]) is calculated and the volume of impacts actually delivered at that price can be determined. Therefore, media buyers generally agree to commit a proportion of

[64] Typically, the vast majority of negotiations take place in November and December. However, it should be noted that there are no significant barriers to negotiations being undertaken during an alternative period in the year, or indeed for contracts to cover period of greater or less than 1 year.
[65] Note, SAP is the relevant calculation used by ITV, other sales houses generally use pricing mechanisms that are loosely based on the SAP mode, with sales house revenue and audience performance figures still forming the basis of the various pricing models to a lesser or greater extent.

their SOB to a sales house in return for a discount from SAP[66] and quality of service terms, such as position in break, daypart guarantees, regional shares, programme guarantees and programme access. The size of discounts offered to media buyers and advertisers will depend on a number of factors, including:

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

A6.24 In general, sales houses have discretion to offer a smaller discount, or charge a premium, to those who they judge to be less price elastic, or are less skilled at negotiating.

A6.25 Media buyers and sales houses may agree a range of different discounts, including:

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

A6.26 A key aspect of the annual negotiations is that sales houses and media buyers tend to put considerable emphasis on a broadcaster's SOCI[67]. That is, if broadcasters have been able to increase their SOCI over the previous year, then they would use that to try to get media buyers to commit a greater share of broadcast to them for the following year. Equally, media buyers will be more interested in committing expenditure to broadcasters that have increased their SOCI because that would tend to demonstrate an ability to attract audiences which are of interest to advertisers or are able to deliver a niche set of impacts.

[66] Discounts from SAP are essentially delivered in the form of volume increases in the number of impacts. For example, a discount of 15%, results in 15% more impacts being delivered, therefore if an advertisers buys 100 impacts, after the discount they receive 115 impacts.
[67] One commercial impact represents one viewer seeing an advert once. A channel's share of commercial impacts ('SOCI') is simply the total number of commercial impacts 'delivered' by that channel divided by the total number of all the commercial impacts delivered across all channels.

Calculation of discounts to individual advertisers

A6.27 If a media buyer operates an 'agency deal', once the overall discounts are negotiated with the sales house, the media buyer will need to consider how these are distributed across its advertising clients[68]. This distribution may be influenced by the contracts agreed between the media buyers and their advertisers and other factors such as: the size of the advertiser's contract with the media buyer, whether they are likely to commit a larger budget in the future (for example the media buyer may wish to retain the custom of a large client; the client may have a global or international business with potential for growth in the UK market); if the client is high profile and likely to bring more business to the media buyer in the future; whether the contract with the media buyer is up for renewal in the near future etc.

A6.28 Media buyers cannot grant discounts to clients individually which, when calculated as a whole, are greater than the blanket discount offered by the sales house. For example, the media buyer may be offered a discount of 10% off the Housewives demographic – it may then choose to offer 12% discount to a client that committed a larger than the average share of SOB and offer 8% discount to a client that committed a lower than average share of SOB. However, it is important that the aggregate discount offered to clients does not exceed 10%, otherwise, the media buyer will not be able to meet the terms that it has agreed with the sales house.

Individual campaigns

A6.29 Prior to booking each individual campaign, the media buyers and their clients will agree the specific advertising objectives of that campaign. These objectives will generally include targets for cover and frequency in a given month or over the campaign. For example: an advertiser may estimate that a typical viewer will need to see the advertisement three times before responding and may structure its campaign accordingly.

A6.30 The media buyer will also continually estimate the likely cost of the TVRs/impacts over the year. These estimates will take into account information from broadcasters about expected price and the likely demand for impacts among all other advertisers that month.

A6.31 Once a media buyer has determined the precise needs and requirements of an advertiser, the media buyer will develop a detailed media plan to be approved by the advertiser. These plans set out the number of TVRs (impacts) that each channel must provide in order to meet the advertisers' coverage and frequency objectives, and are based on estimated future costs of impacts across the channels. The resulting budget estimate for the campaign may lead advertisers to either increase, decrease or maintain their original budgets for the particular campaign so that they can ensure the delivery of the required number of impacts for the campaign or to amend coverage, frequency and impact delivery plans.

A6.32 Once the media plans are agreed, media buyers book the campaign with the sales houses by the 'advance booking deadline' (for the ITV sales house this will normally be 8 weeks in advance of the advertisement broadcast date) to avoid a late booking penalty.

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

A6.33 The sales houses, for their part, use an airtime booking system to aggregate the demands and requirements of the advertisers and then optimise their airtime accordingly. Sales houses optimise their allocation of advertising airtime so that adverts are shown during programmes that they expect will be seen by the greatest possible number of people in that target audience, rather than from other target audiences. For example, a higher number of impacts for ABC1 Men can be achieved against programmes which are popular among this audience. Through optimisation sales houses can maximise the number of impacts traded and effectively achieve a higher number of impacts than would be the case if adverts were shown randomly throughout the day.

A6.34 During the advertising year media buyers and advertisers may also separately negotiate a 'burst deal'. This is a short term or one-off agreement between a single advertiser (usually negotiated by the media buyer on their behalf) and a sales house. A burst deal is typically used in regional advertising by some seasonal advertisers and for some retailers for 'one-off' advertising campaigns.

Ongoing reconciliation

A6.35 Sales houses and media buyers must also ensure that the impacts traded throughout the year, via the individual campaigns, are consistent with the overall deal agreed during the deal season and that the overall discount agreed at that time has been delivered.

A6.36 If, in a particular month, the sales house fails to deliver the expected number of impacts, then it is considered to have overtraded (or under-delivered) and must give the media buyer extra impacts in a future month. In contrast, if more impacts were achieved for the advertiser than agreed, the sales house will have undersold (over-delivered), and will have to achieve fewer impacts for the advertiser in a future month.

A6.37 Overtrading essentially means that individual advertisers are receiving less than their 'agreed share of impacts' in that month. This means that the sales house owes a 'deal debt' to advertisers/media buyers. If this is carried over into the following month, the sales house will face an increased difficulty in delivering on all its discount commitments in that month. Sales houses therefore seek to ensure that this deal debt does not escalate.

The pricing of advertising

A6.38 As described, media buyers and sales houses do not set an absolute price per impact during the deal stage as neither party can be sure of the future demand and supply of impacts. Media buyers, therefore, do not know precisely how many impacts they will receive in return for their SOB commitment.

A6.39 Although broadcasters will, in some cases, offer fixed price deals or sell specific spots, the most common pricing concept is the broadcaster's SAP. The SAP is an average price per impact across a channel (or sometimes a range of channels[69]). There will be different prices for different demographic groups. A key feature of SAP is that it is calculated *ex-post* i.e. the SAP is determined by the level of advertising expenditure and the volume of impacts actually achieved by a broadcaster.

A6.40 The SAP for ABC1 Men, for example, is calculated monthly as:

[69] However, this is not the case under CRR where the price on ITV1 is calculated individually.

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

A6.41 SAP is an average price based on the total distribution of impacts. Rather than entitling media buyers to a given number of impacts, the SAP mechanism entitles media buyers to a share of the impacts actually delivered. In a simple world with one type of impact, the number of impacts delivered to a media buyer is determined both by the share of ITV1 revenue that the media buyer's spend accounts for and the total number of impacts actually delivered. For example, if a media buyer spends £10,000 and total ITV1 revenue for the month is £100,000, the media buyer receives 10% of total impacts delivered. Therefore, if the total number of impacts delivered is 1000, the media buyer receives 100 impacts; or if the number of impacts delivered is 900, the media buyer receives 90.

A6.42 A discount from SAP equates to a bigger proportion of impacts than the proportion of spend (for example, a discount of 15%, results in 15% more impacts being delivered, therefore if an advertisers buys 100 impacts, after the discount they receive 115 impacts). However, given there are a fixed number of impacts, this must be offset by someone else getting a smaller share.

A6.43 The sales houses are able to offer discounts from SAP due to the practice of airtime optimisation. If adverts were broadcast randomly throughout the day, without considering when these adverts were most likely to be seen by the target audience, then sales houses would not be in a position to offer a discount from SAP. However, by matching the adverts with an appropriate performance slot and appropriate target audience they are able to maximise the number of impacts and achieve a higher number of impacts for a particular demographic than would occur if the advert was broadcast randomly. It is, therefore, theoretically possible for all impacts to be sold at a discount.

A6.44 There are two main reasons why the SAP achieved may be lower or higher than planned. First, programmes may achieve different ratings than expected e.g. if they achieved higher than expected ratings this would increase the number of impacts delivered and reduce SAP compared to forecast. Second, media buyers may incorrectly forecast the total expenditure committed by all buyers. For instance, total revenues committed to a particular demographic may be higher than anticipated, raising the SAP for that target audience. An increase in committed revenues raises the overall revenue of the sales house for the period relative to achieved impacts, thereby raising the SAP and actual price paid by each media buyer. Thus, the increase in expenditure effectively increases the price of TVRs.

A6.45 In most instances, the price paid by an advertiser on an individual campaign will be determined by the media buyer rather than the broadcaster: it will be up to the media buyer to determine how to share the discount from SAP it receives across its different clients[70]. The use of auditors is a way for advertisers to compare the price they have been charged with 'the market rate'. However, the auditing of advertising campaigns tends to focus on the relative rather than the absolute level of price for the delivery of commercial impacts against particular demographic groups.

[70] The exception being where the media buyer has negotiated a line by line deal with the broadcaster, on behalf of its client. In this case, the advertiser will have an individual price set for access to advertising on that channel(s).

Annex 7

The two-sided TV Advertising market

A7.1 In this Annex we consider the implications of the two-sided nature of the TV advertising market for any analysis of the effects of a fall in advertising minutes.

A7.2 We first examine the viewers' side of the market. Essentially if viewers are very sensitive to the level of advertising, this would influence whether it would be feasible for a channel to withhold impacts by withholding advertising minutes.

A7.3 We next consider whether, even if it were feasible for a broadcaster to reduce impacts by reducing minutes, such a reduction would be profitable. This involves an examination of the advertisers' side of the market.

The viewers' side of the market

A7.4 The number of advertising minutes broadcast by the channel could be regarded as the price paid by viewers to watch commercial channels. This is because whilst advertising provides information to potential consumers about goods and services available, it may be seen as a nuisance and inconvenience when watching programmes.

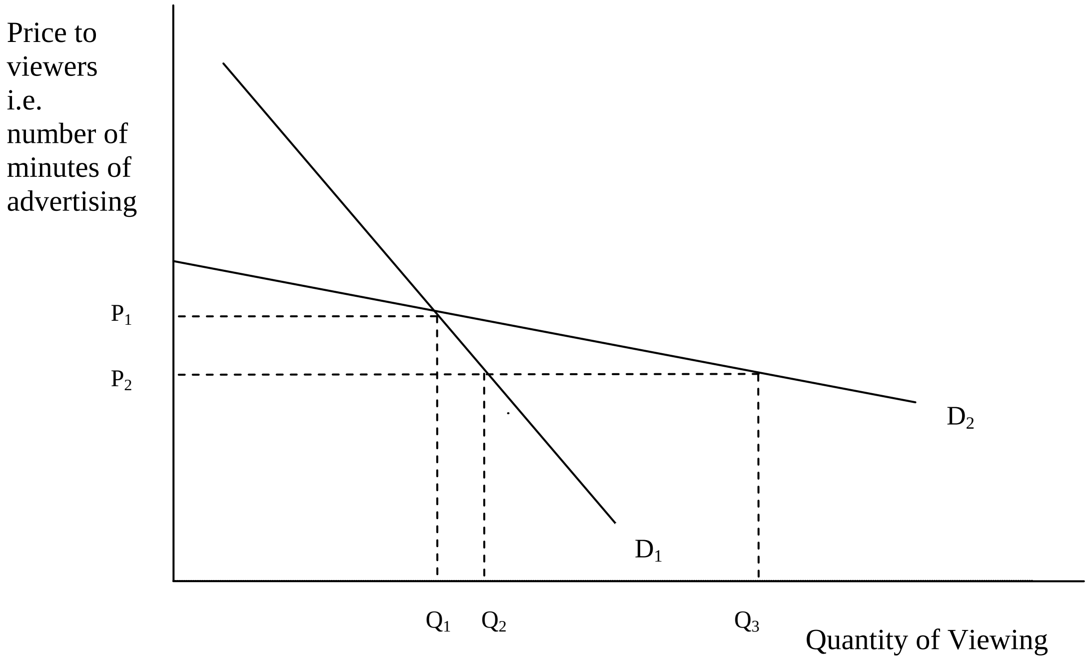
A7.5 Therefore if a channel engages in a withholding policy and reduces the level of advertising minutes broadcast, this would reduce the price to viewers of watching the channel. If the price or cost of watching the channel falls, viewers may react by increasing viewing. They may do this by switching viewing from other channels or by increasing viewing overall. An increase in viewing will increase the level of impacts received in the remaining advertising minutes.

A7.6 The extent to which viewing increases in response to a change in advertising minutes is termed 'viewer elasticity'. If viewers are very sensitive to levels of advertising minutes (advertising represents a significant nuisance and inconvenience), then a fall in advertising minutes could result in a significant rise in viewing. To be precise, if this increase in viewing is proportionately greater than the fall in advertising minutes then viewing is 'elastic'. When viewing is elastic and advertising minutes fall, the amount of viewing will rise significantly and so will the amount of impacts received from the remaining advertising minutes broadcast.

A7.7 If viewers do not perceive advertising to be a nuisance or inconvenience then they may be relatively insensitive to levels of advertising minutes broadcast. To be precise, if the increase in viewing is proportionately smaller than the fall in advertising minutes, viewing is 'inelastic' to levels of advertising broadcast. When viewing is inelastic and advertising minutes fall, viewing may remain constant or only increase to a small extent. Therefore the amount of impacts received from the remaining advertising minutes will remain constant or only rise slightly.

A7.8 The differing types of viewer elasticity are shown in Figure A7.1 below.

Figure A7.1 – The viewers' side of the market - viewer elasticity and the effect of changes in advertising minutes (price) on viewing



A7.9 In the diagram there are two types of viewers, those who are sensitive to changes in levels of advertising (with the demand curve D_2) and those who are relatively insensitive to advertising (with demand D_1). The 'price of viewing' is determined by the level of advertising minutes – so P_1 could represent 10 minutes of advertising and hour and P_2 eight minutes of advertising an hour. For ease of exposition we have assumed that the demand curves cross at P_1, the higher price (or higher number of minutes).

A7.10 If the price of viewing is reduced through a fall in advertising minutes, this can be represented by a fall in price from P_1 to P_2. In both cases, the fall in price will result in viewers increasing their viewing and hence increasing the amount of impacts delivered to advertisers from the remaining minutes of advertising. However, the viewers which are sensitive to levels of advertising (demand curve D_2) will have a larger increase in viewing – from Q_1 to Q_3 - than the viewers which are more insensitive (demand curve D_1) - who will see an increase from Q_1 to Q_2.

A7.11 Viewer elasticity is important when considering the feasibility of a withholding policy. When advertising minutes are reduced, the volume of impacts will fall as a direct result. In other words, the advertising minutes no longer broadcast would have been seen by viewers and so would have supplied an amount of impacts – these impacts are therefore 'lost' to the market place.

A7.12 However, viewer elasticity will affect the amount of impacts generated in the remaining minutes of advertising. If viewing increases as a result of the fall in advertising minutes, more impacts will be generated from the remaining minutes broadcast. This increase in the amount of impacts will offset, at least to some extent, the 'lost' impacts due to the fall in advertising broadcast.

A7.13 Hence a withholding policy would only be able to lower the quantity of impacts, if viewers are not particularly sensitive to levels of advertising. If they were sensitive to changes in advertising minutes any attempt to reduce impacts via withholding minutes, may be rendered ineffective because impacts would increase significantly in the remaining minutes of advertising broadcast.

The advertisers' side of the market

A7.14 We now consider the advertisers' side of the TV advertising market. We assume that viewing is relatively inelastic i.e. that if advertising minutes fell, impacts would also fall.

A7.15 This sub-section therefore considers whether any change in the volume of impacts would be profitable in the short run – it concentrates on theories of advertiser demand and the nature of the channels' underlying costs.

A7.16 Ofcom considers that ITV1, C4 and Five each supply a differentiated product to advertisers. There may be several reasons for this, for instance, the nature of the programming the three channels broadcast may make their impacts particularly attractive to buyers or buyers may like the fact that certain of their programmes attract mass audiences. It implies that the channels will each face a 'downward sloping demand curve' for their impacts from advertisers. In other words, if price of one of the commercial analogue channel's impacts fell, buyers would be prepared to buy more of these impacts.

A7.17 This also implies that if one of the commercial analogue channels attempted to withhold minutes and this reduced the volume of its impacts, this would lead to a rise in price of those impacts. However, whether this price rise would be large enough to result in an overall increase in revenues and profits depends on advertisers' 'responsiveness' to the fall in volume of these impacts.

A7.18 If advertisers' demand for advertising on channel A is relatively 'unresponsive' and the volume of channel A's impacts falls, we would not expect advertisers to switch much of their demand to the impacts supplied by other channels. In this case, the price of channel A's impacts will rise by a larger proportion than the fall in volume of impacts and we would expect the broadcaster's revenues to rise[71].

A7.19 However, if advertisers are prepared to buy other channels' impacts i.e. advertisers are 'responsive' to changes in volumes, then we would expect the price of channel A's impacts to rise by a smaller proportion than the fall in impacts and the broadcaster's revenues would decrease[72].

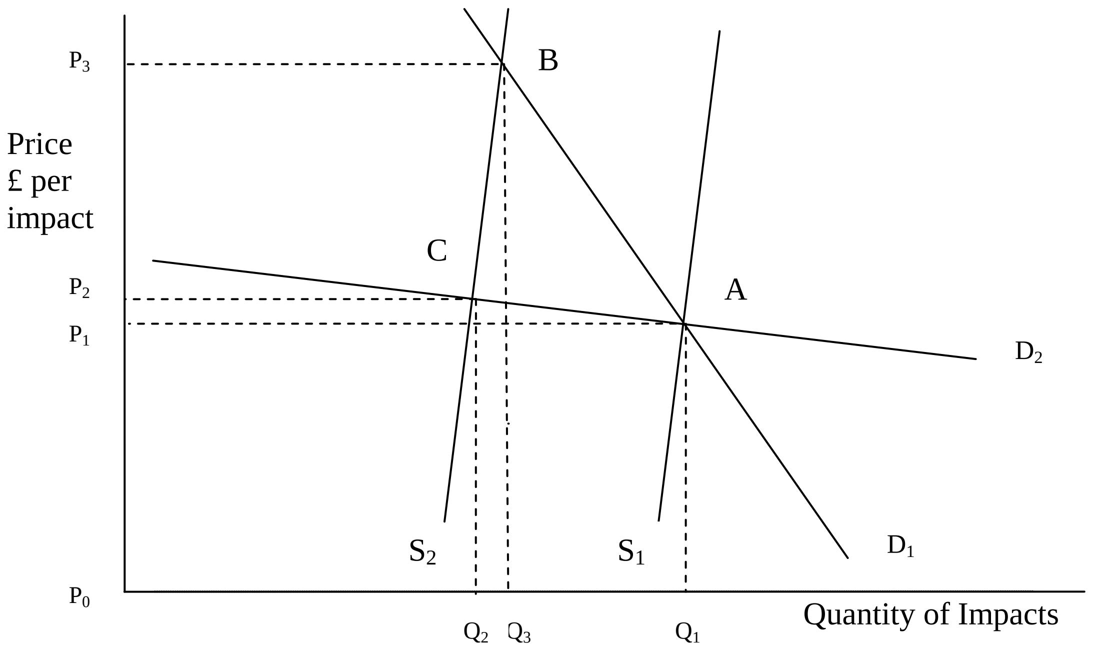
A7.20 An example of a broadcaster's attempt to withhold advertising minutes is represented in Figure A7.2 below. The curves S_1 and S_2 represent the different supply curves for impacts – one represents supply of impacts given the original level of advertising minutes and one represents the supply of impacts after advertising minutes have fallen.

A7.21 S_1 represents the higher level of advertising minutes e.g. 10 minutes of advertising per hour. At 10 minutes of advertising the supply of impacts is relatively high for

[71] We express this as 'unresponsive' rather than 'inelastic' demand as in this case we are considering a percentage change in price as a result of the percentage change in quantity – which is the inverse of the usual demand function.
[72] Similarly, we express this as 'responsive' rather than 'elastic' demand because we are considering a percentage change in price as a result of a percentage change in quantity – which is the inverse of the usual demand function.

any given price. S_2 represents the impacts supplied at a lower level of advertising minutes, e.g. 8 minutes per hour, and takes into account the effect on the level of impacts of viewer elasticity (i.e. the effect on the level of viewing due to the lower level of advertising minutes broadcast).

Figure A7.2 – The advertisers' side of the market - advertiser demand and the price of impacts



A7.22 The supply curve for impacts is shown as relatively 'steep' as it is assumed that if advertising minutes are kept constant, it is difficult to change the level of impacts supplied in the market place in the short term. This is because there are limits to the ability to change programming in the short run (and so change viewing of the programmes and so impacts) and limits to the extent to which the channel could free up other types of airtime (such as that used for the promotion of its programming or other channels) to increase advertising.

A7.23 Before any changes in the level of advertising minutes, the broadcaster supplies Q_1 impacts at price P_1. Revenue will therefore be equal to the area $P_0P_1AQ_1$. The diagram shows the effect of a change in minutes, and so impacts supplied, given two types of advertiser demand: one which is responsive to changes in the volume of impacts and one which is less responsive.

A7.24 As outlined above a restriction in the supply of advertising minutes (and as a result a fall in level of impacts) can be represented by the change in the supply curve for impacts from S_1 to S_2 (noting that S_2 takes into account any effects on the viewer side). Quantity purchased would fall to Q_2 and price would rise to P_2 if demand is relatively responsive, or elastic (represented by curve D_2) i.e. advertisers would respond to the fall in the channel's impacts by switching to other sources of supply. In this case the new level of revenue is represented by the area $P_0P_2CQ_2$ in the diagram.

A7.25 In contrast if demand were unresponsive, or inelastic, to changes in the volume of impacts, then quantity purchased would fall to Q_3 and price would rise to P_3. Advertisers would be less willing to switch to the impacts supplied by other channels. The new level of revenue would be represented by the area $P_0P_3BQ_3$ in the diagram. Therefore illustrated revenues are more likely to be higher after the change in supply of impacts if demand is unresponsive to changes in impacts.

A7.26 Costs can also affect profit levels. In broadcasting costs are not likely to be strongly related to the level of impacts and instead are likely to be relatively fixed in the short run. In this case, changes in revenue will translate directly into changes in profits.

A7.27 Therefore, if a channel reduces its advertising minutes and this leads to a fall in impacts, then theoretically this will only lead to an increase in prices, revenues and profits if advertising demand for that channel's impacts is unresponsive or inelastic. In this scenario a broadcaster would be incentivised to undertake a withholding policy.

A7.28 However, if advertiser demand is responsive or elastic, the increase in price as a result of the fall in supply of impacts will not yield an overall increase in revenues and profits. In this latter situation, the broadcaster will not be incentivised to undertake a withholding policy.