Ofcom

Airtime Sales Review

An IPA response

June 2010

Ofcom: Review of the Airtime Sales Rules

The IPA welcomes the opportunity to submit views on the various questions posed by Ofcom as part of the above review.

A About the IPA

The Institute of Practitioners in Advertising is the trade body and professional institute for UK advertising, media and marketing communications agencies. Our 263 corporate members, who are based throughout the country, handle over 80% of the UK's advertising business agency business with an estimated value of £18 billion in 2007 (Source: Advertising Statistics Handbook, 2008), on behalf of many tens of thousands of their client companies and organisations.

As the Ofcom will be aware, a key element in the IPA's brief is to promote and to ensure the continuation of cost-effective commercial media for promoting the products and services of British business.

As such, we are vitally concerned that no moves take place that would jeopardise our members' ability to buy fairly and effectively in the media market-place and it is against this backdrop that the comments which follow are made.

B General Observations

Given the detailed nature of both the consultation paper and the questions posed, we have been very much dependent on our members' Heads of Broadcast in the preparation of this response.

As such, Ofcom will find that in many instances, our answers will replicate the information already supplied by agencies in their individual submissions to this review.

Equally, because many of the questions overlap, there is an inevitable repetition of the data in a number of our answers.

C Specifics

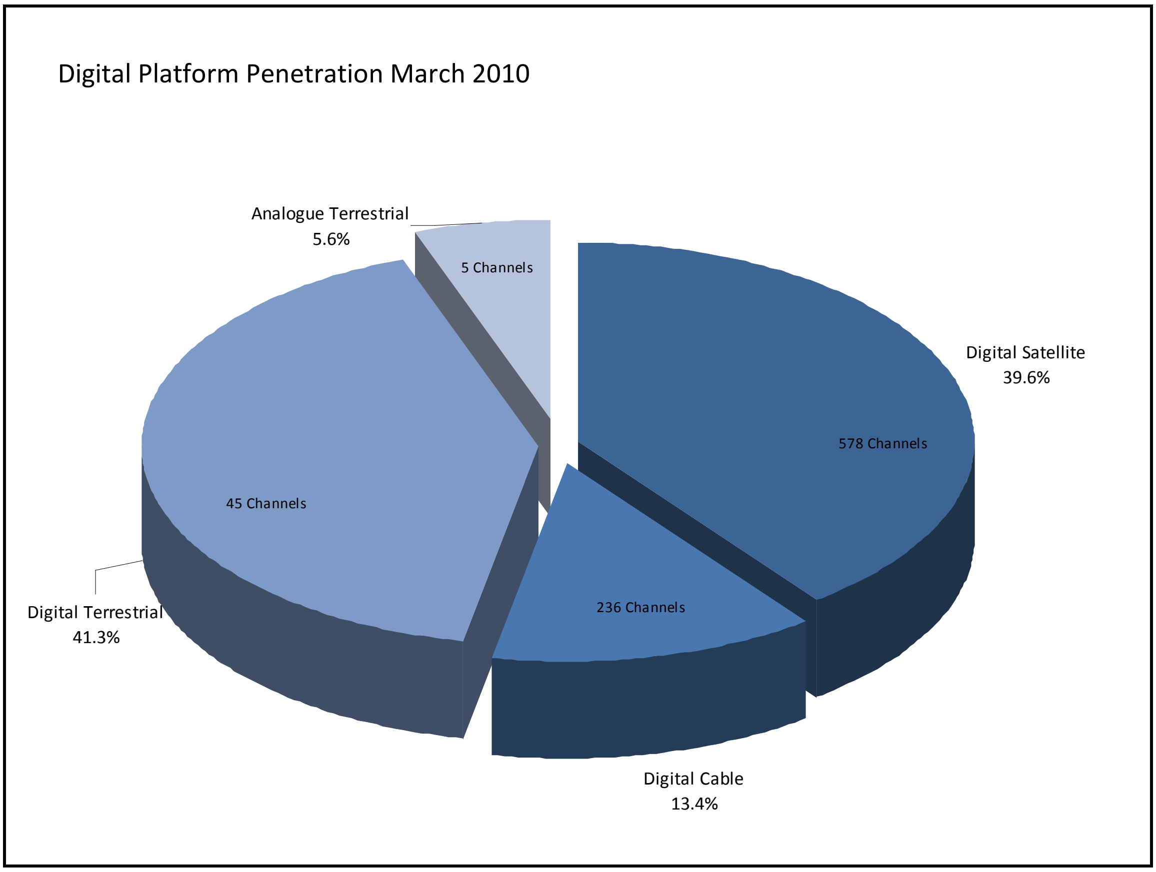
Q 1. Do you agree with our description of the key developments in the TV advertising market since 2003?

In order to answer the above, we have isolated key paragraphs from the consultation paper on which to base our observations.

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

a. *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;*

While it is factually correct for Ofcom to point out that there has been a significant increase in the number of digital channels available to viewers since 2003, the impact of this growth is in fact considerably less than might be supposed. A significant proportion of the viewing population only has access to around 45 channels, i.e. DTT homes– accounting for 47% of homes in March 2010.

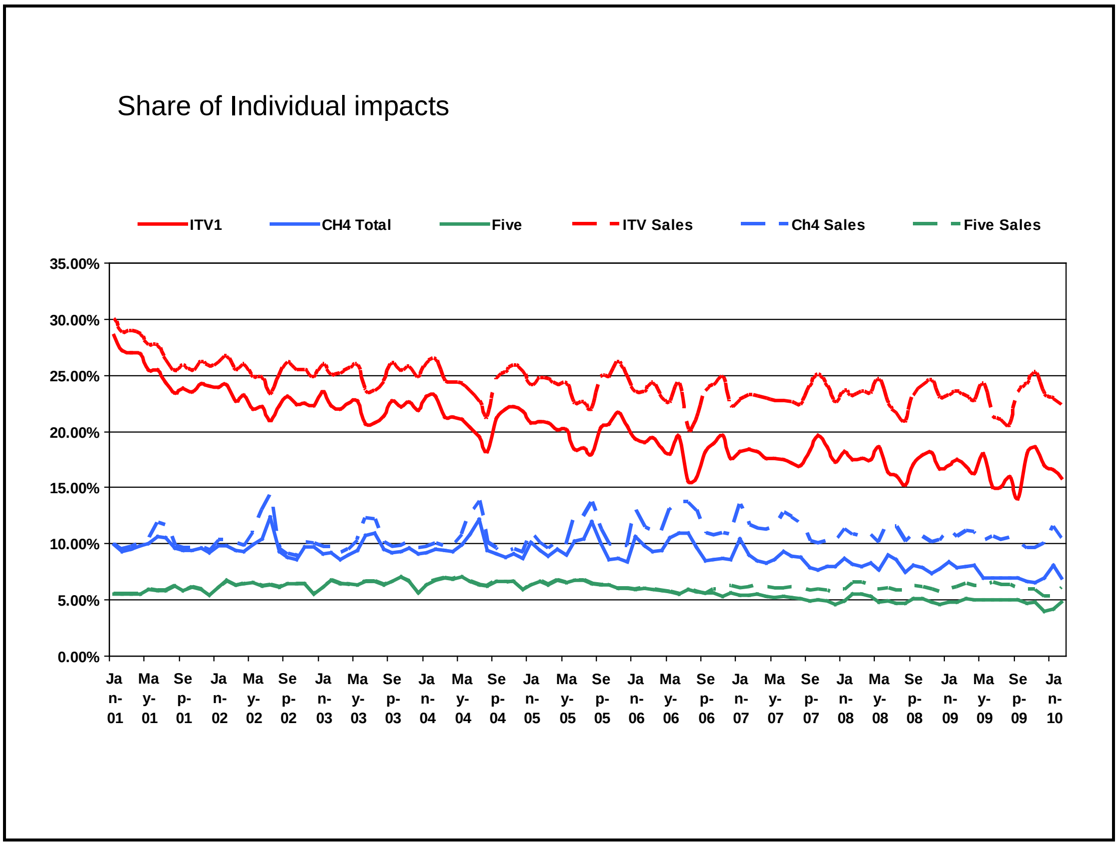


An almost doubling of digital TV uptake in the UK, with almost 90% of UK households now having access to digital TV services;

We are in agreement with this point

b. *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;*

We are in agreement with this statement. We would note some PSB channels that have lost viewing, have more than compensated for this loss with their digital 'family' performance. The chart overleaf shows the increasing impact of digital 'family' channels, and how they have helped to grow or maintain market share.



c. *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.*

We are in agreement with this point.

d. *A narrowing of the gap between the shares of commercial impacts for the largest and smaller sales houses;*

This point refers to the data in Figure 7, page 22. It is factually correct; however recent developments in the television airtime trading sector have rendered this point redundant. With the inclusion of GMTV sales into ITV and VBS into Sky Sales, there are only 5 sales houses in the market of any substantial size.

	Total Impact share for Top 5 Saleshouses
2003	80.7%
2010	95.1%

Essentially there are no "small" sales houses with any power or significant growth.

e. *Consolidation of media buyers.*

We are in agreement with this point.

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

The advent of more choice for television viewers has created more commercial supply in the marketplace since 2003. However, it is debatable as to whether this has actually led to greater levels of competition. There is now more product to sell (supply of impacts), however the number of sales points has decreased which has effectively reduced the choice and options for media buyers.

In addition, the point made by Ofcom about there being less reliance on ITV1, C4 and Five (4.56) is incorrect as there are still a substantial number of advertising campaigns (an amount that has not reduced since 2003) that need ITV1, C4 and Five to satisfy their communication objectives. For example...

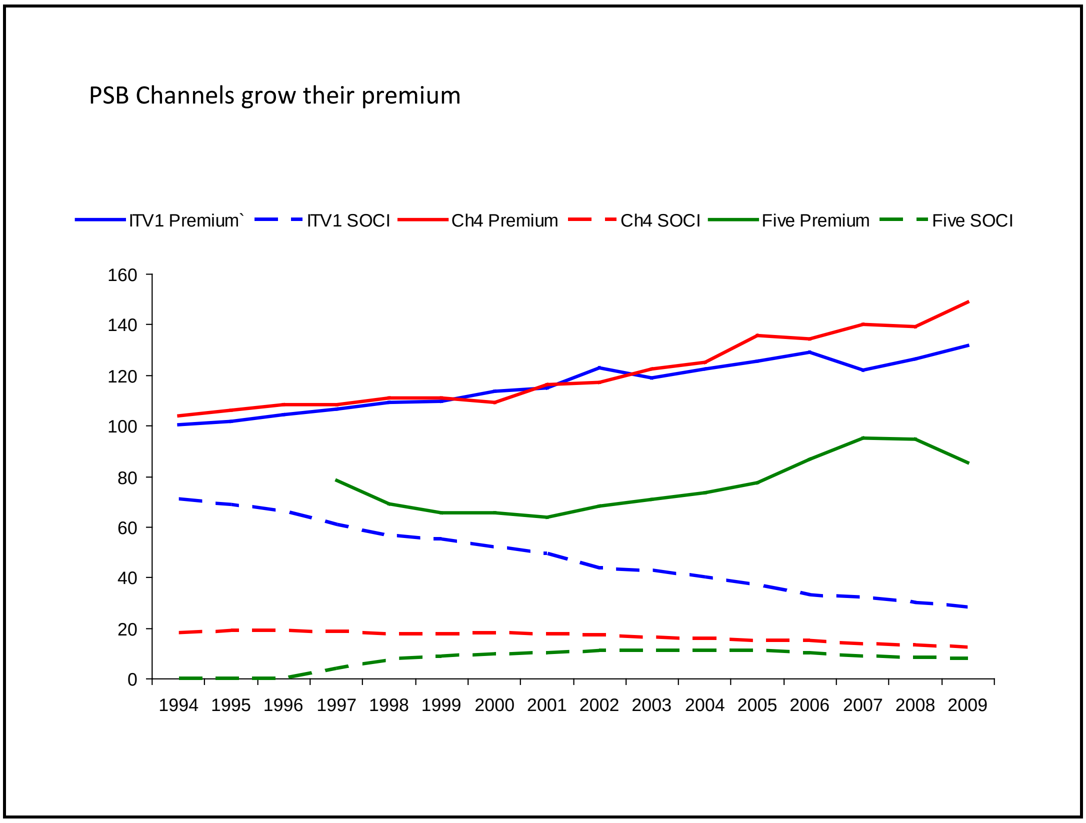
% of the top 1000 advertisers in the UK spending on ITV1

	% of the top 1000 advertisers in the UK spending on ITV1
2003	87.6%
2009	95.6%

In simple terms – these broadcasters still hold a unique and essential place on advertisers' schedules and Ofcom will be aware of the reasons for this from earlier consultations:

It is obviously vital for advertisers to find the correct target audience for their product. This target audience needs to be attracted in sufficient volume, and at the right time of day to produce the desired response. However, in the majority of instances, it is the quality of the broadcast environment that is the deciding factor in the effectiveness of the advertising campaign. In the now fragmented market there exist numerous channel combinations available to a TV planner when attempting to achieve the right target audience in sufficient volume. However, TV channels are not equal in their ability to deliver a quality environment for their advertisers and are therefore priced accordingly.

Furthermore the argument put forward by Ofcom in point 4.56 bullet 3, that lower SOCI leads to lower negotiating power is factually incorrect. The PSB broadcasters have been able to increase their negotiation power even when their SOCI levels have reduced. This has been achieved through the leveraging of digital family inventory, enabling them to grow their premium (relationship between SOCI and SOB) in the marketplace. Please see answer 8 (b) for evidence. The following chart illustrates the premium growth on the PSB channels.



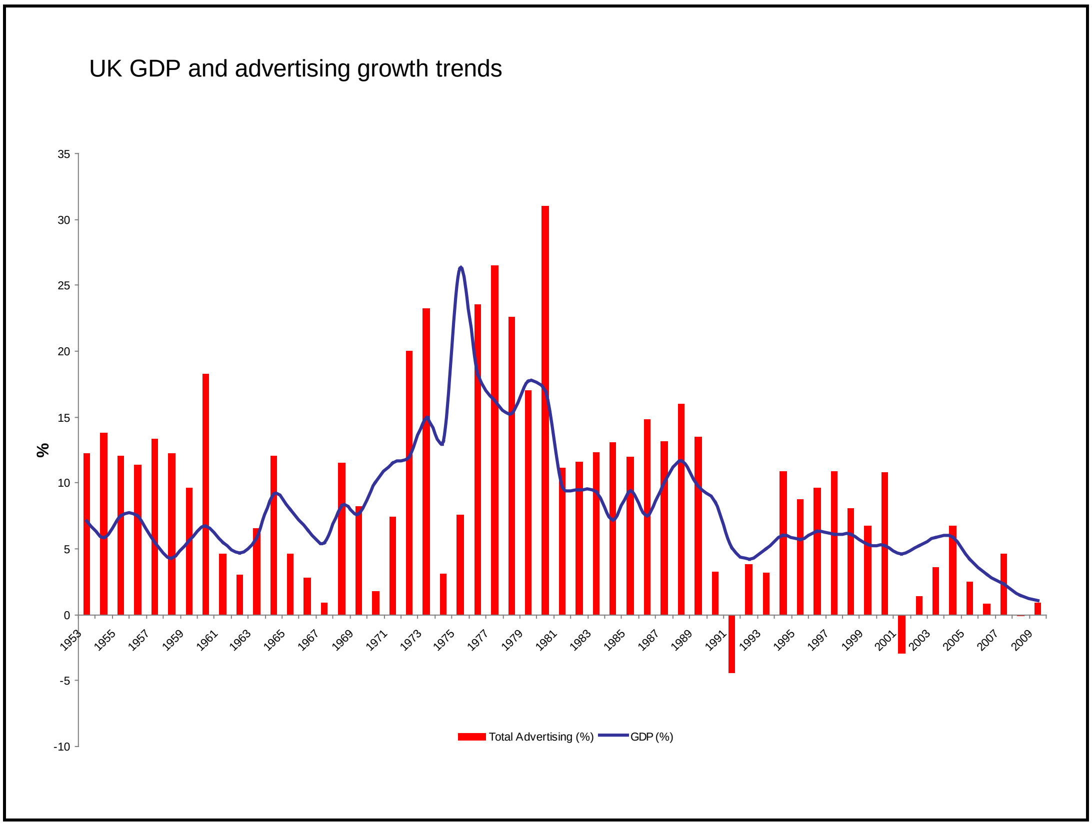
We would thus argue that the consolidation of media buying points has had no real affect on competition in the television airtime sales marketplace or any affect on reducing prices. There is now less choice in terms of sales points for media buyers and this has actually reduced competition. Negotiation power for media buyers allows a buyer to attempt to achieve better discounts from broadcasters and better terms and conditions. However, this has no bearing on the actual price of advertising which is set by the market under the SAP (station average price) mechanic. Lower prices in the marketplace are driven by wider macro economic variables and by significant shifts in commercial supply.

Para 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.*

As has been stated above, we do not believe that Ofcom's assumptions with regard to competition are correct – rather that competition has in fact decreased in the television market since 2003. As a result we would foresee no increase in competition in relation to any future developments.

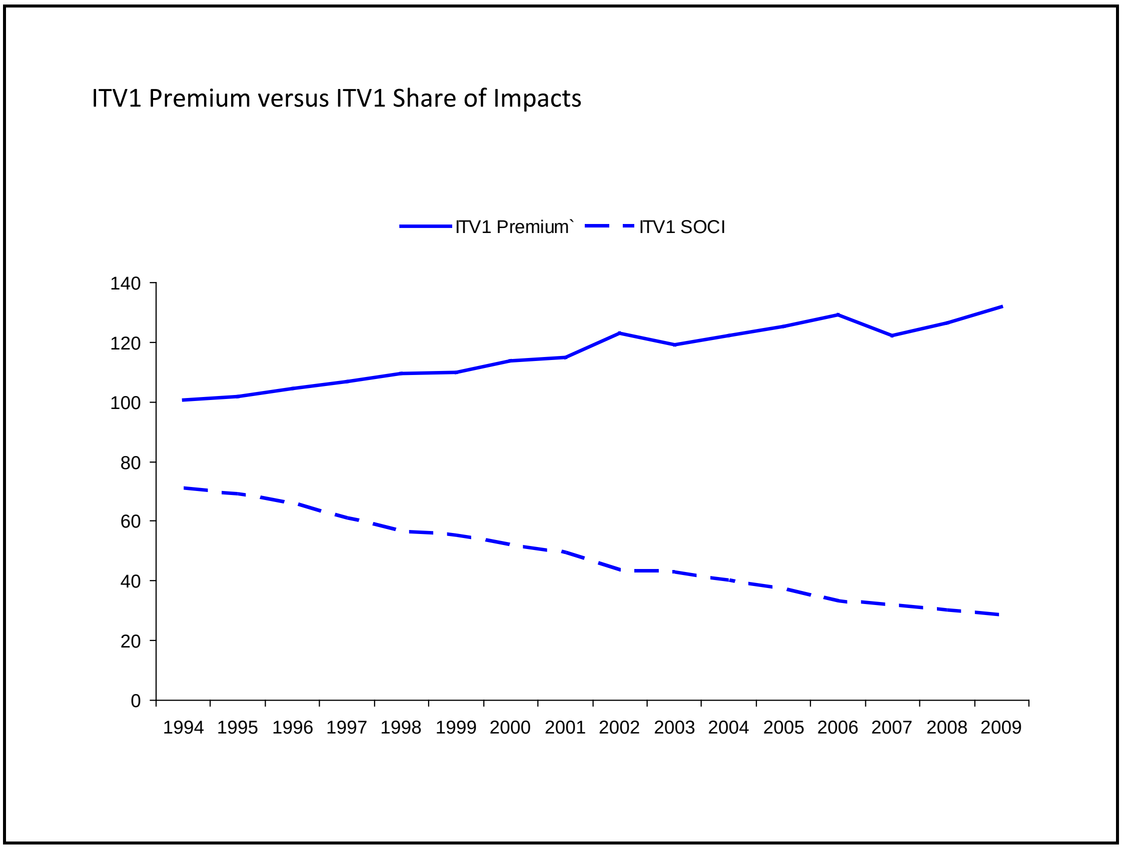
Q2. Do you think we have missed any other recent market developments or trends relevant to competition in the advertising sector?

Wider macro economic conditions have formed the most substantial factor to affect the advertising market from 2003 to 2009. The economy has underpinned everything - by the end of the 2009 we saw media market revenues decline for seven quarters in a row. We witnessed unprecedented declines in revenue across the board with over £2bn coming out of the sector. Inevitably investment in product, content and infrastructure suffered, and major changes in management and company structures ensued. This has had singularly the most dramatic affect on competition. The following chart illustrates the relationship between GDP and Advertising expenditure.



Q3. 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?

Airtime negotiations have historically always involved some element of audience performance as advertisers need to find the correct target audience for their product, in sufficient volume, and at the right time of day to produce the desired response. With this in mind, SOCI will always play an important role in television airtime trading. However, the amount of SOCI a broadcaster achieves, and the year on year change in that measure does not always guarantee a corresponding change in SOB. For example, even in light of the CRR mechanism (which essentially formalised this relationship giving advertisers/buyers the right automatically to reduce the proportion of their spend they give to ITV if audiences shrink) ITV has been able to grow its premium as its SOCI has decreased, as demonstrated in the chart below:



There are numerous variables that also are taken into account in the development of a television airtime deal i.e. advertisers specific brand/audience requirements, quality of programming content etc. In summary, SOCI is an important benchmark for trading television airtime but is not the key determinant in negotiation and therefore committing expenditure.

Q4. 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?

In short our answer is 'no'. We believe that the growth areas for digital advertising will continue to be rooted in search, direct response, and social media. The actual brand display market online only represents a tiny fraction of total advertising spend– 1.3% (Industry Estimates) and this is showing no signs of significant growth. The Internet marketplace would need to show substantial structural change in order to begin to prove itself as a real branding competitor to traditional media.

Q5: Is there any other relevant evidence we should consider in order to examine the ongoing need for the withholding rule?

Ofcom has produced evidence in three areas to form its conclusions : its study on elasticity of demand, its analysis of the competition in the market, and the distribution of minutage across the day.

Unfortunately, while Ofcom has kindly made its elasticity study available, the highly technical nature of this analysis makes it difficult for us - as non-econometricians – to make any authoritative observations. All we can say in these circumstances is that evidence from the study does not correspond with our experience or what we observe in practice.

Moving on to competition in the market, we believe that Ofcom's evidence does not consider the effect of the sales house ie percentage control of the market and does not project forecasts on further consolidation in the market. This will have a significant effect on competition. We have provided some further evidence in our answers in Q6 and Q8.

Finally, the minutage distribution charts only show that the broadcasters currently manipulate to maximise their impacts in a SOCI driven market. We accept that it is difficult to present evidence of behaviour under a different trading environment, but we believe to use this to conclude the broadcasters would always maximise impacts would be incorrect.

Q6: Do you agree with our conclusions that the commercial analogue broadcasters do not appear to have strong incentives to withhold airtime? If not, why?

We strongly disagree with a number of the assumptions Ofcom has made when analysing the mechanics of the UK TV market - and specifically the potential resultant behaviour of the broadcasters if the withholding of airtime rule were lifted.

Para 5.53 (Conclusion): *There is no incentive to withhold in the short run*

Ofcom notes that due to the complicating effect of the TV advertising model, it is likely that broadcasters would not be certain that any changes in impact levels would lead to higher revenues within the trading year. This is based on the assumption that because agencies are tied by year share deals, any increase in price driven by lowered impacts would not drive revenue, as they would only receive the same share in a fixed TV advertising budget.

This does not consider the practical reality of how advertising budgets are planned and bought. The majority of TV advertisers work to fixed (or minimum) communication targets eg reach - therefore an increase in price would force advertisers to protect these targets and increase or divert budgets to TV. Even in the instance where one broadcaster employed withholding to drive price on its own channel, the requirement to meet share deals drives money to all broadcasters fuelling price inflation across the market. The UK market is self-fulfilling. Demand drives price and increased pricing drives further demand. In a normal inflationary market, advertisers do not maintain budgets rather increase budgets to meet targets. In a market free of restrictions, it is unlikely in the extreme that the broadcasters would not use withholding to some extent to drive inflation and thus increase TV revenues, particularly to protect a declining market.

The broadcasters are fully aware of these market dynamics with the result that we have severe doubts as to whether Ofcom's conclusion - that these broadcasters would not engage in a withholding policy, due to uncertainty that advertisers would not increase budgets - holds true.

We do accept, however, that in a market where SOCI performance is the measure by which share deals are traded, the pressure to protect SOCI and therefore a broadcaster's negotiation position could outweigh the revenue gains made through withholding. In a market free of the CRR/ARM mechanic, this might not be a consideration for the broadcaster. We have discussed this further under Conclusion 5.55 below.

Para 5.54 (Conclusion): *There is no incentive to withhold due to increased competition*

Given that we believe that Ofcom's conclusions re an increase in competition in the market are overstated, we do not believe that it follows that advertisers can therefore more easily switch-away from broadcasters.

Ofcom notes that with the substantial increase in digital penetration since 2003 and the increase in the number of channels broadcasting in the UK, viewer behaviour has fragmented - suggesting greater competition on the viewing side and by definition that this should imply more competition on the advertiser side of the market too.

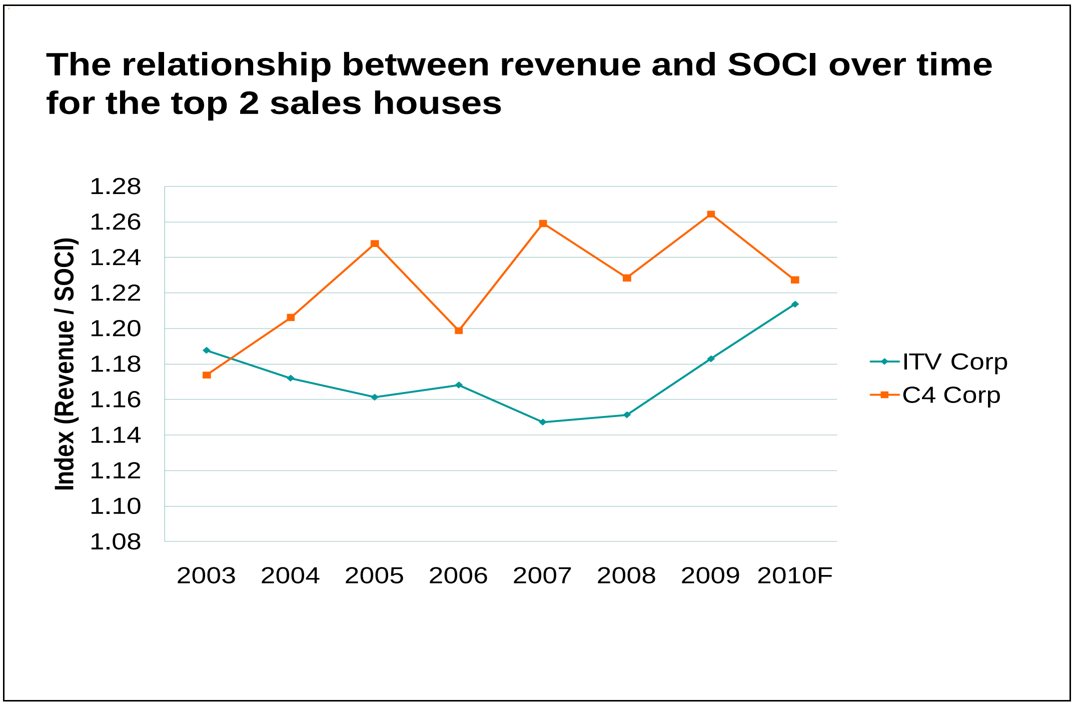
We have shown in a previous response that although the number of channels broadcasting in the UK has increased from 294 in 2003 to 495 in 2008, the number of sales houses selling these channels has declined from 8 to 5 over the same period with 80%+ of revenues now being controlled by 3 of these. This, we believe, argues against greater competition in the market – moreover, given the likelihood that we will face further consolidation in sales points, this situation is likely to become more acute.

While Ofcom states that a recently commissioned econometric study suggests any increase in price across all PSB's would be minimal (and that there would therefore no incentive to withhold), as mentioned earlier, this does not tie in with our practical experience and we would need to analyse this report ourselves before we could come to any firm view as to whether these conclusions are sound.

Para 5.55 (Conclusion): *There is no incentive to withhold due to SOCI*

Ofcom notes that media buyers will allocate share of broadcast revenue to channels or sales houses based on their ability to deliver impacts ie SOCI drives share. It concludes that broadcasters therefore will not withhold minutage to reduce impacts that would damage SOCI performance and so future revenues.

We believe that to draw this conclusion is to over-simplify the relationship between share of broadcast revenue and SOCI. Although SOCI is used as a performance indicator, negotiations in the TV market do not follow a linear relationship due to leverage exercised in the market ie a 1% decline in SOCI does not equate to a 1% loss in share of revenue, particularly in the top 3 sales houses. This is evident from the index of share or revenue to SOCI over time. Even within a CRR trading environment, ITV has managed to increase this index.



Given the above, and being aware of the probability of further consolidation in sales points, we feel there is no reason to believe that a sales point would not look to sacrifice SOCI in return for short run revenue increases through withholding and use their leverage in the market to hold revenue share in negotiations.

Moreover, Ofcom's conclusions do not consider a trading market without CRR and SOCI. SOCI has become the measure partly due to simplicity but also because of CRR and ARM. ARM uses SOCI as a measure for ITV1's share of broadcast and the relationship has effectively become an industry trading standard across all sales houses. There is no reason to believe that other trading currencies may appear or be forced on the market by the top 3 sales houses. If the withholding restrictions were removed, Share of Viewing (SOV) which measures viewing (rather than SOCI inventory) could become measure by which the leading broadcasters position themselves in the market. This would allow them to manipulate their inventory and therefore price through withholding without damaging their negotiation position. In this scenario, there would be high incentives for the broadcasters to withhold in the short and long run.

As a result of all the above, we believe any decision to lift the restrictions on withholding must only be made as part of a market wide review.

Q7: Is there any other relevant evidence we should consider in order to examine the ongoing need for the conditional selling rule?

We believe there are a number of areas where Ofcom might consider more, or different, evidence.

a. *Share of viewing (SOCI) and advertising revenue (NAR) at a sales house level*

In its review, Ofcom has mainly concentrated on the increase in the number of channels and the resulting increase in competition, but this only focuses on the effect of competition on the broadcaster/viewer side of the TV advertising market. As Ofcom notes in its consultation, the TV ad market is two-sided in nature and Ofcom has not, we believe, fully considered the seller/buyer side (at sales house rather than broadcaster level). As has been discussed elsewhere, since the last consultation on the conditional selling rule in 2003, there has been a decrease, rather than an increase, in TV ad sales competition, despite the viewer-side increase in competition driven by an increase in channels. As has already been pointed out, in 2003 there were 8 TV airtime sales points of note (Carlton, Granada, Channel 4, Five, Sky, IDS (Flextech), Viacom and GMTV); today there are just 6, or even 5 if the current ownership of GMTV is taken into consideration (ITV (inc GMTV), Channel 4, Five, Sky, IDS). In 2003, 4 sales points controlled c81% of TV ad revenues; at the end of 2009 c83% of revenues were controlled by just 3 sales points.

b. *The relationship between SOCI and NAR*

This relationship has not been considered in Ofcom's consultation, yet it is important because from it we can derive a 'power index', that is an understanding of the premium a broadcaster or sales house is able to command for its inventory relevant to the competition. As the evidence we give in answer to Question 8 shows, there has been an increase in the 'power index' of the major broadcasters since 2003, which runs contrary to Ofcom's conclusions in this consultation.

c. The possible impact upon, and relationship with, CRR

Ofcom has largely declared CRR outside of the scope of this consultation other than to suggest its existence would prevent conditional selling by ITV (with relation to *ITV1). However, we believe that it needs to consider the impact of removing the* conditional selling rule on CRR, and specifically ITV's ability to 'work around' CRR in that context.

d. The existence of market power

Ofcom has concluded that it does not see evidence of sufficient market power and anti-competitive conditional selling in the TV advertising sales market currently to justify the existence of the conditional selling rule. We believe the observations we have made in this paper strongly supports a different view.

Q8. 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?

As mentioned earlier, we strongly disagree with a number of the assumptions Ofcom has made when formulating its view. Specifically:

a. *That there has been increased competition in the TV airtime sales market since 2003.*

As we have indicated, while Ofcom notes that the number of channels broadcasting in the UK increased from 294 in 2003 to 495 at the end of 2008, in fact the number of stations actually viewed by viewers is far lower than this. In addition, as we have pointed out the consolidation of airtime sales, including the merger of Carlton and Granada, has more than offset any benefits from the increase in channel numbers. In

2003 there were 8 TV airtime sales points of note (Carlton, Granada, Channel 4, Five, Sky, IDS (Flextech), Viacom and GMTV); today there are just 6, or even 5 if the current ownership of GMTV is taken into consideration (ITV (inc GMTV), Channel 4, Five, Sky, IDS). In 2003, 4 sales points controlled c81% of TV ad revenues; at the end of 2009 c83% of revenues are controlled by just 3 sales points.

b. *That the decline in both SOCI and NAR (or either) of the larger broadcasters/sales houses is an indication of greater competition.*

Ofcom has made the case that the decline in these two metrics, in tandem, for larger broadcasters/sales houses shows that there has been an increase in competition, despite acknowledging in Para 4.40 that PSBs have largely had their SOCI losses since 2003 offset by increases in the SOCI of their digital stations, and accepting in Para 4.49 that "the majority of the recent revenue gains to digital channels as a whole have actually gone to the commercial PSB portfolio channels". These facts alone show that the movements in SOCI and NAR do not point to increased competition, but more likely that there has been a decrease in competition, and this despite the impact of CRR. In this context, we would suggest there is one analysis of SOCI and NAR figures that Ofcom might consider which we believe is key, relating to the changing gap between NAR and SOCI for each sales point over time and the resulting change in its 'Power Index', e.g. the ability of each sales point to secure a premium for its inventory. Our analysis reveals that there has been a significant increase in the gap between NAR and SOCI, and thus the Power Index, for the leading sales points since 2003. For instance, the combined ITV1 position in 2003 was a NAR share of 50.6%, SOCI of 43.1% and therefore a Power Index of 118. In 2009 this had moved to respectively 36.4%, 28.5% and 128. Other top broadcasters and/or sales houses have similarly increased their market power and the top 3 or top 4 sales points, accounting for more than 80% of NAR that we referred to previously, have also increased their Power Index as shown in the table below:

Broadcaster/Sales Point	**2003 Power Index**	**2009 Power Index**
ITV1	118	128
ITV Sales	113	117
Channel 4	120	145
Channel 4 Sales	118	126
Top sales points (4 in 2003, 3 in 2009)	115	118

NB, based on all adult 30" equivalent impacts

c. *That the trading mechanism will provide sufficient incentive to prevent conditional selling.*

As mentioned elsewhere, we believe that this assumption ignores the possibility that the withholding rule may be removed or changed and that other trading currencies may appear instead, particularly Share of Viewing (SOV) rather than SOCI. The former measures audiences and the latter measures inventory. Currently, because of the withholding rule, these two measures are the same, or more correctly year on year changes in these two measures are the same. This is because the requirement and/or practice of fully selling all inventory means that changes in viewing behaviour are the principal driver in changes to SOCI. It has only been for simplicity that the industry mainly relies on the one measure as the basis for its trading currency and SOCI has the advantage of only covering commercial stations and so removing the need to adjust figures to take account of the BBC channels. It is likely, should the withholding rule be lifted, that the leading broadcaster would shift to SOV as its trading currency whilst reducing its ad inventory, which would have the effect of maintaining or increasing demand, limiting supply and increasing pricing. This is an argument for the maintenance of the withholding rule, but it also demonstrates how potentially dangerous it could be to believe that the current trading mechanism will continue and/or provide sufficient incentive to prevent conditional selling should the ASR prohibiting it be removed.

d. *The price example used does not in anyway reflect or capture the current price dynamics in TV airtime sales or model the likely outcomes of conditional selling.*

We believe there are three significant flaws in the model - with near consensus on the current value of each channel, not least through station average price mechanisms, no two buyers would have such divergent views on the value or relative value of each channel; the model assumes that a buyer would just walk away if the price charged was above that which it was prepared to pay (ignoring the many arguments against the substitutability of TV advertising and specific elements of it, including those made in Ofcom's own proposal); that sellers would only be looking to realise a price equal to the sum of the parts, when our view is that they would (and currently do) seek to realise a price significantly ahead of that. We would suggest that a model that took these factors into account would produce a very different outcome.

e. *That it is not appropriate to consider market power.*

Throughout its paper, Ofcom has referred to a theoretical increase in competition in TV airtime sales, the likely reduction in market power of key players that such changing circumstances would give rise to, and the major focus on market power any investigation into airtime sales practices would have in the absence of ex ante regulation preventing conditional selling. It is our view that there are broadcasters and/or sales houses – most notably ITV – who still have considerable market power and who would be able to exercise that power through conditional selling to the detriment of the TV airtime sales market.

Ofcom has, we believe, over-estimated the possible positive incremental effects of bundling, including conditional selling. The main benefits highlighted – greater efficiency in sales practices, optimisation, etc. – have already been achieved by the current bundling of airtime sales that takes place on the very edge of what is permitted under current regulations. There is no evidence, we believe, that any incremental gains would be made by allowing conditional selling (the current bundling of airtime being maintained) – eg all sales points currently optimise their airtime inventory, and no sales points are currently forced to negotiate sales contracts for different parts of their inventory separately, with the exception of ITV under CRR. The only impact, we would suggest, would be that some sales points would have the ability to exert greater leverage and force advertisers to spend and/or pay more to the detriment of individual advertisers and the market as a whole.

Conversely, we feel that Ofcom has significantly under-estimated the likely negative effects of conditional selling. The only likely result for advertisers and agencies we believe, would be increased prices and a reduction in choice, and the shifting of the burden to them to prove that sales points' conditional selling is detrimental to them and the market and the significant extra resource and expense that would be entailed in this.

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

As will have been gathered from all the above, we strongly disagree with this statement and believe that to provide important and necessary protection to advertisers and the wider market, both rules should remain in place. Further, we believe the case to lift both rules should only be made as part of a market wide review.

Q10. 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.

Both ASRs should remain in their current form, at least.

In our answers to previous questions, we have set out where and why we disagree with the case for lifting both the withholding rule and the conditional selling rule - and why the rules in their current forms are necessary and best fit regulation. The only change we would advocate is either a tightening or greater enforcement of the conditional selling rule, as it is our view – and one that has been put forward in other consultations – that conditional selling *does* currently take place and that it has a detrimental effect on the market place. For both rules, we have presented evidence and arguments that competition in the TV airtime sales market has actually decreased since 2003, is likely to continue to decrease, and is not at a level that could keep the adverse effects of lifting both rules in check.

Finally, in the absence of ex ante regulation in these areas the protection that Ofcom refers to as being in existence in its consultation would be of no practical use whatsoever. The need for advertisers or agencies to raise a complaint to Ofcom, and then for Ofcom or other bodies to analyse that complaint with reference to various legislation, would be problematic for advertisers and agencies in many ways, but most importantly it would be so lengthy a process that it would be completely ineffective. Almost all TV airtime trading is conducted in the space of a few weeks at the end of each calendar year, both by convention and for important marketing reasons, eg in accordance with the creation of annual marketing plans. (It is similar practice in most major markets globally for trading to be similarly time focused). Any retrospective judgements or rulings, or their possibility, would offer no protection to advertisers or discouragement to sales points, as significant damage could already have been inflicted and the interrelated nature of all deals in TV trading (underpinned by share commitments) would make the unpicking of any such damage next to impossible.

CRR regulations themselves acknowledge this - with the requirement of the Office of the Adjudicator to respond swiftly on any disputes between advertiser and ITV, recognising that the impact from detrimental behaviours can be immediate and almost impossible to reverse.