

OFCOM “FUTURE OF RADIO” CONSULTATION

RESPONSE FROM GCAP MEDIA PLC

1. Introduction

There is much for the radio industry in general and for GCap Media in particular to welcome in “The Future of Radio”. We applaud Ofcom’s decision to open the debate on issues such as digital switch-over, content regulation and ownership regulation. These are areas where the ground has shifted substantially under the industry’s feet in the last few years and continues to do so. Change is needed, and Ofcom is right to lead the move towards it. Many of Ofcom’s proposals seem to us to be soundly based and will benefit the industry: the proposal to simplify analogue formats, for example, is particularly timely. Other proposals, while in our view not always going far enough, still offer a strong starting point.

Nonetheless, we believe that there is a risk that we will miss a major opportunity for more comprehensive change, change that is essential for the future health of the radio industry, and for GCap Media as a major contributor to it. In our view it is essential that the regulation of commercial radio reflects the full extent of the competitive and financial pressures facing the industry and the degree to which the commercial radio landscape has changed since Parliament last debated the legislative and regulatory structure governing commercial radio. These pressures, coming to bear at a time when the industry is struggling to maintain the momentum towards a transition to digital radio, threaten to derail and marginalise independent radio.

Put bluntly, what radio requires now is for Ofcom to take the lead, as it has done in its regulation of other sectors, and to respond to these different circumstances by relaxing and reshaping the regulatory framework that was applied in a different commercial environment, and which is no longer appropriate. Radio in 2007 and beyond needs flexibility and freedom to respond to intense competition and to innovate to win listeners and advertisers, in a regulatory environment that encourages continued investment in digital radio, and accelerates its take-up. At the same time, we believe that Ofcom must work with the industry to define a clearer migration path to digital for radio. We believe that the proposals in “The Future of Radio”, while based on sound analysis of the challenges facing commercial radio, do not go far enough to provide such an environment, and without it we fear that commercial radio will decline in quality and impact, and digital radio will wither on the vine.

We have contributed to and support the Radiocentre's detailed response to the consultation document, and we do not intend to cover the same ground here. Instead, we begin our response with some general observations to illustrate the gap between Ofcom's perception of the business environment and the reality we encounter. We then focus on three individual areas of concern: format issues both in terms of localness and for INR; digital switchover and future licensing flexibility, and ownership regulation. We will be pleased to expand upon any of these matters with Ofcom.

2. The context for the future of radio

Ofcom's proposals read to us as rooted in a past when commercial radio was able to command a premium for its services, and the market strength of radio companies justified extensive regulatory intervention. That era has gone for good, and the regulation of commercial radio needs to reflect that.

As Ofcom notes, the technological and commercial developments of the last five years have brought with them intense competition for listeners and for advertising. Radio's audiences have been attracted away by internet music services, internet radio and personal music players. Partly as a consequence of these trends, the internet has increasingly taken the place of radio on many advertising schedules, compounding the impact on the industry of a weak advertising market. In 2006, the second successive year of decline in spend on radio advertising, the Radio Advertising Bureau reported that radio advertising revenue had fallen 5.2%. In a high fixed cost industry like radio, the impact upon profitability is of course proportionately much greater.

Such fundamental market changes require new business approaches from radio companies, approaches which may cut across the existing regulatory regime. And in a tough competitive environment like this there can be no presumption that commercial radio revenue will be able to support the delivery of public policy objectives as it has in the past. For example, the provision of local content and the drive to digital radio do not have the same commercial attractions in the current weak market as they did in a strong one, as new technology brings new, unregulated competitors, offers new outlets for advertising spend, and as each new platform requires investment in technology and content.

Ofcom clearly recognises this: "The Future of Radio" concludes that *"increasing competitive pressures mean that existing programming commitments may no longer be sustainable"* and *"these changes have had a more rapid and profound impact on the radio industry than was foreseen just a few years ago when the existing legislation was put in place."* We agree with these sentiments. But we are also of the view that the detailed proposals in the document stop short of proposing the comprehensive remedial measures which would allow the industry to respond to the changes which Ofcom identifies.

This is particularly disappointing as in other sectors it regulates Ofcom has implemented more wide-ranging initiatives than those proposed for commercial radio. GCap urges Ofcom to take the same forward-looking approach for radio as it has, for example, in encouraging digital TV take-up and unbundling of local loops in telephony. The radio industry could be transformed by the right approach from Ofcom, but the current proposals are too limited in scope to achieve this. A new regulatory framework is needed to help the industry back to health - tinkering at the margins is not enough.

The proposals in the document do not, we believe, reflect the gravity and urgency of the situation. Nowhere is this more apparent than in the implications for its proposals for digital radio. Digital radio is at a tipping point. Research shows that DAB is reaching good levels of household penetration, but further investment in programme budgets and marketing is needed now to consolidate that penetration and encourage a quickening switch to digital listening, and so that the expensive duplication of transmission can be brought to an end. In the financial year ended March 2007, GCap Media made a net investment of £8 million in DAB Digital Radio and like other radio companies, has to be confident that it will earn a return on its money.

To finance this investment, radio companies have to derive profits from analogue radio, just as those stations provided the funds to launch DAB Digital Radio. There is nowhere else for the cash to come from until digital radio itself is profitable. But because analogue radio is under severe pressure, it needs to be allowed to be more flexible if investment in digital is to be supported. De-regulation is therefore needed now, because the industry is bearing the costs of both analogue and digital transmission now, and not at some point in the future when predetermined levels of digital listening are achieved.

Current levels of investment in DAB digital radio cannot be sustained indefinitely and failure to take action now will induce a vicious circle. Radio companies' investment plans will be shelved or cut back because regulation reduces the cash available. With less cash, investment will stop, and when digital listeners tune in they will hear under-funded stations, be disappointed with what they hear and not return, so that digital take-up slows down or stalls, and the objective of a switch-over from AM and FM becomes impossibly distant. We don't want to see that happen, and we are sure Ofcom does not either.

Instead we want to see investment in a strong mix of digital stations with high quality programming, encouraging listeners to tune in again and to tell their friends, so that the audience grows amidst a buzz of self confidence, speeding up the achievement of the public policy objectives and the switch-over date. With a greater commitment to digital switchover, Ofcom can promote this virtuous circle.

3. Content and related issues

(i) Formats and timing of changes

GCap Media supports Ofcom's proposal to simplify analogue radio formats to bring them into line with DAB formats, but we believe that the time to introduce this, and other changes is now and not, as Ofcom propose, at some point in the future based on projections of digital listening.

(ii) Localness

GCap Media knows that localness is a key reason for listeners to choose to listen to our "heritage ILR" stations. Our research shows that local elements are twice as important to listeners as any 'national' components of the station and even twice as important as the music that is played. Overall, localness accounts for almost 50% of what listeners require from our stations. It is, therefore, in our interests to continue to place localness at the heart of what our stations do, precisely because our research tells us that it is what our listeners want to hear. But it is clear that listeners have no interest in the inputs that create local content. Research points to the fact that over 65% of listeners think that it would be a very good idea for local radio stations to broadcast local news and information in regular bulletins as part of a national programme, while only 19% specifically want this type of information to be fed throughout an entire radio programme. Nor does the listener care from where in England content is presented. Again, our research shows this very clearly - 60% do not care where their local news and information is presented from.

In the end, what really matters is the sense of community, and for almost two thirds (64%) of listeners, their local community is important to them. Listeners, therefore, want and expect to hear this reflected in the output, and to experience that through innovative means, such as the involvement of local personalities, coverage of local events, news, and competitions. What matters to listeners is the active participation of stations in their local communities - getting behind local fundraising campaigns, supporting causes that matter to local people, and helping to find solutions to local problems. We do not believe that this can be effectively regulated by specifying where or how programming is produced as Ofcom propose. Rather, this approach stifles innovation without effectively ensuring the continuing provision of modern, relevant localness.

Indeed, there is a risk in starting with the presumption that it is regulation that keeps stations local, and that without regulation localness would disappear. As a result of this false assumption, we believe that regulation has become increasingly anachronistic, concentrating on programme production inputs and apparently hoping that these will act as a proxy for the output that the listener hears.

Digital production techniques and producers' research-based understanding of which aspects of localness matter most to listeners mean that input regulation can no longer have any place in matching station output to public policy, and constitutes an unreasonable and unnecessary burden on the industry.

It is important that Ofcom should also recognise that the delivery mechanism for localness is no longer solely confined to what comes out of the loudspeakers. Online is playing an ever-increasing role in the delivery of localness. For those who use local information – whether it is traffic and travel, weather, news, events or sports - more than half are using the internet more to obtain this information. This is clearly evident in the media sources that people turn to in order to obtain their local news and information. Apart from traffic and travel, radio as a medium is used by less than half of listeners – and is the main platform for less than 25% (again, traffic and travel is the notable exception). Already more than four in ten (42%) would not require local news and information bulletins to be broadcast on air – they would be happy to access the information online. The need for local output to be modern and relevant is not simply a matter of content - it also applies to delivery mechanisms, and as more and more listeners go online, the depth of local content will increase.

We do not therefore agree that the proposal to require a minimum number of hours of locally produced and presented output varying on a rising scale with station size is an appropriate or effective means of ensuring the ongoing provision of localness. We believe that any minimum local programming requirements are particularly inappropriate for local AM stations, where audiences have declined as overall AM listening has declined. We are opposed to the concept of input regulation, and we do not understand the logic for proposing different obligations for different stations based on station size. Any variable arrangement would, we believe, unfairly distort the market by imposing differential cost and programming requirements on stations which should compete on equal terms for listeners and advertisers.

GCap Media believes that the regulator and the industry share the same interest in ensuring that localness continues to be a key characteristic of these stations, and that this can be achieved through an alternative regulatory framework which focuses on output rather than input. We support the Radio Centre's view that the right way forward is to abandon the present input-led regulation and to replace it with self regulation, based on guidelines drawn up by a development group drawn from the industry and Ofcom. We are ready to be a leading member of that group, bringing to bear our deep understanding of the aspects of localness which matter to listeners, and sharing our research and our experience of best practice on local production techniques. Other areas of Ofcom's responsibilities have blossomed under self-regulation. Ofcom has the opportunity to repeat that success here. We urge Ofcom to grasp it.

(iii) INR Format Regulation and licensing

We find it difficult to understand what objective lies behind Ofcom's proposals in relation to the three INR stations. It wants to remove statutory format requirements from national analogue services, but makes no mention of discontinuing the system of auctions for INR licences which would, we believe, lead to a serious conflict with Ofcom's objectives for orderly digital switchover. This licence auction process has been withdrawn from every other area of broadcasting, and we believe these factors - removing the format requirement but continuing with the licence auctions - put at risk the continued success of Classic FM and the transfer of its audience to digital radio. If Ofcom's plan is to introduce indefinite licences terminable on reasonable notice to achieve a common switchover date, we cannot see how licence auctions can operate alongside this.

It is worth restating what it is that Ofcom has helped us achieve through the existing regulatory regime for Classic FM. Currently, Classic FM's programmes contribute to all 6 of the public purposes for radio on page 21 of the "Future of Radio". By attracting more than 6 million listeners to classical music, the station stimulates creativity and cultural excellence. Outreach activities through Classic FM Music Makers promote education and learning and sustain citizenship and civil society. Partnerships with orchestras and arts organisations countrywide take Classic FM to the UK's nations, regions and communities. The international nature of classical music ensures that Classic FM brings the world to the UK. Overall, the station promotes social gain and community cohesion by providing a focus for classical music lovers, and by introducing new listeners to the delights of this music - the young (under 20) audience for Classic FM stands at over 700,000 listeners. Small wonder, then, that the former Culture Secretary Tessa Jowell referred to the station as *"a glorious rebuttal to all those who insist that the public will never take to 'serious' music"*

We see powerful arguments for aligning the re-licencing of the INR stations with the rest of the industry. For the rest of analogue radio, Ofcom proposes introducing indefinite licence terms, with the ability to give notice to terminate to achieve an orderly transfer to DAB Digital Radio. As discussed below, we believe that Ofcom and the industry need to work together to develop a clear plan for migration to digital to balance the uncertainty which will result from variable licence terms. The INR stations need this certainty too. The next five years will be years of extensive change and uncertainty as the industry moves towards switch-over. The INR stations cannot be expected to maintain the quality of their output, to plan for an orderly transfer and to engage the enthusiasm of their staff for that, if their licences are potentially to be taken away from 2011. To cope with this uncertainty and instability, the stations need to know that they have the licence through to switch-over.

In addition, it is hard to see how any bidder in an auction for the INR FM licence in 2011 could be expected to prepare a rational bid, when Ofcom plans to review the longevity of the licence in 2012, within a year of its award. No responsible business would want to prepare a business plan on that basis. By auctioning the licences in 2011 Ofcom risks receiving bids prepared on the basis of speculation rather than sound commercial analysis.

The auction of the licence in 2011 could lead to the creation of a new national station broadcasting on FM. Not only would this deny listeners the excellence of Classic FM, it would be likely to slow the process of transfer to digital. The new owners of the INR franchise would have every reason to seek to keep its lucrative FM licence alive for as long as possible, and not to encourage its listeners to transfer to digital radio. So, just as the majority of operators were preparing the audience for the final transfer across to DAB Digital Radio, one station - likely to be heavily promoted at launch, perhaps through a range of strong media partners - will be promoting the benefits of the FM channel it had just bid for.

The statutory format requirement for the FM licence to be “non-pop” in nature has underpinned Classic FM’s success, by ensuring that the licence was not awarded to a more profitable pop-music station. That success has in turn enabled the FM station to generate revenues to invest in the development of the digital station, and to lead the move towards digital radio. We firmly believe that the transfer of Classic FM to digital requires the continued support of an analogue Classic FM throughout the run-up to switch-over, encouraging the audience to transfer and generating funds for investment in the marketing and innovation necessary to make switchover successful. We regard this FM/Digital link to be essential to a smooth transfer of audience to digital

If Ofcom removes the stipulation that the FM licence has to be non-pop, and if the licence is re-auctioned in 2011, we believe that there is a substantial risk that this FM/Digital link will be broken. Bidders will have the opportunity to acquire the licence with a business plan for a national pop music station, which as experience has shown can be expected to be markedly more profitable than a classical music station. This will mean that the ability of Classic FM itself to encourage those listeners to migrate to digital would be lost.

As a result of auctioning the INR licences and changing the format requirement Ofcom will, at a stroke, have put into reverse its plans to secure an orderly transfer, have stepped back from its policy aspirations for UK radio by the reduction in Classic FM’s audience, and seriously damaged radio’s record of achievement against its public purpose objectives.

We find it impossible to see where Ofcom thinks that the advantage lies in removing the statutory format restrictions from the INR licences, or requiring re-licencing by auction in 2011. The audience for Classic FM, the industry as a whole, and the public policy achievements that Ofcom wants will all suffer as a result.

To give the stations the certainty they need in order to lead the switch-over we urge Ofcom to leave the format requirements as they are, and to recommend that re-licensing arrangements be adopted in line with those for all other FM and AM licences.

4. Digital switchover and future licensing flexibility

We believe that there can be no licence termination plan without an accompanying plan for digital switchover. To suggest mechanisms for closing part of the industry down without balancing these with firm proposals for what will follow is, for listeners and the industry itself, an abdication of responsibility by Ofcom. In its consultation, Ofcom seeks a range of powers to *“maximise flexibility in the licensing system so as to be able to free-up spectrum for other uses, when the time is right”* (p.13). Increased flexibility for a regulator brings with it, of course, increased uncertainty for licensees. The capacity for Ofcom to determine licence end dates, for example, is sensible and pragmatic in the context of a planned switch-over. In the absence of specific plans for switch-over, however, the uncertainty that Ofcom’s flexibility implies will damage the businesses affected.

That damage takes several forms. First, as Ofcom acknowledges, commercial radio already faces considerable financial uncertainties. Investors tolerate these uncertainties because they are clear that licences have a sufficient minimum period to run, over which they can expect to recoup their investment and see a return. The closer we get to switch-over, the greater will be the uncertainty around the longevity of the licence, until investors can look no further forward than the two year notice period. This will decrease the investment attractiveness of the sector and increase investor concern, and with it the cost of capital of the radio companies.

Secondly, the radio sector is struggling with the financial burden of running the analogue and digital transmission systems in parallel. These costs are significant in proportion to the profitability of the radio industry, and leave the radio companies undesirably exposed to fluctuations in revenue. At GCap Media, for example, analogue transmission costs are £7.4 million per year and digital transmission costs are £15.1 million and growing, while pre tax profits are £14 million. So long as there are no plans for how switch-over is to be handled, companies like GCap are unable to assess the scale of the future impact of the costs of dual transmission, and to plan its investment programme accordingly.

Thirdly, uncertainty over the timing of digital switch-over is damaging the market for digital radio receivers, and thus slowing the migration of listeners. In sectors where radio receivers are sold direct to the consumer, digital take-up is going well. In the kitchen portable and personal stereo markets, for example, DAB now accounts for 81% and 58% respectively of sales by value.

But in the important sector of car radios, where the radio is only one element in the purchasing decision, and where car manufacturers operate on tight financial margins, the take-up has been very slow. Only 1.3% of car radio sales are digital.

The experience of the Digital Radio Development Bureau is that car manufacturers are unwilling to add to the vehicle cost by installing digital radios in the absence of clear indications that analogue will become obsolete reasonably early in the lifetime of their vehicles. Until there is a clear switch-over plan, car manufacturers will not commit to installation of a DAB digital radio as a standard fit item. We see that as a major weakness in persuading listeners of the desirability of a move to digital radio.

This damage caused by flexibility in the licensing regime can be reversed if the uncertainty around digital switch-over is removed quickly and authoritatively. GCap Media urges Ofcom to balance its proposals for licensing flexibility with a clear plan setting out the objective that this flexibility is intended to achieve - the switchover to DAB Digital Radio listening. To help Ofcom arrive at such a plan, we support the Radiocentre proposal for a cross-industry Working Group, comprising Ofcom, Commercial radio, the BBC, Community Radio, DCMS, DTI, manufacturers, the DRDB and other stakeholders. We believe that the Working Group should be formally constituted, and be required to report in early 2008 on the prospects and methodology for digital transition in radio. The Group should consider, among other issues, whether that should be a complete or partial transfer, how the process might be phased, and the legislative, regulatory and other changes that would speed up the transition.

Without wanting to pre-judge discussions in the Working Group, at this stage we see merit in phasing switch-over in radio, just as is proposed for television. In radio's case, however, we should like to see both a sectoral and geographical phasing. Our analysis suggests that AM accounts already accounts for less than 5% of all radio listening, and continues to decline, though we note that Ofcom's analysis suggests AM listening is slightly higher at 7%. Our current view is that switch-over of most if not all AM services should be achievable within a relatively short time-frame and perhaps as early as 2010.

We also note Ofcom's forecast that by 2015, 80% of all listening will be digital. We believe, however, that the speed of uptake of digital and DAB in particular will in part be a function of the stance taken by Ofcom, the commercial radio industry and the BBC working together.

We therefore believe that 2015 could be an appropriate target date to begin phased switchover of FM services if all relevant parties are aligned.

5. Ownership regulation

At page 46 of “The Future of Radio” Ofcom says that it is clear that *‘the current level of regulatory intervention on the analogue local commercial radio sector will become increasingly unsustainable and unjustifiable’*. We agree with Ofcom’s assessment. We have experienced ourselves the unwelcome and heavy burden imposed by the points system, representing as it does an additional layer of scrutiny of ownership of the radio industry, on top of the triple layer of the Public Interest Test, the Cross-Media Ownership rules and the OFT/Competition Commission oversight.

In addition, we believe that the existing points system has become increasingly difficult for Ofcom to apply, and will become more so, because it is impossible to apply a static system of rules based on arbitrary numerical criteria to an industry in flux. The points system has already had unintended and undesirable consequences: the example of the Scottish local digital multiplexes lying empty given by Ofcom in the consultation document being just one of them. In our view Ofcom will struggle with more, and more difficult cases if it seeks to fit the points system to a radio industry which has changed radically since the concept was developed.

Given all this, we are disappointed that Ofcom proposes to continue with a “Points System” to regulate radio ownership. The proposed new system appears to us to be just as heavy a regulatory burden on the radio industry as the current one. We can see no justification for continued regulation by Ofcom on radio company ownership. Radio is the smallest of the regulated media sectors and yet it is the only media sector subject to specific ownership controls. How can it possibly be that the three other layers of regulation (OFT, Public Interest and Cross Media) are sufficient for television, whose power to influence the consumer is huge, and yet they are not sufficient for radio?

We urge Ofcom to recognise that ownership regulation should consider each situation not by an arbitrary points system, but on a case-by-case basis, and that the best way to do this is through the existing OFT/Competition Commission oversight of mergers, using an appropriate definition of the market. We agree with Ofcom’s analysis that in this regard it is appropriate to include radio advertising as part of a broader local or national display advertising market .

We are of the view that the OFT/Competition Commission procedures are sufficiently flexible to take account of factors central to the health of the radio industry which no points system can consider, such as changing market dynamics, the public’s taste for new forms of music and audio delivery, and advertisers’ migration to other media. We feel that the OFT/Competition Commission system generally serves the public interest well: but for any ownership issues which do not come within their remit, the Public Interest Test should remain.

If Ofcom genuinely wishes to reduce its level of regulatory intervention, as we hope that it does, it should bring the Points System to a close, and rely on the combined effectiveness of the Public Interest Test, the Cross-Media Ownership rules, updated to take account of digital radio, and competition law to protect the public interest and ensure plurality and diversity.

GCap Media PLC

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