

Global Player or Subsidy Junkie?

Decision Time for the BBC

David Graham

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“Excellent memories are often coupled
with feeble judgements.”

Essays, Michel de Montaigne, translated by J.M. Cohen.

About the Author

David Graham was born in Somerset, UK, in 1943, and educated at Marlborough College, and Bristol and Indiana universities.

He began working as a radio producer in Toronto, Canada in 1967, joining BBC Radio in 1970 and moving to BBC Television in 1973, where he became a producer on *Nationwide*, *The Money Programme*, and *Panorama*. In 1981, David, with Peter Donebauer, set up Diverse Productions to make programmes for Channel Four. Under his management, Diverse made *The Friday Alternative*, *Diverse Reports* and *The New Enlightenment* among many others. In 1990 David established David Graham and Associates, later to become the media consultancy, Attentional Ltd.

Throughout his career, David has pressed for the liberalisation of UK media. While still a producer at the BBC in the 1970's, he was active in the group that campaigned for Channel Four as a "publisher" channel, opening the opportunity for independent production. In the mid 1980's he was active in the successful campaign for a BBC quota for independent producers. In the 1990's, he supported the campaign for independent producers to retain rights in their productions, implemented by Government as mandatory "Terms of Trade" in 2000.

David has contributed to many publications. In 1986, he co-wrote *The New Enlightenment* with Peter Clarke. David has co-authored a number of other reports including *The Courage to Compete* (1995), *Building a Global Audience* (1996), *Out of the Box* (2001), and *Beyond the Charter* (2004).

David is married to Imogen Graham. Their three children, Matthew (31), Patrick (27), and Abigail (22) work respectively in the film and fashion industries.

David is currently CEO of Attentional Ltd. The views expressed in this report are his own and not those of his company.

Executive Summary

- The UK's current model for broadcast regulation is exhausted. The BBC is at the heart of that model. Reform should start there.
 - The BBC is a hugely important institution in Britain and elsewhere. For many, it is the most trusted source of information about the world they live in. But this report argues that the BBC could “work harder for Britain”.
 - The BBC needs to maintain forward momentum. This report envisions an enhanced global presence for the BBC. The BBC has a powerful sense of purpose and employs some of the best executives in the country. It could make a greater contribution to the UK creative economy.
 - Public policy should aim to maximise the contribution of the UK's audiovisual media industries *both* to the national economy *and* to public welfare. This report argues for the following steps to achieve that.
 - The BBC should give up the Licence Fee, currently the source of most of its income, for the following reasons:
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- It criminalises poor people.
 - It forces people to pay for genuinely “free” services funded by advertising.
 - It obliges the BBC to replicate a crude commercial model based on mass-audience advertising.
 - Universal broadband and the Internet make a “licence” to broadcast obsolete. On the other hand, they enable direct delivery of services outside the UK. The current funding model denies access to Britons and others resident overseas.
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- The BBC is, in reality, a subsidised entertainment firm with some non-commercial obligations. The BBC should no longer be allowed to exploit the exclusive benefits of public subsidy. The hostility of its competitors is justified. Continued commitment to subsidy via the Licence Fee will mean contraction and decline.
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- This report proposes voluntary subscription as an alternative funding model. Subscription or Pay-TV is the medium’s largest and fastest growing revenue stream, and has the greatest ability to meet and “monetise” diverse tastes and preferences. Subscription services in the US have been responsible for some of the contemporary content most admired by professionals.
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- Voluntary subscription (with some subsidy for core public service content) affords the opportunity to enhance ownership, involvement and participation. Nearly everyone in Britain watches or listens to BBC services every week. A large majority would be likely to subscribe.

- However, the BBC remains committed to its subsidy status. It invests heavily in opinion management and has systematically captured its regulators. One of its strategies has been to argue that there is extensive “market failure” in the UK, and to promote a broad definition of “public service” content that includes many entertainment genres. This argument, driven by institutional self-interest and subsidy dependence, lacks empirical support.
- As part of the reform process, Government needs to take back responsibility for defining core public service content, which should be free to all citizens. These services may be defined as “public goods” to which all should have access in the public interest. Government ought to determine the nature of this content by answering the following questions:
 - What are the essential public services in broadcasting?
 - What is the level of funding needed to provide them?
 - Are there genuine market failures in entertainment genres?
- This report proposes what those core public services might be and argues that core public service content would cost a fraction of the current Licence Fee. It ends with some initial ideas about how to implement the changes it proposes.

1 Introduction

This is being written at a particular moment in time: July 2010. One concern will dominate all others in the next decade: the need for the UK, like other European governments, to reduce the deficit inherited from the 2008 financial crisis.

The UK's creative industries are potentially one of its strongest sectors. Our government, in the full knowledge that we have to trade our way out of the 2008 recession, should want this sector to be as dynamic as it can and grow its contribution to GDP. However, Radio and Television's contribution is at present modest – at 3% of Gross Value Added (GVA) by creative industries.¹

This is a moment rich in new opportunities: as Jeremy Hunt, the UK's new Culture Secretary, has put it, the internet is a new “trade route” for the export of goods and services.² But the ambition to be a creative “hub” must be more than a slogan. To achieve it, we will

- ¹ According to Creative Industries Economic Estimates, February 2010, DCMS, the Creative Industries contributed 6.3% (£59.9bn) to UK Gross Value Added in 2007. Of this, Radio and TV contributed £2bn, 3.3% of the total. Radio and TV Exports totalled £1.1bn in 2007.
 - ² “Trade has always been the foundation of our prosperity. The internet has opened up new trade routes as surely as the Silk Road did for Chinese merchants or Pax Britannica did for the East India Company.” <http://www.jeremyhunt.org/newsshow.aspx?ref=480>.
-

need radical reform and the restructuring of our “public service” broadcasting system.

The opportunity needs to be seized. All our partners in the EU – with the exception of the Republic of Ireland – are accustomed to English language material in primetime, for the most part dubbed or subtitled. The UK content industry should aim to rival the American dominance of that space. The medium of the new age will be broadband via the global internet, enabling the delivery of content anywhere in the world with virtually zero transport costs.

There is not, at this moment, a crisis in British broadcasting. Most people in Britain are happy with what they are getting and unconcerned with the structure of the industry and its regulation.

I argue that problems with this equilibrium will emerge, and soon. But what matters more is this: we should ask TV and Radio to make a bigger contribution both to the UK economy and to public welfare. To achieve that, they need basic reforms that will elevate ambitions and liberate energies.

The potential for economic gains resulting from a reform of our broadcasting structure – and the means to achieve them – are the main subject of this report. I also look at the role of Government, at what Government intervention is justified, and at the role Government should play in a reformed UK media economy.³

The need for reform clearly goes beyond the BBC. However, the BBC, as the primary institution in the system, occupies most of this

3 This report implies a very different approach to media regulation without specifying in detail what is wrong with the current system or what the new regulatory structure should be. This report is about the BBC and I did not want to blur its focus. Government, with a capital G, is, in this report, simply shorthand for the executive function that implements the changes I am talking about.

report. A serious debate on the future of the BBC will start, in my view, in 2011 and 2012. The changes facing broadcasting and other creative industries are massive and must be carefully considered before the end of the current Licence Fee agreement in 2016.

I will argue that there are two choices facing the Government. One retains something like the current structure, but accepts that the BBC cannot be allowed to exploit the exclusive benefits of public subsidy in a (now) much tougher competitive environment. This is the safe option. Its disadvantages are that it could significantly reduce the scale and presence of the BBC, that it faces considerable technological challenges, and that it has a narrow, inward-looking focus. Importantly, it does nothing whatsoever to enhance the contribution to UK exports and the national economy.

The other option is a radical shift, a transition to a BBC funded by voluntary subscription. This would free the BBC from the justified hostility of competitors over the unfair advantages conferred by subsidy. It would harness its huge reputation and high-calibre staff to new, ambitious objectives, and would encourage the BBC to lead the drive to create a bigger presence for itself and other UK players in global media.

This report concentrates on two main issues: why the BBC should move to voluntary subscription and how Public Service, in the context of broadcasting, should be redefined. To address other issues, such as the future governance of the BBC or a new regulatory structure for UK media, would have required a much longer work. Nevertheless, I hope this report, which does not have all the answers, will open a new phase of debate.

2 How the Current System Works

Our public broadcasting system has been through many phases.

The current system, taking in the BBC, ITV and Channels Four and Five, is funded both by commercial revenues and by a mixture of direct and indirect subsidy. In return, recipients have to meet a number of obligations and are subject to specific regulation, the BBC by the BBC Trust, the others by Ofcom.

ITV, Channel Four and Five are funded mainly by advertising but receive some revenue from other sources, such as sponsorship, DVD sales and rentals, production for other broadcasters, and the exploitation of programme rights. The mix varies: while ITV studios, for example, produce programmes both for the ITV network and for others, Channel Four is enjoined by its constitution to be a “publisher broadcaster”, contracting content production out to independent producers or other broadcasters.

The BBC, too, receives commercial revenues, notably through the operations of BBC Worldwide.

Public service broadcasters (PSBs) also benefit from non-cash or “implicit” subsidies – the term used by the regulator, Ofcom.⁴ Among them is access to digital spectrum and prominence on electronic programme guides. You will have noticed, for example, that the PSBs always come top on electronic programmes guides (EPGs) like the Sky guide, the Virgin guide or the Freeview or Freesat guides in the UK. Statistical studies show that these slots have very significant value.⁵

Historically the most important subsidy was preferential access to scarce spectrum. In the early days of broadcasting, there was only room for a limited number of channels: a “wavelength” was a hugely valuable asset for the regional franchises now mostly merged into ITV. Later on, the PSBs were favoured with prime access to the multiplexes, which carry the digital terrestrial service known as Freeview. Access to scarce spectrum has been incredibly important to the PSBs over the years, the key to their still-dominant brands and shares of viewing.

However, the value of this “implicit subsidy” is now declining fast. Conversion to digital media virtually eliminates spectrum scarcity, leaving only a few remaining items, such as guide prominence, as residual benefits of being a PSB.⁶

While the subsidies to commercial PSBs decline, the BBC’s revenue has continued to grow in real terms. The BBC receives

- 4 I will use the abbreviation PSB from now on for the UK’s licenced public service broadcasters – BBC, ITV, Channel Four and Five.
- 5 *Assessing the Impact of Sky EPG Positioning on Channel Performance*. Dr. Farid el-Husseini. Attentional for Discovery. 2008. http://stakeholders.ofcom.org.uk/binaries/consultations/psb2_phase2/responses/DiscoveryNetworksUKAnnex2.pdf
- 6 “Ofcom estimated that £130m of “implicit funding” for PSB output has already disappeared out of the commercial sector by 2008, a figure predicted to rise to £300m by 2012.” The Guardian, April 10, 2008.

over £3.5bn in direct funding from the Licence Fee, an obligatory payment of £145.50 a year by anyone who owns a TV that receives live broadcasts. In 2009, BBC's total income was £4.6bn, the additional items being £296m for the World Service and £776m from "commercial" activities, i.e. BBC Worldwide.⁷

In return the BBC has to meet various obligations, signally the "public purposes" that are part of the current Charter. The obligations on the commercial PSBs are more specific. They mainly concern relations with independent producers, a commitment to original UK production and to local news.

In the rest of this report, I will be critical of this system and recommend its reform. It is therefore important to understand what defenders of the system might have to say.

They would argue that most British people are happy with the system. For them, the BBC is a much-loved entertainer with a global reputation, a veritable beacon of the values of objectivity and public service. It is a provider of authoritative and accurate news and documentary programming, one of the best in the world. It has the resources to address key education and social issues in a helpful way. It "reaches" virtually the whole population of the UK.

They would say that TV is a pervasive medium, present in nearly every home. A Government *should* be concerned about the nature of its impact on everything from children's learning needs to the knowledge required for democratic participation. The UK, they might suggest, seems to have found a solution that does not require direct Government intervention, but which effectively delegates its

7 BBC Annual Report and Accounts, 2009.

welfare role to non-governmental institutions, mainly paid for by the public, for the most part voluntarily.

In the light of this, they would ask, why would anyone should think seriously of changing the current structure of the BBC, or the public broadcasting system of which it forms the key part?

This report seeks to answer that question.

3 Government and the Broadcasters

The UK model is lauded as expressing an “arm’s length” principle, which avoids direct Government intervention while at the same time relieving some broadcasters – the PSBs – from the full pressure of commercial competition. In return, they provide “public services”. The Reithian trio of objectives, “to inform, educate, and entertain”, though associated most strongly with the BBC, serve as a working definition of this “public service” role. “Public service”, it should be noted, has always floated on a river of entertainment.

But this model leaves the BBC – and the other PSBs – with a large measure of freedom to define the scale and content of “public service”. “Public service”, in other words, is shaped by circumstance.

Yet times are changing for the commercial public service broadcasters. What were once valuable privileges have diminished in value. “Implicit subsidies”, as above, are reducing to nothing. Commercial competition and recession have put public obligations under the severest pressure and heavily compromised public service content on the commercial PSBs.

On the face of it, the BBC Licence Fee insulates it from both technological and economic change. However, this presumption can be misleading. Maintaining the Licence Fee has always been one of the main preoccupations and concerns of senior BBC management. Its recent strategy has been to protect itself against resistance to the Licence Fee by winning a high level of “Reach”, that is, ensuring that a very high proportion of the British population tune to the BBC on a very regular basis.

It knows that to maintain its privileged position it must remain popular and compete effectively for share of audience with commercial rivals. But as the number of channels has increased and some viewing has moved to the internet, the BBC has found it harder to maintain its Reach. In fact, the share of total viewing – another key measure – that goes to the current BBC portfolio of channels has declined at the rate of just under 1% per year from 39% in 2002 to 33% in 2009.⁸

Thus, while insulated from *pure* commercial pressure, the BBC nevertheless competes strongly with its commercial rivals, reacting to changing circumstances as much as anyone and modifying its content strategy accordingly.

While nominally avoiding competition, the BBC (and, in particular, BBC1) replicates a commercial model based on mass audience advertising. In concrete terms the BBC needs to stay popular and popularity does not equal public service.

It is clear that the continuing decline in audience share challenges the BBC’s public service obligations. However, the BBC likes its public service obligations to be kept rather fluid. The meaning of “public service” has been very largely “managed” by the BBC, as I explain later.

8 Source: BARB/Attentional Ltd.

Today, it is not unfair to describe the BBC as a subsidised entertainment firm with some non-commercial obligations. Some public service messages need to reach wide audiences and an entertainment medium can provide them. However, subsidising the entertainment itself is a different matter. Later in this report, I will look at the negative impact that has on other players.

The questions I raise here go to the very heart of current broadcasting policy. Is it good policy to allow public service content to be contingent on the rest of the entertainment economy, in particular on the interests and circumstances of particular institutions? Indeed, what is the best basis for Government policy on broadcasting?

Here is my answer: Government must be empowered to define public service objectives and to secure their satisfactory execution. In addition, it needs the tools to find the right balance between public welfare and economic objectives.

In Britain we are very attached to our institutions. The BBC is one of which many people are proud – and with justification. Nevertheless, I will argue that the current system fails on these criteria. The very mechanism set up to insulate the BBC from commercial pressure fails in its core purpose. Our governments have been too willing to leave the definition of public service largely to institutions and their satellite bodies, lacking the will to look hard at what public service really means, specify its essentials, and see that it is delivered in the most efficient way. To do that now they need to get a handle on what the market can best provide and where public provision should start.

I return to the role of Government later, moving first to the flaws and weaknesses in the current system.

4 The BBC Licence Fee: obsolete and unfair

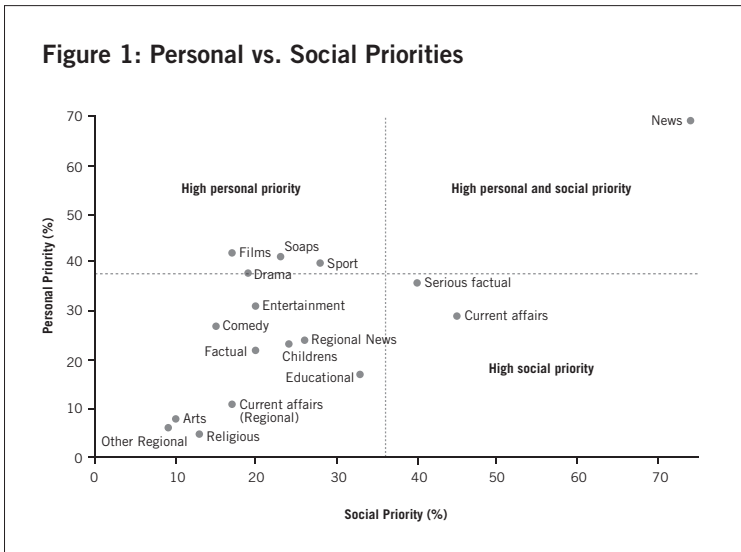
The Licence Fee is an emotive issue. There have been a number of high-profile dissenters but no sustained or widespread opposition to it.

The practical reasons for that are simple. Opinion polls tell us that people are ambivalent about the Licence Fee. In short it would seem that many do not think it is a very good idea but do not feel strongly enough to resist it. Put simply, the £145 people have to pay annually is affordable for most, and represents good value for what they are getting. However, the fact that the cost seems reasonable does not necessarily mean support for the way in which it is levied.

We can see this ambivalence in surveys for Ofcom's Second Review of Public Service Broadcasting in 2008: Ofcom asked some 2000 people to rate the programme types they considered important "for the good of society as a whole" (Q1) as against the types that were "most valuable to you" (Q2).⁹ The results are displayed on the graph below.

⁹ Ofcom's Second Public Service Broadcasting Review. Phase One. 2008. pp 34/35. The format of the chart is my own.

Figure 1: Personal vs. Social Priorities



From this you will see that people recognise that News, especially, and Current Affairs are “social priorities” whereas entertainment genres are personal priorities. (For parents, Children’s programmes fall into the right-hand quadrants too). There are genres that most people simply could not do without – Films, Soaps, and Sport, up in the top left quadrant – but these are not seen as a “social priority”.

This suggests to me that many people support, at least in principle, public funding for social-priority genres but not for personal priority genres. This is borne out in the polls that I am aware of, none of which find a majority in favour of the Licence Fee:¹⁰

2004: an ICM poll for *Panorama* found that 31% were in favour of the existing Licence Fee, 36% said the BBC should be paid for by a subscription, and 31% wanted advertising to pay for the programmes.

¹⁰ Summarised from Wikipedia at http://webcache.googleusercontent.com/search?q=cache:JcllygDb5q4J:en.wikipedia.org/wiki/Television_licensing_in_the_United_Kingdom+BBC+Licence+fee+Opinion+polls&cd=1&hl=en&ct=clnk&gl=uk

2008: an Ipsos MORI poll commissioned by the *Guardian* found that 41% agreed that the Licence Fee was an “appropriate funding mechanism”. 37% disagreed.

2009: In the *Guardian*/ICM Poll Licence Fee support rose slightly to 43% amid doubt over commercial viability during a recession.

Support for the BBC fluctuates through phases in which attitudes are almost certainly influenced by events both inside and outside the BBC – like the 2009 brouhaha over Jonathan Ross and the 2008 banking crisis.

While most people have bigger things on their minds than resistance to a fee that they see as simply the cost of watching the BBC, the polls demonstrate a consciousness – if not a vivid awareness – that something is wrong. For many members of the public recognise the obvious fact that the BBC is mostly “entertainment” – content for personal pleasure rather than social need.

The truth is that the Licence Fee discriminates against genuinely free channels. People are paying for the right to watch free channels, supported by advertising, like ITV and Channel Four, because they cannot watch them without mandatory payments to a competitor, the BBC.

Nor do most people see the darker side of the payment process. The Licence Fee is chargeable to any household that receives a live broadcast, whether that is a BBC signal or not. Failure to pay results in prosecution. In 2008/09 there were 168,000 prosecutions for evasion, nearly 15% of all prosecutions.¹¹ Most of those charged are

¹¹ See Charles Moore, *The BBC's worst scandal lies in our courts*, Daily Telegraph, May 11, 2010.

poor, often young single mothers. The only way you can avoid this payment is by watching no live TV, literally having your set disabled.

Here is a magistrate giving her own views of this system:¹²

“As a JP, I have for 20 years had the difficult task of sentencing TV licence defaulters, followed some months later by the often hopeless task of fine enforcement. Unlike other offenders, TV licence evaders are predominantly female, many of them benefit recipients with children. The majority are single, struggling to keep their families financially afloat. Food and electricity tokens often take priority over a weekly TV licence payment. If still without a licence, offenders can be re-prosecuted almost immediately unless they dispose of their TVs.”

*The fact that the Licence Fee criminalises poor people has been the main ground of dissent from public figures like Charles Moore, or Geoff Mulgan, a former advisor to the Labour Government, who said: “The Licence Fee alone stands as an inegalitarian flat-rate charge, linked in no way to ability to pay. (It is a tax) which has no democratic component: it lends no choices to those who pay and conveys no information to the broadcaster”.*¹³

Recently, in a public forum convened by OpenDemocracy, Frank Field MP, had this to say: “for many of my poorer constituents it is an outrage that they have to pay it and all too many of them end up in court...”¹⁴

12 Joan Horton, in a letter to The Times in 2003, quoted in *Beyond the Charter*, David Cox, David Elstein, David Graham, Geoff Metzger, and Barbara Donoghue. (2004).

13 Quoted in *Beyond The Charter*, cited above.

14 See at <http://www.opendemocracy.net/panel-one-role-of-licence-funded-bbc-and-significance-of-strategy-review>. Field went on to say that the BBC “should not be undertaking a range of broadcasting that could as well be done by the private sector...”

Many prominent people continue to believe that the current mode of BBC funding delivers universal access and therefore enables a trickle-down process whereby the poor and the less educated can gain knowledge about the world and of our heritage and culture. For example, on a recent Radio 4 programme, former Director General John Birt argued that the key argument for keeping the compulsory Licence Fee was that those who might be thought to benefit most from the BBC – the poor, the less well educated – would be the likeliest to cease paying if choice replaced compulsion.¹⁵

But given the inequity of the Licence Fee, given that the poor are the very people most likely to be in default and therefore unable to receive the “knowledge” John Birt refers to, should not those who share his concern be arguing for a *better* basis for public service than the current system?

Then there is the issue of technology.

The BBC Licence Fee is payable, according to my sources, *when someone is receiving a television programme at the same time (or virtually the same time) as it is received by members of the public*. In other words, it is based on simultaneous reception of a live transmission. Although many people now record content off air and watch it later, “time-shifted” viewing falls within the Licence Fee rules because it requires the reception of a live transmission. However, technology is advancing again. Large volumes of content are stored on servers around the world and can be watched “on demand”. Watching content that is downloaded, whether or not it is

¹⁵ *Decision Time*, BBC Radio 4, Jan 12, 2009, hosted by Nick Robinson, with John Birt, Emily Bell, David Graham, David Mellor and Sue Street

BBC content, does not require the payment of a Licence Fee under current legislation.¹⁶

On-demand services are only viable with an adequate broadband signal. With adequate bandwidth, you can watch live or recorded content on a personal computer. Technically, you do not even need to pay the Licence Fee to watch content on the BBC iPlayer. The vast majority of viewing to TV still takes place both on a conventional TV and in the home. But what happens when people are able to avoid live broadcasts and rely on downloads and on-demand services? As one of my colleagues said: “Will everyone with fast broadband end up having to pay a Licence Fee?”

I predict that we will shortly start to hear talk of a new basis for the Licence Fee, to be paid on broadband access rather than on a given receiving device. There will be justified resistance to this, especially if the fee is, as now, proposed as the primary method of funding the BBC.

If this happens, I hope it intensifies the debate that this report is intended to stimulate. Digital technology enables the identification of what each person or household is watching (which is why it provides so much more of the “intelligence” Geoff Mulgan referred to above). Where people are watching TV on a digital device, it will surely make sense to pay on the basis of *what* they watch, not on the basis of whether or not they own equipment that enables them to receive a broadcast signal. It is now technically simple to make content available only to those who have signed up for it.

16 This may be behind the BBC's desire to promote “hybrid” devices like Canvas. At a recent conference, a BBC executive, Richard Halton, said that Canvas, a hybrid device that combines access to the internet and to broadcast channels, required the payment of a BBC Licence Fee because it was capable of receiving a live transmission. www.marketforce.eu.com/broadcasting

Digital convergence offers the chance to remedy other defects in the licensing system. According to BBC data published in 2006, an estimated 5.5m British people live permanently abroad – almost one in 10 of the UK population.¹⁷ A large number of other Britons are travelling at any one time. Currently none of these can access the BBC via the iPlayer although it would be quite possible for them to do so. Some will have paid their Licence Fees, and are therefore being deprived of what they have paid for. Others, if the right mechanism was available, could become a new audience for the BBC, and, if the BBC was smart enough, a new source of income. Because the Licence Fee looks exclusively to the UK government for its maintenance and exclusively to the domestic consumer for its payment, it militates against an outward-facing BBC, fully realising both its potential domestic *and* global presence.

As any businessman will aver, and as common sense will confirm, a guaranteed public subsidy is a safer and more dependable source of revenue than anything a commercial business can get its hands on.

The BBC as an institution is utterly committed to the perpetuation of the current funding system. Its key staff are programmed to perpetuate it. That's not surprising. But I hope this report will make some people ask: do we want this institution to continue to be locked into a public subsidy? Could it do better for its country, its audience and itself under another plan?

¹⁷ http://news.bbc.co.uk/1/shared/spl/hi/in_depth/brits_abroad/html/. I suspect this estimate is very wide. Let's just say there are a lot of Britons abroad.

5 BBC Executives spend too much time managing opinion...

If subsidy is a firm's major source of income, its biggest incentive will be to keep the tap running. This means not only that the BBC has a strong incentive to match its share of audience with commercial rivals, but that it sees one of its other primary roles as securing continued support from Government and regulators for its current funding model.

The senior executives of the BBC come in the main from the entertainment industry and I am sure most of them believe deeply in the value of what they are doing. Where production staff are concerned, the BBC has a very strong internal culture – I know that because I was once one of them. But the BBC also feels the need to devote tremendous effort to securing Government backing and invests heavily in opinion management, directed both at the public and its regulators and sponsoring departments. In the many reminiscences of former Director Generals, one of the key “successes” mentioned is winning an increase in the Licence Fee.¹⁸

18 E.g. *The Harder Path*, John Birt. 2002. pp 334 -336.

One way of serving this interest has been the development of a kind of double talk or meta-language in which there are “public service” versions of popular genres, whereby BBC drama is said to be more “public service” than ITV drama, or that home grown comedy is hard to develop and would not exist without the special freedom that the BBC has to “take risks” and trial content on secondary channels before it reaches BBC1.

The truth is that the difficulties and risks that accompany the attempt to develop hit shows are inherent to the entertainment business. However, it suits the BBC to argue that such difficulties are examples of “market failure,¹⁹ an instance of a social good or benefit that the “market” simply cannot provide.²⁰

You could say, given the history of the BBC and of public broadcasting in the UK, that market failure was simply *assumed* when broadcasting started nearly a century ago. One of the BBC’s main interests over many years has certainly been to convince everyone that the market continues to “fail”.

However, there is not, and there never has been, any concrete, properly supported evidence of market failure to back such arguments. A local difficulty over the production of a genre, like situation comedy, could be down to many things – lack of good comedy writers, a change of popular taste, a lack of innovation. In fact if there is any evidence of market failure, it may run in another direction entirely, as will become clear when I speak about BSkyB later.

19 Defined in the *Penguin Dictionary of Economics*, Bannock, Baxter and Evan Davis, 1997 as: “An outcome deriving from the self-interested behaviour of individuals in the context of free trade in which economic efficiency does not result”.

20 E.g. <http://www.prospectmagazine.co.uk/2009/07/markthompsononthefutureofthebbc/>

What we can say for sure is that the growth of the media industries in recent years, and the end of spectrum scarcity, should have helped to eliminate any residual market failure, especially where entertainment genres are concerned. People have almost indefinite choices and the “market” has lots of ways to provide for them. If it has not done so, that’s not the market failing. It may well be institutions failing the market.

It has thus suited the BBC to define “public service” in broad, non-specific terms, and that is exactly what it has achieved. It needs to do this to counter an argument neatly put by Gavyn Davies, the BBC’s former chairman, in his 1999 report on BBC financing, when he said that “the inherent disadvantages of the Licence Fee system imply that we should fund the minimum BBC services necessary to maintain a healthy broadcasting ecology in the UK, not the maximum amount that could be usefully spent”.²¹

Any attempt to get specific about market failure or to define the core elements of Public Service has been anathema to the BBC. Companies may have missions and objectives, and exemplify and express public and private values, but part of the job of senior BBC executives has been to protect the Licence Fee and promote a fuzzy definition of Public Service content. I am afraid that the BBC line on “market failure” is, ultimately, an argument of convenience, driven by institutional self-interest and easy money.

The BBC prefers generalities to specifics. Take the series of ‘public purposes’ by which the BBC Trust monitors the BBC’s performance. They are:

1. Sustaining citizenship and civil society
2. Promoting education and learning

21 Quoted in *Beyond The Charter*, 2004.

3. Stimulating creativity and cultural excellence
4. Representing the UK, its nations, regions and communities
5. Bringing the UK to the world and the world to the UK
6. In promoting other Purposes, (helping) to deliver to the public the benefit of emerging communications technologies and services and (taking) a leading role in the switchover to digital television

I am not going to attempt to evaluate the way the Trust monitors compliance with the purposes. Others have done that and discussed the structural weaknesses that enable “regulatory capture” in detail.²²

Public purposes like “stimulating creativity and cultural excellence”, or “bringing the world to the UK and UK to the world” could be the objectives of any major communications company with a national audience and a global reputation. The person who described the “public purposes” as “regulation by platitude” had a point.²³

In truth, it is governments who must define the core elements of public service, acquiring the tools and techniques to identify true market failure and looking, of course, across the totality of its communications media, not just to one institution, to assess the best way to deliver them. In a later section I will propose what those core elements might be.

22 See *Changing the Channel*, Mark Oliver, Policy Exchange, 2009

23 Overheard at an OpenDemocracy workshop in May 2010.

6 BBC Funding has led to multi-layered intervention...

The BBC has an income of over £4bn, the largest proportion coming from the Licence Fee. Support for the public broadcasters extends beyond the BBC in the form of allocated spectrum at reduced rates and “prominence” on electronic programme guides. This has, until recently, given all the public broadcasters a joint interest in existing arrangements.

That is changing. “Implicit” subsidies have slumped, while the BBC Licence Fee, as a mandatory levy on TV owners, insulates the BBC from trade cycles and from “disruptive” technology like the Internet.

The sheer stability of the fee now makes it very tough for commercial competitors like ITV, Channel Four and Five, which rely mainly on the cyclical and unpredictable advertising market for their revenues.

One of the key consequences of public policy to date is that the public broadcasters still dominate the funding of new content. New primetime content in high-cost genres like drama and

entertainment is what galvanises the mass audience. Public subsidy (in the case of the BBC) and other “implied subsidies” have helped public broadcasters to keep their brands strong even as other channels have proliferated. New content in the high-cost genres of drama and entertainment still strongly differentiates the public broadcasters from the (now) many thematic or “niche” channels like Discovery, Living or ITV2. As a consequence the PSBs still command over 70% of all TV viewing.

This market dominance is in fact recognised in a number of ways and has required extensive regulatory intervention. For example, in response to the ITV’s dominance of TV advertising revenue, regulators have imposed Contract Rights Renewal (CRR) clauses which constrain the prices ITV can charge.

More relevant to the BBC are the various rules that have been imposed in recent decades to encourage independent producers.

Because the BBC and other public broadcasters are the main buyers of originated content in the UK, Government, via its regulator Ofcom, has imposed “Terms of Trade” on them. Under the most recent version of these terms, independent producers of commissioned content retain secondary rights in the programmes they make, enabling them to exploit them on other channels, sell them overseas, and so on. These rules, imposed in 2000, have produced a dynamic independent production sector whose total market capitalisation is now on a par with that of the broadcasters.

In the 1970’s, similar rules, called the Financial and Syndication rules, were imposed on the United States on similar grounds, i.e. that the “networks”, NBC, ABC and CBS, had excessive buying power. When the concentration of buying power diminished, as it

was deemed to have done in the United States by the early 1990's, the Financial Syndications rules were “sunsetting”. Independent production companies with stock exchange listings or significant capital assets have now largely disappeared in the US.

Interventions based on particular conditions have a habit of sticking around. But when and if that happens, it can distort and constrain a media market to no obvious benefit. When conditions change and when their benefits have been taken, such interventions should lapse as they did in the US.

One outcome of the UK's current structure is that “vertical integration” is still treated as a constraint on market freedom, requiring intervention. This is because the public service broadcasters dominate the commissioning of new content.²⁴ Such is the concentration of buying power that, without intervention, a handful of companies would be able to produce, transmit and exploit nearly all original content made in the UK.²⁵

Thus, we have in the UK, a case where extensive intervention – a system of detailed actual and implied subsidy – requires more intervention to moderate its impact. Nor is the situation stable. There are constant efforts to shift and adjust the balance and endless lobbying by interested parties.

24 Technically, they constitute an oligopsony, that is a market defined by a few buyers.

25 While recognising the reason for it, this constraint is itself inefficient. Business texts often split media companies into Content, Packaging and Retail. Content develops and produces the work: Packaging (which is called Distribution in the UK) prepares it for and sells it to a Platform which delivers or “retails” it to consumers. Most stable and profitable media companies (in Films and TV) combine at least the first two of these. For a recent take on this, see, for example, *The Curse of the Mogul*, Knee, Greenwald and Seave, Portfolio, 2009.

7 ...and has benefited commercial competitors like BSkyB

The outcomes of regulation are often unanticipated. The case of Sky is interesting. Sky's subscription satellite services were launched in the early 1990s. Sky purchased rights in premium sports and did movie deals with Hollywood studios, introducing Pay-TV to Britain. Sky became highly successful and has continued to grow its revenues every year. Indeed, subscription or Pay-TV is now the strongest revenue stream in the UK television industry, and continues to grow.

Sky's success is based on superb technology and excellent marketing skills. The promise of access to sport and films via an electronic guide, and a time-shifting box that offers hundreds of channels, has meant that over 10m British homes readily pay up to £40 per month to Sky. This is in spite of the fact that some 60% of viewing on subscription channels goes to content that is available elsewhere on "free" services.²⁶

26 *What would you pay to see shows on ITV?* David Graham, Farid el-Husseini and Zak Shaikh. Television, March 2010.

Since the public broadcasters provide a ready supply of UK-originated content in the popular drama and entertainment genres, Sky, now the UK's richest commercial player, has felt little need to invest in or acquire these. As a result Sky's buoyant domestic revenues have gone largely to buying sports rights (thereby inflating the revenues of, say, football clubs) and paying for (mainly) American films and TV series.

The fact that Sky's own investment in UK content has largely avoided the need to compete with other broadcasters in the riskier areas of popular drama and entertainment is a direct result of Government support for those broadcasters' operations.

8 Now the BBC faces “death by a thousand cuts”

There was a time, when, though rivals, the interests of the public service broadcasters were more or less aligned. As the so-called “implicit subsidies” have diminished in value, as competition has increased and with severe economic conditions prevailing, Channel Four, Five and ITV have become more critical of the BBC’s scale and scope. The voices of complaint, coming from these and other broadcasters, are getting louder, and focus on BBC’s disproportionate market power and presence.

Their case is based on the scale of the BBC, but intensified by events like the relative growth in the Licence Fee over the period of the Labour Government, the impact of the recession on its competitors – especially ITV and Channel Four – and the BBC’s large push into the internet through its websites, its platforms (the iPlayer is the most prominent) and its news services. The BBC’s competitors have sought the support of competition arguments, directed mainly against proposed platforms like the archive platform, Kangaroo, and now Canvas, aiming to extend BBC’s “free” presence onto the open internet.

There is an emerging political and industry consensus that the Licence Fee should be held down, even reduced, and that the BBC should return to “core activities”.

One version of this approach would introduce some “contestable funding”, separating parts of the licence fee and putting them in the hands of a body free to place some public service contracts with other, more suitable suppliers. No version of this approach, as far as I am aware, favours the complete removal of the licence fee but “top slicing” is certainly on the agenda. Under pressure, the BBC has announced a move back to “core” output and the dropping of some services that could be supplied by commercial competitors.

A recent paper for the think-tank Policy Exchange best captures this emerging consensus. *Changing the Channel*, by Mark Oliver acknowledges the problem of regulatory capture, analyses its causes, and makes detailed proposals on a new institutional structure to address the BBC’s disproportionate market power.²⁷ It proposes the abolition of the BBC Trust and its replacement with a BBC Joint Board; more “contestability” in the way the BBC selects and administers public service projects with some allocation of revenues to others (“bottom slicing”); a body to validate this process, “champion” public service content and negotiate “access” to it; and removing responsibility for digital services like Freeview from the BBC. In addition Oliver recommends reinforcing market impact assessments and removing them from the Fair Trading Unit of the BBC. The paper also recommends the privatisation of BBC Worldwide.

27 “This has become the case with the BBC Trust where it has ended up making joint submissions and responses to Government with BBC management. This “regulatory capture” when combined with the lack of contestability on decisions about new BBC services and funds allocation means that there is little effective testing of the BBC’s ability to maximise public value in between Licence Fee settlements.” *Changing the Channel*, Mark Oliver, Policy Exchange, 2009.

This Policy Exchange paper offers a commendably detailed set of recommendations that recognises the now-unacceptable position of the BBC and attempts to level the playing field for its competitors. It is also absolutely correct, in my view, that public funds should be concentrated on “quality” content, though the extent to which “quality” can be judged by committees is open to question!

However, the Policy Exchange paper leaves important issues unexplored. It makes no proposal on the future of Licence Fee. Is it a direct payment from Government, or is it to be levied on the same basis as before? Nor does the Policy Exchange paper address potential loss of public support for the BBC, and consequently for the Licence Fee, as a result of a reduction of output or popular content.

I have no doubt commentators will take these issues further before long. Others may well suggest an alternative to the privatisation of BBC Worldwide by which a combination of Worldwide commercial revenues, reduced public revenues and a strict focus on content only could pay for a scaled-down BBC.

But I do not like the inward-looking and protective posture of the proposals. Continuity is important, but there comes a time when the old model needs to be scrapped. We know its flaws are numerous. Do we have to live with them? In the end, *Changing the Channels* posits only a Little Britain solution, dedicated to protecting a network of old institutions and insulating them against disruptive change. It fails to imagine public service content without the current institutions, seeing the two as inextricable.

There is a philosophical issue at the heart of this debate. The Policy Exchange paper takes a particular view of public taste. “(Consumers) are more likely to buy fast food, cheap holidays and chocolate than

invest in education, pensions and health. It is the same with TV"... "A strong output of British programmes...protects us from being swamped by imported US programmes which are readily available".

I think this is patronising and wrong. It overstates the "public good" argument.²⁸ Yes, a shortage of domestic content would be a matter of concern. But experience tells us that people hugely prefer home-made fare.

Likewise with culture. "Culture" has many meanings to different people, but culture is also something humans make like birds make nests. Humans have an instinct for making culture. It explains why one country's culture remains resolutely different from that of others.

We may have museums for our heritage. But it is not at all clear that our contemporary culture needs protection. Culture grows out of the choices made by individuals.²⁹ What it does need is the scope for individuals to express their different tastes and preferences, pursue their passions and generate new demands that a market can meet. Their ability to do that is our best protection against cultural market failure. (In a few pages I show how the freedom of some American homes to pay more created some of the most outstanding content of the decade).

If British TV and radio does not give people enough scope for choice, they will look elsewhere to satisfy their broadcasting preferences.

28 "...For example, a public health measure that eradicates polio protects all, not just those paying for the vaccinations". Economics, Paul Samuelson and William Nordhaus. 2010.

29 It really is important that Government bodies and regulators have a good grasp of contemporary work on culture. As a starting point I would recommend *Not by Genes Alone*, so refreshingly different from the academic cul de sac called Media Studies. Boyd and Richerson. 2005.

9 A better option: the essentials of a new structure

The BBC is the UK's strongest media asset. It is a global brand. Here are the outlines of a rather different approach from the one described above, the main components of which, expressed in their most basic terms, are as follows:

- The BBC would, over a limited period of time, allow licence payers to either lapse or switch to voluntary subscription.
 - “Public Service” would be redefined to essentials and the monitoring of these would come from a specialist unit within the relevant Government department.
 - Core public service content would be “free” and include news, but not entertainment genres or most documentary and factual output. The over-75 free-access options would continue.
 - Content intended to promote the UK (like the present World Service) should be directly funded by Government as it is now.
-

10 TV's most buoyant and dynamic revenue stream: subscription

Subscription, or Pay-TV revenue, has now outgrown all other revenue sources from broadcasting. It is still growing, overtaking both advertising and the BBC Licence Fee.

Technological change is already playing a key role in the expansion of Pay-TV and will play an even greater one in future. The internet together with fast home broadband opens up wholly new possibilities. Recently, I hear, good money was earned from the sales of US basketball games to China for \$1 per game per person.³⁰

Nor does subscription rule out other revenue streams: in the UK, Sky and Virgin Media sell advertising too.

The BBC's current funding mode both isolates it from the industry's fastest growing revenue stream and ties it too narrowly to domestic income sources.

30 In a presentation of a product called Vobile at the British Screen Advisory Council.

11 Why Subscription is the Right Choice

We're often told that people enjoy some services as citizens and other services as consumers. Public funding is needed for citizen services. "Citizen" is a word that has entered the TV debate quite recently. The word has been used to capture the "social value" of media. Most of us are indeed happy to pay taxes for some things, things that society needs, like a good health service or education system. But it is quite wrong to completely separate the public and private sphere.³¹

Everywhere you look *membership*, doing things together, is important to people. You see it in the rise of private members' clubs in London, or "friends" on Facebook. In TV, the key players currently appear to see "subscription" merely as a cost of receiving extended choice via satellite or cable. That's wrong. Subscription is about membership. It is about playing a role and helping valued institutions to prosper. Yes, it's about value-for-money too – but people assess that value in more complex and sophisticated ways when they subscribe. It is from this multi-dimensional complexity

31 I owed this point to *To inform, educate and entertain? British broadcasting in the 21st century*. Martin Le Jeune. 2009. Centre for Policy Studies.

that subscription derives its dynamism as a revenue source. If the BBC was a club, who would not want to be a member?

Subscription pays. TV subscription revenues amounted to £4.32bn in the UK in 2008. Experts at my company, Attentional Ltd, calculate that platform operators were earning 24p of subscription revenue for every hour of pay-TV viewing in 2008. By comparison, ITV got just over 9p per person from each hour of ITV1 viewing. In other words, each hour of pay-TV viewing generated over 2.6 times more revenue than an hour of ITV1.³²

Subscription is well-designed to exploit phased release and differential pricing, the business model at the heart of the content industries. It is best illustrated in the case of films but it applies equally to every creative sector. A film is released first in the cinema, following an often expensive marketing operation. The “theatrical” release is a film’s debut, the opportunity for a high-profile launch. It is the most expensive way to view it, but, in the cinema, you see it first and you see it in comfort, on a big screen. Following the theatrical launch, the film is released to other “windows”, in phases – to rental and retail media, to Pay-per-View options like Sky Box Office, to film channels and then, finally, to free TV. Each window has a different cost to the consumer – with the basic principle being, the longer you wait, the less you pay.

Subscription or Pay-TV works like that too – there are channels of new material and channels of repeats. Just as in film you have art-house and mainstream theatres, you have niche channels and mainstream channels. All the major fiction series can be bought on DVD, too. Look at it as elementary economics: the more points

32 Calculated by Dr. Farid el-Husseini using BARB and other data sources. See Television, March 2010.

at which you can touch the demand curve, the more money you will earn.

Yet it is not just about money. Subscription is more complex than that. I am a member of my county cricket club. I may only go there once a year but it allows me to exercise certain choices: I can wander over on a sunny afternoon and watch for an hour, or wait until a game gets to a critical point before slipping out of the office. I can influence policy by voting at meetings. What I belong to is also part of my social identity, the means by which I pursue a particular passion and share it with others.

Translate those differences into a media situation and we can propose a principle: channels based on advertising need to keep people watching for as long as possible; channels based on subscription need to offer items that people value highly. Value is worth more than Volume.

A model that attracts much attention in the UK is HBO, the US premium cable channel. It is an excellent channel, and it has a lot to teach us, but it not the right model for the UK.

About a quarter of US homes think it well worth paying a premium to get access to HBO. (Many others, of course, buy the DVDs later and there are healthy overseas sales). HBO makes and airs some of the world's finest TV drama – *The Sopranos*, *The Wire*, *Six Feet Under* – pinnacles of the art. Figures for 2007 suggest that HBO received just under \$9 per month from about 29m US homes, delivering revenues (including home video) of \$3.4bn. Of that it spent about \$1.5bn on production, making only about 140 hours of original content, a low volume compared with the amount of new

content made or commissioned by major UK broadcasters. Yet HBO is very profitable.³³

What HBO demonstrates is the value of quality content meeting a special need or giving a particular pleasure. HBO plays alongside “networks” like NBC or CBS, free to air channels reliant on advertising but which do not always meet the needs of homes that pay HBO subs. On the basis of (relatively) few hours of production HBO attracts the revenue required to make work of the highest quality.

HBO is often used as an example that tells us why subscription would not work in the UK. The reason? Because the 29m households who sign up for HBO are more than the total households in the UK.

What the HBO example *does* tell us is that people value choice and a lot of them will pay for content that they do not get from mass-audience “networks” like NBC or CBS. But that does not mean that HBO subscribers never watch NBC or CBS. Far from it. They watch networks too.

“Network” or mass-audience content is an important part of what the BBC offers. A subscription-based BBC would thus be offering incomparably more than HBO. If the BBC retains the majority of its current licence payers, it would be able, on a current monthly fee comparable with the HBO sub, to offer a comprehensive range of options – popular content, highly valued niche content, a complete service of news, entertainment and information. This offers vastly more value than the much-praised HBO.

33 This information was gathered from various sources by Zak Shaikh of Attention Inc.

The first step in this scenario is to ask: how many people would drop out and decline to pay? I do not know the answer to this question.³⁴ But if the system is well built and administered, the BBC has immense advantages to start with. Over 96% of the population of the UK watched one or other BBC service for at least 15 minutes in December 2009.³⁵ Its brand is extraordinarily well-formed and distinct. Its content is well-known and well-loved.

Big benefits would come from the extra intelligence that a subscription model brings. The BBC Licence Fee mimics the crudest commercial model – mass audience advertising – which simply requires presence or, to repeat an industry term, Reach. It delivers no intelligence about that presence – it simply tells an advertiser that someone is sitting there available to watch an ad. So the BBC has to use all sorts of additional survey tools to try and find out what people think about what they are watching. Subscription delivers so much more intelligence, in the form of a one-to-one relationship with each paying household.

How is this content to be delivered? I do not wish to be prescriptive as to whether BBC should deliver from its own platforms or from others. There is no reason why it should not be both. If the BBC delivers via other platforms, it should receive carriage fees, that is, fees paid by platforms like BSkyB, in the UK, to the channels carried on their platforms. In 2008 about 60% – 58.2% to be precise – of viewing on Pay-TV in the UK was to the Free-to-Air channels. In other words, the majority of viewing on platforms for which people

34 I searched for relevant work on “willingness to pay” and found nothing robust or recent enough to estimate the potential drop-out rate of licence payers or the potential revenues available from a switch to subscription. The work that I have seen suggests that people would put a wide range of values on BBC services, implying scope for phased release and differential pricing. In *Beyond the Charter (2004)*, referenced above, we surmised a dropout rate of 20%.

35 Source: BARB/Attentional, calculated by Fiona Keene of Attentional Ltd.

pay a monthly subscription remains to channels accessible from free TV. But despite accounting for the majority of viewing on pay-TV, the free-to-air channels do not currently earn a proportion of pay-TV subscription revenues (£4.32 billion in 2008).³⁶

Nor is there any reason to rule out advertising revenue – except on the basis of whether or not it enhances the value of the offering. Traditional advertising “breaks” are very intrusive and visitors to the US from other countries are invariably shocked by the length and regularity of the breaks. That too is changing: some new pay channels run with fewer ads or single “pre-rolls”, a single advertising message that has to be watched before the chosen content continues.

36 Source: BARB/Attentional Ltd.

12 An Ambitious, Outward-facing BBC

There is a world outside the UK that knows and values the BBC. The BBC should address it.

The UK is an island with a global footprint. The UK is also part of an economic unit comprising nearly 500m people. Moreover every country in the European Union (except UK and the Republic of Ireland) watches subtitled or dubbed English-language content in primetime. That should give the UK a huge competitive advantage. (The dubbed and subtitled content is currently, of course, usually American).

I have already referred to the 5m Britons who, according to BBC research, live outside the UK. But there are also millions of people around the world who would be ready to use the BBC as a source of both news and entertainment – and as a means to improve their language skills.

The BBC has, in BBC Worldwide, probably the largest content distributor outside the US. It already adds over £700m to the BBC Licence Fee revenues of £3.6bn. BBC Worldwide also operates the

many channels outside the UK which broadcast British material. It is therefore in an ideal position to pioneer the direct delivery of content outside the UK, along with the appropriate payment models. The problem – or opportunity, depending on which way you look at it – is that, as a legacy from the past, content is licenced on a country-by-country basis. The BBC, which controls a large block of content, is in a good position to move forward on this, and re-licence its own content for international carriage, always depending of course on the right technology phases and market conditions. The UK should join the European Commission in campaigning for an end to restrictive licensing practices.

13 Could the UK PLC do better?

The UK's strongest line in exports is probably Factual, consisting of documentary and natural history content. The BBC and other British broadcasters are famous for this around the world and this is clearly one of the spin-off benefits of extensive public funding. The UK does indeed also do well in Reality Shows and Factual Entertainment. Britain's independent producers, liberated by the Terms of Trade and starting with successes like *Who Wants to be a Millionaire*, have developed special skills and formats like the *X-Factor*, which are known around the world.

But the UK has performed less well in drama. The regular surveys of our export performance report that overseas buyers continue to say that our drama is too slow, and often comes in the wrong shapes and sizes. The international TV market is accustomed to US series lengths (annual series usually run to 22 or 23 episodes). Drama is a very important genre internationally, because so many countries can afford little drama of their own and use imported drama for large parts of their primetime entertainment. The US provides intense competition. But other flaws seem remediable, and not obviously at the expense of domestic tastes or quality. I once heard an overseas buyer describe most UK drama as

“talky and narcissistic”. Tough words, but not entirely inconsistent with the findings of the UK’s annual export survey which, like many others before it, tells us that UK drama is too “slow” and “gritty”.³⁷

It is instructive to look at the revenues of the six US studios, which produce most of the expensive content – that is, drama, comedy and entertainment – for US TV networks. Drama is the most important type of traded film and TV content. Figures for 2008 tell us that total revenues from licensing content and DVD sales by the six US studios was over \$21bn, with \$9.2bn – that is, 44% of total sales – coming from content sales outside the US.³⁸

There is no equivalent figure for the UK, but the TV Export survey conducted annually by Pact, the trade association for independent producers, indicates total sales of finished TV programmes (including DVDs) at £610m. (This survey does not include films, so it is not directly comparable with the US figures cited above). In addition the UK report does not break down the UK figures by genre. Assuming a large proportion of the £610m, say £400m, is probably fiction, it is nevertheless immediately obvious that the relationship between home and overseas revenues in the US and UK are totally different.

Should the UK not be setting its bar higher? Should we not aim to become the entertainment capital of Europe? We have significant competitive advantages. We are Europeans. We have a strong production industry. But despite competitive advantages and with some exceptions, the UK has not yet found enough narratives that resonate around the world.

37 “The main shortcoming of UK content is the low number of episodes per series specified by domestic broadcasters, whereas overseas buyers demand longer runs...Problems with UK programming were also cited, as it can be UK-centric, slower and more gritty than is desirable for international tastes.” UK Trade and Investment, 2008. Pact and UK Trade and Investment.

38 Source: Attention Inc. Data gathered by Zak Shaikh.

14 British Broadcasting in the Future

Let us imagine the future. I see the BBC as a modern communications company, known around the world, confident in its role, clear about its identity.

It would have as its main role its service to the people of the British Isles. But it also speaks to Europe, for in Europe it is the iconic broadcaster, the company that expresses, as other European firms do for their own countries and in other fields, not just that in which Britain excels, but the essential values and essential freedoms of a European country. At the same time, it must be smart enough, robust enough, and alert enough to find a track through great technical changes that are coming our way.

I am not going to be prescriptive about how it should set about meeting the objectives below. Both the BBC and BBC Worldwide have many talented and skilled executives, well able to start addressing the challenges posed by the following transition plan. Nevertheless, here are some ideas:

1. Starting now, the BBC should begin to investigate/explore all sources of revenue at home and overseas, and conduct detailed estimates of projected subscription revenues. It will need to make plans for all its services, including radio.
2. If it thinks these ideas have merit, Government should set up a Commission on core public service content, the size of the fund needed to guarantee it, and the means of financing it.
3. The Government should then start to explore the impact on other players. Government should review the TV production industry to determine the future of the current Terms of Trade. These steps will help to inform a new Communications Bill to be published in late 2012.
4. The BBC could be offered a transitional guarantee for three years from the date when licence payers would first be given the option to terminate licence payments and switch to voluntary subscription. This would come from a Public Service content reserve fund.

15 The Proper Role of Government

TV is still the most prevalent communications medium of the day. Government ceased “licensing” publications hundreds of years ago and licenced broadcasters are fast becoming an anachronism. But that does not mean Governments do not have legitimate interests and preferences, or that they do not need structures to accommodate and communicate them.

Indeed, Governments have legitimate concerns, and, in their custodial role, need the ability to address them. There is a framework of theory for such concerns – market failure, public goods, externalities, etc. – but here I merely give examples of what seem to me legitimate – indeed necessary – powers of government where communications are concerned.

News and Current Affairs: Widely disseminated, accurate information, relevant to political choices helps to inform the electorate. An informed electorate is better for everyone than an uninformed one.

Public Health and Welfare: A Government must be concerned about the health, welfare and human capital of its population.

If it wishes to promote its concerns or communicate the need for actions – and if it deems TV to be the right vehicle – it should have the freedom to do that. It would of course have to pay commercial operators if it wanted them to carry labelled Government content.

Children and Education: Government should certainly be ready to investigate possible negative side effects of mass entertainment if it thinks there are grounds for doing so. Young children watch more television than they used to and it may well have an impact on the way they are socialised. On the basis of sound evidence, a government should have the ability to amend or extend the content available to a group, such as young children, where a negative social impact or a clear opportunity to enhance social capital has been identified.

Heritage: Each country has its own culture and cultural legacy. A Government may find it appropriate to support re-creations of the “classics” of its own and other cultures on popular media.

Promoting the UK overseas: Mass media have an international dimension for Governments, sometimes called “soft power”, the way in which the positive features of a country are projected around the world. BBC News, for example, is highly regarded and trusted all over the world, whether broadcast on radio networks or, increasingly, via the internet. Our Government should be pleased to see a stronger role for UK content around the world. It currently supports this objective by funding the World Service.

Market Failure: We have already alluded to “market failure”. A Government might well wish to determine if each part of its population is getting what it wants, and if those wants are available at reasonable prices – though not necessarily from a specific

institution. If not, it may wish to determine if this is the result of flaws in the structure of the market and act if it deems fit. Market failure is an economic term with a specific body of theory behind it. It may have been comprehensively misused to justify large-scale and continuing intervention in broadcasting, but it should still be part of government's toolbox.

The items on which there is a high degree of consensus for proscriptive rules – pornography, incitement, for instance – are in fact rather specific and a relatively small part of our entertainment landscape. While civil liberties advocates will and should debate the precise way in which these are limited, monitored or controlled, they are not issues which need detain us here.

I do not think this list is comprehensive, and, as above, many of these requirements have multiple potential solutions, some of which need not involve broadcasting at all. In thinking about its role, Government should put content and access first.

But because Government will also want a robust, competitive successful broadcasting industry, it will recognise that interventions cost public money and distort markets. A prudent Government will be rigorous in its choices and careful about what it spends. In a country with a strong tradition of freedom of speech, its role will be watched and critically reviewed.

It is now time in the UK for government to take back governance of public service broadcasting and look for the policies most likely to provide economic growth from our communications industries. I believe that the key public service tasks that Government would need to fulfil would cost some hundreds of millions of pounds a year, a figure far short of the current £3.6bn BBC Licence Fee.

16 How Will Public Service Content be Funded?

The body established to administer public service content would, in essence, be a body established to monitor and remedy market failure. In the medium and long term it would be the body that would monitor communications and determine if widespread needs were being met and if not, what should be done. It would have to address all the unexpected developments that rapid structural and technology change might throw up. It would also have to ensure that core public service requirements were being met.

The internet has delivered wholly new ways of delivering social messages and the need for efficiency should keep the best way to deliver them under constant review. The needs and the best available technology will change constantly.

I therefore think Government should set up a body to administer the transition with a reserve of, say, £300m for content funding. It would not commit to spend it but, as part of its negotiation with the BBC, determine first what core public service content the BBC was

ready to deliver. The BBC would have an incentive to do as much as possible to keep its centrality, in the minds of the population, as the organisation which you want to be connected with. As I have tried to explain, people think and act very differently as subscribers than as consumers. Part of the pleasure and satisfaction of membership is that the body of which you are a member offers both personal and social benefits.

This commission could then consider using part of its fund to support free content on other platforms.

17 Conclusion

I expect criticism for this work. I am sure some will say that the UK is too small a media economy for unaided market mechanisms to generate enough quality original work. This should not be accepted as a given. If our Government is going to aim for “new trade routes” along the internet, if we are going to encourage a new spirit of entrepreneurialism, then subsidy and protection are not the ways to do it. Change involves risk but featherbedding promotes decline. It may be a widely held view across Europe that no country can compete with the US and that all need public support for indigenous production. Yet a “common audiovisual market” is an aim of EU media policy. The UK could be the first European country to challenge protectionism and subsidy-dependence.

No regulatory system should deprive consumers of the benefits of change. If the emphasis is on the protection of specific institutions, it runs the risk of failing them. Government needs to move on from protecting *institutions* to ensuring that the system as a whole delivers what the community needs from its communications media. At a recent conference, a speaker from another country said that the UK media industry had a reputation for “negative innovation”, that is changes designed to protect the interests of existing institutions and structures. That does not preclude

transitional arrangements that preserve a degree of stability, but there is truth in what that speaker said.

The technologies of media production have, in fact, been in constant change for 50 years. In my own period of employment in the UK media, I have seen the switch from film to video, the arrival of computer graphics, and numerous innovations in editing technology. They have invariably resulted in cost reductions and efficiencies. Along with the development of satellite and cable, these have together delivered more output and more choice. We may or may not be on the verge of a revolution in delivery systems driven by universal fast broadband – it is too early to say. However, we can be sure that the technology will keep changing and the trend will be to make it easier and cheaper to produce video content and deliver it.

Let me add a personal reflection. During my career I have consistently argued for the liberalisation of our market, and with others, have campaigned successfully for Channel Four to be a “publisher”, sourcing content from independent producers, for a BBC quota for independent producers, and for mandatory Terms of Trade which enabled producers to exploit their own content.

I was fortunate enough to be asked, in September 1987, to attend the Downing Street seminar, chaired by Mrs Thatcher, on broadcasting. At some point she said words to this effect: “The thing is, the old guard want to keep what they have and the new ones want it for themselves.” I sensed she thought Government’s role was to enable transition, often against opposition from incumbents, and that this cycle of change was what delivers public value to the community, the “service” that society expects from the rich and famous.

Those who play a vital social role in the community, and who do not earn high wages, should have both esteem and security. The ambitious and wealthy take their chances in a rougher place where change is lurking at their door. That's how they make their contribution.

Over twenty years later I was at another seminar. Present was Tessa Jowell MP, who until a few weeks earlier, had been the UK Culture Secretary. "The trouble is: the BBC wants the benefits of the private sector without the risks", she said. I was surprised at the vehemence with which she said it and sensed regret that she had not done more, while in office, to confront the Leviathan.

I will end on a different note. The BBC is a great institution. This report is one person's attempt to fit it for the future. Because I see that future as a global one with a powerful European flavour, I offer these words attributed to the French chemist Lavoisier: Rien ne se perd, rien ne se crée, tout se transforme.³⁹

39 "Nothing is lost, nothing is created, all is transformed."

Q&A

What will be the BBC look like in five years time?

I see a BBC with the global presence of Hollywood studio, but with a wider range of output than a Hollywood studio and an especially strong presence in news and documentary output. Whether delivered direct or via other platforms, I expect that the BBC will prefer advertiser-free services without ruling out advertising. Over time, services delivered outside and within the UK would become very similar.

What will we lose? How will the BBC change?

Radio 3, the Proms, Radio 4, Newsnight, News on BBC1, smaller channels like BBC3 and BBC4? The BBC will not stay the same for ever, but I do not see why any of these need inevitably go. The BBC and the Government must look hard at each service. While the Government should decide what must be free and available to all, the BBC will have all sorts of new funding options to explore: commercial partnerships, sponsorship, subscription on many different tiers, even advertising (especially where new, less intrusive options are emerging), and enhanced revenues from overseas.

Will content made for the UK suffer if overseas revenues become more important to the BBC?

Absolutely not. All the evidence suggests that it is the best content that travels. The BBC's primary audience will still be those who physically live in Britain, along with those who want to experience life in Britain remotely.

Are you talking about privatisation?

I am not certain that the changes that I recommend positively require this. Frankly, this question needs more work.

How will the interim phase work?

The British public, the Government and the BBC will all benefit from as much continuity as possible. First, both the BBC and the Government will need a period of intense internal review to build the knowledge needed to implement a new framework. Then, over a transitional period, subscriptions would replace licences as they fall due. During this period, BBC would retain all its current privileges with a fixed sum allocated by Government to cover possible licence fee losses. This should ensure little change in current output over the interim phase.

What would the timetable be?

The Government has said it is looking to settle a new Licence Fee in April 2012 and publish a Communications Bill in late 2012, to become law in 2015. The current BBC Charter ends in 2016. In my view, it would be in the interests of the Government and the BBC to switch to subscription before the end of the current Charter.

How do you determine the core elements of PSB?

This is essentially a political decision. Government needs to determine the core types – and quality – of media content it wants to see available to all citizens. (I suggested earlier what such core items might be). It would only need to fund core PSB content not otherwise available. It should consider all media options for delivery of PSB content. Some current PSB obligations of broadcasters may be reviewed and delivered by other means.

How would Government pay for PSB?

I cannot say in advance what core PSB content would cost the Government. It would therefore be sensible for Government to create a reserve of, say, £300m, available for PSB content, as and when it puts the new framework in place. This money could come from direct taxation or out of spectrum charges or from other sources.

How would Government ensure that PSB content is freely available?

PSB content on channels or platforms financed completely by advertising would be free anyway. Core PSB content on pay-TV or subscription channels would have to be unencrypted or available without the need for payment. It is technically quite possible to insert free items into a stream of paid content.

How would the providers of PSB content be compensated?

As I have said above, the “market” may provide some core PSB content without subsidy. However, Government would compensate certain providers for freeing up subscriber content that meets PSB criteria. Other content Government might have to pay for.

Government could use the Return on Investment (ROI) approach to arrive at a reasonable marginal cost. A channel or platform carrying free content would require a reasonable ROI, but there may be marketing and brand benefits from carrying such material and Government should exploit this.

Would the Terms of Trade for independent producers remain in place?

I am aware that many people see the subsidy derived from the Licence Fee as supporting a high level of independent production. The current Terms of Trade are a regulatory intervention based on the very high concentration of commissioning of new content within a few broadcasters. They will no doubt be reviewed periodically. If the situation remains as before, there would be a reason for retaining the Terms.

How do you investigate market failure?

Government would use the same techniques to investigate both a widespread but unmet demand for a given type or quality of content and a core PSB requirement that cannot be met without funding. The techniques I am talking are available to competent consultants.

To investigate market failure, you need accurate data for the costs of given types of content and good estimates of what such content can attract on various platforms, windows, and revenue models. This enables the calculation of the potential ROI for a given type of content. If none of the models suggest an adequate return, Government may be prompted to rethink current policy, just as it has already proposed changes in cross-ownership rules to encourage local and regional news.

What happens to BBC Radio?

Radio is a special case in the digital world, for there is no conditional access option and therefore no possibility of subscription services. In practical terms, there is no subscription option for radio. On the other hand radio is a very efficient way of delivering news and information services. Radios 1, 2 and 5 could be funded by advertising with, perhaps, some paid-for PSB segments. Radios 3 and 4 would more likely remain fully funded PSB.

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