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The competition discourse in British broadcasting policy

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Abstract

Successive UK governments since the mid-1980s have sought to create a more competitive framework between firms in broadcasting through interventions which constrain the market power of dominant players. In this working paper the gradual encroachment of the competition discourse is described as it undermined the longstanding social democratic model for broadcasting regulation while ignoring lessons from the USA about the consequences of the changes being wrought. The effect of the influence of this discourse on the regulatory framework, and the evolution of the business models of production companies, is traced as, over time, increasing consolidation between production companies and foreign ownership of the production sector occurred.

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Introduction

This working paper seeks to establish the political and economic context for the evolution of the business models of firms which produce TV drama in the UK today. Competition law has played a more significant role than has heretofore been noted in the successive political interventions which have changed the regulatory environment for television production. This has resulted in the continuing evolution of the types of firm operating in the sector, their business models and ownership. Today the competition discourse has become dominant and in so doing overturned the longstanding social democratic model for broadcasting regulation which had been based on ideas of pluralism and public interest.

A new type of regulation for telecommunications emerged in the early 2000s with the creation of Ofcom, a converged regulator (Simpson 2004), and this increasingly impinged on broadcasting developments. Lunt's and Livingstone's (2012) review of the regulatory environment with Ofcom's establishment focused on the impact of regulation on the audience and concentrated on the social democratic deficit which had emerged from this intervention. However, while the interests of audiences are clearly a crucial matter for broadcasting regulation, which programmes are produced and by which firms are key prior considerations in the regulatory domain. It is this area that is the focus of the analysis here.

Creating a competitive framework between firms and negotiating the relative power of stakeholders, has been the objective of successive governments utilising the legal frameworks enshrined in European Community law and variously expressed through the Restrictive Trading Practices Act (1976), Competition Act (1998) and the Enterprise Act (2002). UK audio-visual policy since the 1990s has broad similarities with the 'ordo-liberal' approach, which seeks to create entrepreneurial forms within society (Lemke 2001). For ordo-liberalism the market can be constituted and is kept alive only by dint of political interventions. The drift to a market-based system based increasingly on competition law has underpinned the changed environment negotiated by production companies. It has altered their operational and organisational structures as the new market conditions have been established. However, like the market, competition, too, is not a natural fact always already part and parcel of the economic domain. In 2011, *The Economist* noted 'the smart industrial strategy for television production that Britain stumbled into where the state meddles in an industry in a way that promotes competition and dynamism' (5 November 2011). However, whether or not the outcomes were intended this strategy has to date a telling conclusion: there is no British TV drama production company of scale which has emerged in the independent production sector that still remains in British ownership. In short, British broadcasting has become ever more reliant on large, and often vertically integrated, foreign-owned ‘independents’ alongside the legacy duopolistic companies.

And, as will be traced below, the key intervention was the change in 2004 in the terms of trade between the commissioning broadcasters and production companies designed to bolster the independent production sector. What is perplexing is that this intervention stands in sharp distinction to the measures introduced and then abandoned in the US two decades earlier to address similar issues: seeking to curb the perceived buying power of the vertically integrated networks when contracting with independent suppliers of programmes. These fundamental changes in the relationship between the broadcasters and the production sector in the UK accentuated the reforms wrought in the 1980s and have resulted in the British broadcasting environment that now exists: fragile and dependent though seen as strong and a key export growth industry, but now weakened in its capacity to realise the ambitions which were attributed to it in previous decades. Following the changes of the last thirty years there must be growing concern that the once much-lauded British television industry is now becoming, like Britain’s film industry, a mere adjunct of globally dominant US companies, continuing to produce innovative programmes in the UK but increasingly dependent on foreign capital and making programmes addressing a global audience.

In a linked working paper, the consequences of these changes will be traced through an examination of the evolution of UK TV drama production companies.

Regulatory interventions

Broadcasting in the UK, as in most states, has almost always been subject to some form of regulatory intervention. The policy objectives have changed over time. In the last thirty years there has been a far reaching change from a social democratic model of public service broadcasting supported by a legislative framework to a market-based one invoking competition as the primary objective. Key interventions are now justified as combatting disparities in market power between producer and broadcaster. As Ariño (2004) has noted competition law applied by competition authorities has become the primary instrument of public intervention in communications industries. This trend has continued as platforms have proliferated despite doubts about the consequences expressed by commentators and key industry figures[1].

[1] At the Edinburgh International Television Festival in 2014 David Abraham was the first industry figure to comment on the dangers of the emerging changes in the production sector.

Many reports about Britain's TV production sector have been written in the last fifteen years as the dominant competition discourse took shape (Mediatique 2005, 2008, 2015; Oliver & Ohlbaum 2008, 2011, 2014, 2015; Ofcom 2005, 2006, 2007, 2015, 2016; David Graham & Associates 2000). In late 2015, Ofcom was requested by the Secretary of State for Culture, Media and Sport to review the terms of trade which had been introduced in 2004. That report, *Review of the operation of the television production sector*, outlined the operation of the Code of Practice which underpins the contractual negotiations on programme tariffs between 'qualifying independents' and broadcasters. *Inter alia*, it noted that there was now a smaller number of producers, with the top ten producers accounting for 66% of all UK producer revenue as well as an increase in vertical integration and of the level of foreign ownership. However, although the number of independent companies had halved from 450 to 250 in the previous 8 years, the continued high level of entry was seen as confirming that the conditions existed for disruptive new companies to enter the market. Unsurprisingly, it did not assay the results of the earlier interventions which had led to an industrial strategy for broadcasting which was dependent on inward investment and had weakened rather than strengthened the UK's ability to establish scalable companies able to compete in global markets. Furthermore, there was no consideration of whether the changes might lead to a reduction in programmes which reflected the diversity of Britain.

A series of connected reports underpin the current economics and organisation of UK broadcasting production. The Peacock Report in 1986 undertook the first full economic analysis of the changed ecology of production following the creation of Channel 4 set up by the Broadcasting Act 1980 following the Annan Report (1977). Then, in 1992/93, there were changes to the networking arrangements at ITV after the linked Office of Fair Trading and Monopolies and Mergers Commission (MMC) reports on the operation of the Network Centre, whose recommendations set loose the discursive genie of competition and markets into the UK broadcasting discourse. Finally, in 2002 the Phillis Report for the ITC proposed amendments to the terms of trade between the commissioning broadcaster and the independent producer.

As will be described in a forthcoming working paper on TV drama production, these interventions have had a direct bearing on the business models of production companies. Firms have evolved as the market and incentives have changed thereby altering the 'fitness landscape'[2] for production companies with increasingly powerful foreign owned and financially secure 'independents' (non-

[2] The concept of 'fitness landscape' and associated terms is utilised in the analysis in the related working paper. It derives from the work of Stuart Kauffman (1993) whose work on biological statistics and complexity theory has been developed in work on organisational ecology by McKelvey (1999), Macready (1995) and others.

qualifying independents) now operating alongside a reducing number of autonomous ‘qualifying’ independents[3].

Markets and competition

UK broadcasting policy has gone through a series of phases. After the end of the monopoly period in 1955, when ITV was established, until 1982 with the establishment of Channel 4, programme production had been principally carried out by the duopoly, the BBC and ITV network companies - vertically integrated firms, producing, broadcasting and distributing TV programmes. Thereafter programme production became fragmented and subject to successive regulatory interventions as more than 1,000 firms were established in a vastly expanded independent sector following the foundation of Channel 4 as a publisher-broadcaster which by statute had no programme production capacity.

Where before 1982 independent production companies were few in number, thereafter many companies were founded but equally many went out of business: a census of firms operating in the programme production space in the last thirty years shows both a changing density of operational companies (gauged by commissions or registration as a member of the trade organisation, PACT) and a variable landscape of firm types over the period.

Measures - quotas and later a change in the terms of trade - have been introduced in succeeding years to foster a competitive market in programme supply. As noted above, current trends are towards increasing consolidation and vertical integration, alongside an expectation from Ofcom of continuing company formation. These start-ups, particularly in drama production, often rely on financial support from existing major players.

There have been significant changes in the business models of companies producing television programming over the past 40 years, as broadcasting in the UK has moved progressively from a social democratic model to market-driven competition. Lunt and Livingstone contend (2012; 20) that ‘social democrats have increasingly, though not without contention, come to accept the liberal argument that markets must be deregulated […] so as to encourage competition and stimulate innovation while also protecting consumers’. The acceleration of this acceptance after the early 2000s led to major changes in relationships across the value chain as the interdependencies of talent and production with distribution and platforms/channels were transformed. As competition law was

[3] Non-qualifying independents are those companies which are owned by broadcasters active in the UK market.

increasingly applied in the legislative discourse of broadcasting it led to pressure on the established conception of public interest, which had been the accepted normative framework even after the creation of Channel 4. An examination of the deployment of the competition and market discourse in broadcasting policy indicates the often unwitting complicity of major actors over more than 30 years in a series of market-driven interventions which has transformed the broadcasting ecology.

Key interventions or changes in market conditions since the late 1970s

1977	• Annan Committee recommends creation of Open Broadcasting Authority
1982	• Channel Four launches as a publisher-broadcaster
1986	• Peacock Committee recommends 40% quota of independent productions on BBC and ITV
1987	• Voluntary quotas for independent productions introduced by BBC and ITV
1988	• White Paper: *Broadcasting in the 90s: Competition, Choice and Quality* • Launch of Sky Television
1990	• Broadcasting Act establishes 25% statutory quotas of independent productions on BBC and ITV; provides for involvement of Office of Fair Trading where there are competition issues
1991	• ITV Franchise Auction
1992	• Consolidation of ITV network (1992-2004) • Channel 3 Networking Arrangements report by Director General of Fair Trading
1993	• Monopolies and Mergers Commission (MMC) Report on ITV Network Centre • BBC Producer Choice introduced • ITC replaces IBA as broadcasting regulator with different terms of reference
2000	• Publication of the Communications Bill
2002	• Joint Committee of the House of Commons and House of Lords reviews Draft Communications Bill • ITC Report chaired by Bob Phillis recommends changes to terms of trade for independent sector
2003	• Communications Act mandates a code of practice on terms of trade • Ofcom established as competition and content regulator
2004	• Negotiated terms of trade and codes of practice come into force • Merger of Carlton and Granada to form ITV plc
2006	• BBC Introduces Window of Creative Competition (WOCC) and reduced in-house guarantee
2013	• Tax incentives introduced for ‘High-end TV Productions’
2016	• BBC announces abolition of WOCC and in-house guarantees and sets up BBC Studios

The competitive framework in broadcasting

In the late 1940s the first analysis of broadcasting economics in the UK was the pioneering work of Ronald Coase on the BBC as a monopoly actor. This coincided with – indeed was in a way a part of – the Beveridge Committee inquiry into broadcasting which looked closely at the monopoly position of the BBC. Coase’s analysis subtly criticised the monopoly of the BBC. For example, he queried a situation where writers were ‘working for a monopoly selling in a permanent buyer’s market' and observed that there was a tendency 'to exaggerate the advantages which accrue to large-scale organisation and to minimise the disadvantages'. He believed the disadvantages would 'be particularly noticeable in such creative work as that involved in the production of broadcast programmes' and concluded that 'it is reasonable to assume that the force of competition would operate as a stimulus to improvements of all kinds' (Coase, 1949:185). The Beveridge Committee's report acknowledged the importance of competition in ideas but discounted the market and resolved only to recommend reforms to guard against those possible adverse consequences of monopoly.

The minority report to the Beveridge Committee by Selwyn Lloyd, a Conservative MP who would later become Foreign Secretary and then Chancellor of the Exchequer, suggested a different solution. He disputed the argument for protecting the higher social values espoused by the BBC (he recoiled from Reith's glorying in the 'brute force of monopoly' to underpin a policy of moral responsibility) and sought regulated commercial competition as was already in place in Australia and Canada. The 1954 Television Act followed this alternative prescription and introduced a commercial 'independent' television system under the aegis of the Independent Television Authority (ITA). Competition was a central ambition of Sir Robert Fraser, the first Director General of the ITA. He wrote (quoted in Sendall, 1982: 66): 'Although I want the system to be vertical in *control*, I want to see it largely horizontal in operation, in the movement of programmes - that is, I want a network connection technically capable of giving an unlimited introduction of programmes from any one region into either of the others. […] Each will be eager to sell, each eager to buy. […] This will be competition with a vengeance, and with all its fruits. The network must be optional - or it is not competition but cartel or market-sharing. […] I would like to see the Authority insist that each producer company should secure a proportion of its own original programmes from sub-contractors. I do not see why this should not be fixed as a percentage, either. This would give competition at another level. Sub-contractors would be in competition with one another and the main contractors would be competing with one another for the best programmes of the sub-contractors. If the network were compulsory there would be only one buyer for sub-contractors to approach'.

The reality of what later came to be called the 'carve up' never conformed to this vision of a competitive supply of programming. Independent Television was destined to become a semi-monopolistic system under powerful public control for many decades. As Sendall noted - somewhat pointedly - 'the very success of the two-tiered system (public authority and private companies) eventually so diminished the appeal of the ideals of competition which prevailed in 1954-55 that competition in television, saving in the form that exists between the BBC and ITA, fell out of favour' (ibid: 67). With what became seen as the cosy duopoly between the BBC and ITV, the British television system became very successful culturally and economically and rated by many as one of the best in the world. This was a vertically integrated system with production and distribution under the control of the BBC and a set of commercial companies regulated by the ITA.

The undermining of Britain's vertically integrated broadcasting sector started with the publication of the Report of the Annan Commission in 1977. It forcefully argued against a continuation of the duopoly[4] - which it saw as preventing experimentation - and responded to calls that a fourth channel should enable access for independent productions to the airwaves by recommending a publisher-broadcaster - an Open Broadcasting Authority to be set up alongside the BBC and IBA[5]. This was its version of competition, not justified by the market, which it saw as constrained by available financial resources, but as a source of creativity and free expression. The consequence of its recommendations, and the Conservative government's interpretation of them as a fourth channel financed by the ITV companies, but with a remit to commission programming from independent production companies, was launched in 1982. 'Independence' for a production company was defined in the legislation as *not* having a shareholding of more than 15 per cent by a broadcaster (later increased to 25 per cent). However, the framing and economic viability of this intervention were only really subjected to stringent economic analysis in 1986 by the subsequent Peacock enquiry, which focused on consumer sovereignty and sketched its vision of future market developments of broadcasting. In so doing it went beyond the scope of its terms of reference – which were centrally about the future financing of the BBC. During its deliberations the enquiry was lobbied intensively by the nascent independent sector to open up the duopoly to a supply of programming by those companies[6].

Channel 4's launch had resulted in the founding of a plethora of new small independent production companies - the barriers to entry were low and, where necessary, Channel 4 offered business planning to these new entrepreneurs. By 1986 it had become clear that commissions from a single channel could not support the aspirations of this number of start-ups. Markets now increasingly became a defining factor in the organization of British TV and how firms might negotiate the commissioning and licensing of programmes a continuing factor in policy deliberations. Furthermore, with the advent of satellite television (Sky Television launched in 1988) the previous

[4] At the time the BBC the operated two TV channels and ITV one.
[5] Anthony Smith's article 'When any number makes Four' in *The Guardian*, 21 April 1972 was widely acknowledged as especially influential.
[6] See Darlow (2004) for a detailed account of this successful lobbying campaign.

constraints on channel availability because of spectrum scarcity became ever more central in the wider political calculations of Government.

Even though the Peacock Commission explained that the broadcasting market was different in that there was a ‘good case for public financing of some broadcasting services which arguably cover such general benefits on the community’ (1986: 29) it recognised the need for firms to be able to gain commissions from more than one buyer, recommending quotas of independent productions for both the BBC and ITV. The duopoly was effectively broken - leading in time to wholesale changes in the structure and organisation of the whole production sector (Producer Choice at the BBC giving programme makers the power to buy services from outside the Corporation, the appointment of publisher-broadcasters in the ITV Network, and the debacle surrounding the creation of ITV’s Network Centre[7]) and an erosion of vertical integration with increasing reference to competition law in determining broadcasting policies.

Peacock’s Report was followed by a White Paper in 1988 (*Broadcasting, Competition, Quality and Choice*) and then the 1990 Broadcasting Act. One small addition to the wording in the latter can be seen, in retrospect, as the poison pill, with the introduction of a competition regulator – the Office of Fair Trading (OFT) – alongside the newly-constituted Independent Television Commission (ITC) in determining the shape of commercial broadcasting. Section 39 of the 1990 Act – ‘Networking Arrangements between holders of regional Channel 3 licences’ – provided for details of proposals for participating in such arrangements to be sent by the Commission to the Director General of Fair Trading. It stipulated that the ITC had to consult with him and ‘if he requests […] any change in the guidance, shall incorporate the change in the guidance’[8]. Darlow (2004) provides candid insights into the lobbying process which led to the introduction of this clause. Legal counsel for the Independent Programme Producers’ Association (IPPA) had advised in 1987 that the ITV networking agreement was ‘probably a breach of the Restrictive Practices Act’. He recounts how frustration with the ITVA’s unwillingness to negotiate led to IPPA urging Government in early 1988 to refer the ITV networking agreement to the Office of Fair Trading as anti-competitive (ibid: 475). The independent producers had learned from Peacock’s critical analysis of the ITV system and identified the weak spot in the longstanding arrangements.

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[7] The ITV Network Centre was designed to provide a central coordinating function between the companies franchised to provide the ITV service. The differential power between the network companies (the larger franchises which provided most programming to the whole network) and the smaller regional companies (which aspired to provide a greater proportion of this network fare) had been a growing source of tension in the 1980s, leading to experiments with various arrangements. See Bonner and Aston (1998) for a full account.

[8] The legal basis for the reference to the OFT was the 1973 Fair Trading Act.

The 1990 legislation also introduced a further range of competition-inspired measures, in particular removing Channel 4 's reliance on ITV for advertising sales (and eventually severing the umbilical cord providing a financial safety net), altering the terms under which ITV franchises would be awarded, and perhaps most important, in creating the Independent Television Commission (ITC) to replace the IBA[9]. The ITC was to be the licensing body and regulator whereas the IBA was a broadcasting regulator and the legal publisher of ITV programmes. The subsequent 1996 and 2003 legislation wrought yet further changes leading to a series of changes in ITV. Consolidation of the companies owning the franchises began in 1992, resulting eventually in the emergence of ITV plc when Granada and Carlton, the two surviving major companies merged in 2004, with encouragement from a government in thrall to convergence and in the wake of the failed digital terrestrial service OnDigital.

Peacock's admonition of the IBA for not advancing competition on ITV, the IBA's inability to influence the ITVA in its negotiations with the independent producers, and the legal opinion that current practices were anti-competitive, together with a recognition that a solution was needed to this problem, had begun further to unravel the settled environment for the duopoly broadcasters[10]. There is a significance to the changing role of the regulators: the ITA and IBA were seen as poor regulators (the cosy duopoly) and the poison pill of future OFT involvement can be attributed partly to Peacock's scathing criticism of them. Once competition had been introduced as an element of regulation, the transition from the ITC to the regime later enacted through the Communications Act in 2003, with the creation of its much more wide-ranging and powerful successor, Ofcom, completed this evolution. Public interest issues faced an accelerating decline in the broadcasting sphere.

[9] See Goodwin (1999) for an account of the impact of Conservative Government policies on UK broadcasting between 1979 and 1997.

[10] Furthering the invasion of competition discourses into British broadcasting policy, Rupert Murdoch delivered the MacTaggart lecture in 1989 at the Edinburgh Television Festival claiming that 'in every area of economic activity in which competition is attainable, it is to be much preferred to monopoly'. (Murdoch, 1989: 3)

The changing regulatory framework

Within a few years of the 1990 Act, the operation of the newly established Channel 3 (i.e. ITV) Network Centre was indeed challenged and duly referred to the Office of Fair Trading.[11] This was the defining victory of the independent production sector. The report by the Director General of Fair Trading (DGFT) in 1992 summarised how the 1990 Act had changed the landscape of UK broadcasting. He commented that with the emphasis on liberalisation and deregulation of markets 'the [1990] Act requires the examination of the competition implications of these [networking] arrangements' (Office of Fair Trading 1992: 23). The application of the 'Competition Test' to the ITV Networking Agreement required that there be no restriction, distortion or prevention of competition in connection with *any* business activity in the UK. Furthermore, arrangements should contribute to the improvement of the production or distribution of goods or services or contribute to promoting technical or economic progress. As the DGFT considered that the Network Agreement imposed unnecessary restrictions and diminished competition, he specified modifications which he considered necessary to satisfy the Test. This was an early indication of the way the OFT drew on European competition law and jurisprudence as it became dominant in UK law[12] (completed with the passage of the 1998 Competition Act and 2002 Enterprise Act), as powers which applied specifically to the broadcasting sector increasingly became secondary to general competition powers.

The OFT Report rejected the argument made by the ITA in 1972 to the Select Committee on Nationalised Industries that 'if the responsibility for the production of the bulk of the programmes which are distributed for national showing is fragmented over too many centres, an uneconomic system of working results' (House of Commons 1972: 41). In the Director General's view, echoing Fraser's comments in the mid-50s, 'even with a single network, competition could have existed in the supply of programmes to the network' but the Authority had 'decided to pick the main suppliers itself' (Office of Fair Trading 1992: 22).

The problems and issues with the recommendations largely went unchallenged, as the primary stakeholders in the discussion were the ITV companies seeking a settlement at a time of considerable change with the franchise auction, along with the Producers' Alliance for Cinema and

[11] Set up in 1973, the Office of Fair Trading's operations developed within the framework of developing European Competition Law whose provisions influenced various legislative measures before its eventual incorporation into substantive UK competition law through the 1998 Competition Act. The OFT subsequently became responsible for enforcing competition law following the Enterprise Act 2002. Bryan Carsberg, DGFT when this matter was referred to the OFT in compliance with the 1990 Broadcasting Act, had previously been the Director General of OFTEL, the then telecommunications regulator.

[12] Cf. *Report of the Joint Committee on the Draft Communications Bill* 2002, p.39

Television (PACT) eager to further its members' interests[13]. The main issue driving the report was ostensibly the improvement of access for the independent companies to the newly formed Network Centre whereas in fact it was about the ownership of the intellectual property rights (IPR) in programmes commissioned by the ITV companies.

The application of the Competition Test was the fulcrum of a revision of the terms underpinning broadcasting policy in the UK. Although the ITC, which had replaced the IBA as the regulatory authority, and the ITVA appealed to the Monopolies and Mergers Commission (MMC) against the OFT recommendations, they were unsuccessful and a slightly revised version of them was imposed. This created conditions that pushed competition to the very top of the broadcasting policy agenda. Almost unwittingly, competition conditions came centre stage, albeit amplified by PACT's concerted lobbying.

It is little realised that the MMC analysis has influenced *all* subsequent interventions. Lobbying by PACT in the 1990s for better terms of trade – and the supporting evidence of a lack of investment in independent production companies – were paralleled by radical changes at ITV after the franchise renewals and subsequent wholesale consolidation of the ITV companies. This occurred alongside the fundamental transformation of the BBC's operations through the introduction of Producer Choice, catapulting many individuals out of the vertically integrated broadcasters into a more precarious existence either as freelancers or in some cases as new entrepreneurs running their own production companies. PACT had also complained about the BBC practice of using BBC Worldwide investment to deprive producers of what it saw as a fair share of the value of programmes in secondary markets. Now markets, profit and shareholder value increasingly took priority over wider public interests. The consequences of this revisionist emphasis of the discourse of competition were taken up again by the ITC in 2002. The role of the regulator had been undermined (or captured) through the successful lobbying of a sympathetic Government by the firms and entrepreneurs in the independent production sector (Darlow 2004).

Steemers (2004) provided an account of the series of reports which preceded the legislative changes made by the newly elected Labour government after 1997 as it formulated its plans to create a new 'converged' regulator, Ofcom, bringing together nine existing agencies. The White Paper *A New Future for Communications* (2000) continued to subscribe to the need for different regulatory frameworks for broadcasting and telecommunications but was emphatic on the benefits of

[13] PACT was formed in 1991 when IPPA merged with the TPA (The Producers' Association).

competition for ‘consumers’. However, as Steemers notes, this attempted balance between competition and public interest was altered during the passage of the legislation so that, as Simpson (2004) suggests, competition factors central to telecommunications regulation began to leach into those for broadcasting.

The Phillis Report

The key instrument of change in the relationship between the production sector and the commissioning broadcasters in the early 2000s stemmed from the *Phillis Report* for the Independent Television Commission (ITC 2002). This report was commissioned after lobbying by independent producers when their concerns seemed to have been overlooked as government modernised the regulatory structures. Its deliberations followed immediately after and complemented those of the Joint Committee of the House of Commons and the House of Lords. Chaired by Lord Puttnam and with Bryan Carsberg, former DGFT as one of its appointed advisers, the Committee had reviewed the draft Communications Bill. *The Phillis Report* based its evidence gathering, analytical framework and interventionist recommendations on the 1993 Monopolies and Mergers Commission’s investigation of ITV’s Network Centre. Despite the example of the US experience of failure of Fin-Syn (Financial Interest and Syndication Rules), designed to stop the US networks monopolizing the broadcast market by preventing them from owning any of the programming that they aired in prime time, the *Phillis Report* recommended similar changes to the terms of trade between broadcasters and independent production companies. Broadcasters would fund the programmes they commissioned but would only gain limited transmission rights, with the production company able to exploit secondary markets with control over the programme’s IP.

The foundational importance of the Channel 3 Network Arrangements prescribed by the Monopolies and Mergers Commission (MMC) in 1993 was made clear in the *Phillis Report* but the competition discourse was elaborated through a series of filters. Buyer power, i.e. the power of the broadcasting commissioners, was seen as too great and required intervention to allow a more equal negotiation over rights. The analysis of programme supply led to recommendations for the revised terms of trade and a code of practice which were subsequently embedded in the Communications Act 2003 (S.318)[14].

[14] The ITC Review of the UK Programme Supply Market (*the Phillis Report*) in 2002 was chaired by Bob Phillis, formerly Managing Director at Carlton Television and Deputy Director-General of the BBC, and its membership included Ann Bulford (at the time Director of Finance and Business Affairs at the Royal Opera House but now BBC Deputy Director-General), and Sir Howard Stringer (then Chairman of Sony).

This measure was ostensibly designed to boost the ability of the independent sector to create sustainable businesses and to profit from the secondary market exploitation of programmes commissioned by the public service broadcasters. The market and competition discourse writ large in the White Paper *A New Future for Communications* (DTI/DCMS 2000) had now become centrally embedded in and extended to influencing how the British state constituted the relationship between the broadcasters and the numerous companies involved across the supply chain. Furthermore, although the market was still dominated by the public service broadcasters, it was facing increasing competition from Sky, the satellite platform carrying multiple subscription-based channels - but these factors were also discounted in the report. The *Phillis Report* asserted that ‘the independent sector remains fragile - producers lack the scale to diversify their risk, and lack the right base which would allow them to attract external finance - only a few independents have been able to grow sizeable and sustainable businesses at home; and fewer still have made inroads in the international marketplace’ (ITC 2002: 5).

The UK’s inability to compete in global markets successfully was also used as evidence of a need for change**:**

> There is a more general shortfall in our international competitiveness, which stems from a number of factors including:
>
> - Insufficient scale of our main commercial broadcasters, producers and distributors, in a world market increasingly dependent on critical mass for the successful creation and exploitation of material.
> - The failure to attract investment and management expertise more widely from around the world, including the US. (ITC 2002: 5)

Arguably, the *Phillis Report’s* prescriptions were based on an incomplete view of market developments as they seemingly ignored relevant developments in the US broadcasting market. Despite some astute asides about the relevance of the US experience with Fin-Syn, these were discounted. It is noteworthy that the report’s conclusions showed how the IBA’s comments on sustainability and economic logic in its evidence to the DGFT in 1992 had been borne out by the US experience with Fin-Syn, which by 2001 no longer operated. The implications of these changes were ignored or not made explicit as they would have contradicted the recommendations.

In many ways the changes levelled the playing field between the BBC and ITV in their relationship with independent producers. The 1993 Network Centre agreement had contributed to the weakening of the ITV system which had responded to its rapidly changing market position through the consolidation of most franchise holders into a single entity. Indeed, it took more than a decade for ITV to recover some stability. In parallel, the path of increased marketisation at the BBC continued first, with the introduction of the Window of Creative Competition (WOCC) in 2006[15] and then, the creation of BBC Studios as a commercial subsidiary of BBC Worldwide in 2016.

Some of the formulations in the *Phillis Report* lacked any significant evidence base or could be directly contradicted. Certainly, though, local investment in the independent sector was then limited. Furthermore, there was little questioning by third parties or government of what the possible consequences of the *Report's* recommendations might be. The *Report* has the hallmarks of an afterthought to justify a policy change where a decision had already been made.

While there was acknowledgement of the advantages of a mixed economy of companies in the production sector, with vertically-integrated firms existing alongside a range of independent production companies, it was PACT's lobbying position which was accepted by the *Report*. This was based on the optimistic prediction that a change to the terms of trade would lead to the creation of companies of scale which would be able to compete in global markets (and by implication perform better than the incumbents). There is no evidence of any interrogation of the 'fitness landscape' of the independent sector at that time even though several cross-genre mini-majors were already operational. Nor was it asked how changes might affect existing firms: there was merely a call for an undifferentiated group of companies to create a critical mass to facilitate global competitiveness. The analysis undertaken used the hypothetical monopolist test, i.e. the market definition used looked at national and supply/demand activity for programme production and effectively ignored the growth of the pay-TV sector and its relationship to production companies.

As noted previously, the *Phillis Report's* deliberations followed those of the Joint Committee examining the Draft Communications Bill in 2002. The *Report's* recommendation to intervene to provide a sustainability cushion for the independent sector through a change in the terms of trade laws was confirmed in the legislative provisions of the 2003 Communications Act. However, this had been contested during the deliberations of the Joint Committee on the Draft Communications Bill by the then Director-General of the BBC, Greg Dyke. While the use of the BBC's licence fee money as 'venture capital for the nation's creativity' was promoted by Tessa Jowell, then Secretary of State for Culture, Media and Sport (Joint Committee 2002: 83), Dyke questioned 'whether it is

[15] The Window of Creative Competition enabled in-house and both 'qualifying' and 'non-qualifying' independent producers to compete for 25 per cent of eligible BBC TV commissions each year.

the BBC's job to make large numbers of independent producers extremely rich' (ibid: 84). This view was explicitly ignored as it was seen to underestimate 'the difficulties facing the average independent producer'. Furthermore despite evidence from the BBC on the likely impact of foreign capital on the sector this was disregarded too, with the views of City financiers given greater weight [16]. Indeed, the *Phillis Report* recommended 'reduced barriers to overseas investment, resources and expertise' (ITC 2002: 7) in the expectation of greater efficiency and profitability but offered no evidence whatsoever to support this contention or suggested any consideration of the wider implications.

Implementation of the *Report's* recommendations fundamentally altered the conditions under which the UK television production sector operates. The rapid consolidation of the independent sector after 2004 was not foreseen (Doyle and Paterson 2008). The *Report* suggested that the need for quotas of independent productions on the public service broadcasters should be reviewed once these measures had been introduced, as it was believed that the workings of the market over time would remove their necessity. That the review by the DCMS in late 2015 led to a decision not to remove the quotas is perhaps indicative of a faulty prescription in 2002 and a lack of awareness of the unforeseen consequences of likely foreign owned consolidation[17]. It is also noteworthy that BBC production's separation from the main broadcasting function was considered in the *Phillis Report* and rejected because it 'would likely impose significant costs on the Corporation' (ITC 2002:13). One must assume these 'costs' were transaction costs though this is not specified. And of course, in 2016 the BBC itself implemented precisely this structure with the creation of BBC Studios as a subsidiary of BBC Worldwide, claiming it would improve competitiveness, innovation and value for money and allow the BBC to attract the best staff to provide programmes for commissions from both the BBC and other broadcasters (BBC 2016: 24). This underlines the long-term structural impact of the competitiveness agenda.

Ignoring lessons from the USA

The neglect of the evidence available for the ending of US regulatory interventions through the Fin-Syn rules is perplexing. It is unclear what role Howard Stringer, chairman of Sony, by then the only US studio without a broadcast network, played in the formulation of the *Phillis Report*. Major changes of ownership had begun in the US broadcasting market when the expiry of the Fin-Syn

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[16] The BBC's consultation on the BBC Studios proposals (BBC, 2016) uses the outcome of these policy changes as part of its justification for making its production activity a subsidiary of its commercial arm BBC Worldwide.

[17] Ofcom carried out a review of terms of trade at request of then Secretary of State for Culture, Media and Sport (Ofcom, 2015).

rules once again allowed the broadcast networks to hold a financial interest in all the shows in their line-ups. This had opened the floodgates to a series of mergers and acquisitions: Disney and ABC in 1996, Paramount and CBS in 2000, and then later Universal and NBC in 2004. The issues associated with vertical integration and the role of buyer power were not fully examined by the *Phillis Report.* This did not sufficiently grasp the wider implications for UK broadcasting companies which were unlikely to match the scale and reach of an integrated US major. Indeed, Kunz (2009) noted that 'Sony Pictures is the one major not aligned with a broadcast network. In 2001, Sony announced that it planned to halt development of new prime-time programming because of the challenges that non-aligned producers faced and in 2003 it was a member of the Coalition for Program Diversity that called on the FCC to institute a 25% "Independent Producer Rule"' (ibid: 645).

A number of academics examined the Fin-Syn rules at the time of their demise. Rosencrans (1990) described the rationale for the Fin-Syn rules as:

> (1) to enhance the profitability of program producers;
> (2) to restrain or diminish the networks' bargaining power, resulting from their control of access to their affiliated stations, which was allegedly used to extract syndication rights and other financial interests from producers; and
> (3) to prevent the networks from favouring the programs in which they had acquired these interests.

In other words, these were the very same set of objectives as PACT was seeking.

However, the outcome of the Fin-Syn arrangements had been that rather than increasing the profitability of the programme suppliers by enabling them to charge higher fees for the network licences, the networks merely paid less for a licence which did not include syndication rights so that 'deficit financing' became critical. With larger production companies, such as movie studio divisions, able to spread the risk in a way similar to the networks, power became increasingly concentrated in the hands both of the networks and studios. Consequently, as Covington (1994: 5) notes, although the original set of financial interest and syndication rules was adopted to curb 'the excessive power of the three major broadcasting networks in the financing, development and syndication of television programming' and to 'promote diversity of programming sources and distributors' it failed and the beneficiaries were not undercapitalized new entrants but rather the Hollywood production studios. It is regrettable that these dynamics in the US market – seen as the best comparator to imitate – were not considered when the changes in the Terms of Trade in the UK were recommended. In fact, the issue of deficit financing, and the role of distributors in meeting producer needs, became a critical factor accelerating consolidation as the companies making acquisitions were financially strong and often vertically integrated with an existing distribution arm.

What the *Phillis Report* failed to consider was the complexity of the balance of forces that would emerge after a change in the terms of trade in the UK. Without powerful studios to combat 'network commissioning power' in the UK there was a naive supposition that foreign investment would be a neutral factor in the market and provide a countervailing force. In some ways this has indeed occurred but it has not meant a stronger UK sector, merely the acquisition of UK companies by foreign investors coming from an array of interests – the studios, networks and new media companies. Again, it is worth noting how the US national interest was invoked in the debate about Fin-Syn, with the networks claiming they needed to be able 'to compete with foreign giants who buy up the major producers of their programming with a consensus […] building that if the U.S. will not limit the domestic investment opportunities available to foreigners, it must at least ensure that American companies are not actively disadvantaged' (Rosencrans 1990: 75). The harsh reality against which the 'competition enamoured' *Phillis Report* took its position was the conclusion of Goolsbee's 2007 report for the FCC report that 'primetime broadcast television is a heavily vertically integrated endeavour and one can see that the life of an independent producer of programming is likely to be rather difficult' (quoted in Kunz, 2009: 638). Or as *The Economist* (2016) recently noted, in the US 'whichever way the wind blew, big companies showed a genius for turning federal regulations into barriers to entry'.

In the narrower context of television drama production in the USA once Fin-Syn was scrapped, Kunz (2009: 645) found that in the 2004-05 and 2005-06 seasons, less than a handful of comedy and fictional programmes came from outside the six major conglomerates and were sold across the world. The *Phillis Report* was aware of the possibility of generating revenue through both traditional and non-traditional markets but ignored the oligopolistic structures in the global market. The analysis was wrong, the prescriptions were wrong and the Creative Industries Federation's lament in 2014 about the lack of scalable UK companies was an indictment of the measures taken. Now, UK production companies have been acquired and are tied to foreign distributors.

So, there is a dilemma which has to be resolved in the UK if scalable UK companies are indeed needed in this sector. The interventionist framework was seen as required to resolve conflicting industrial positions and was premised on beneficial consequences resulting for global competitiveness, claiming a public interest in the competitive supply market in broadcasting. Buyers' power, where there are many sellers but few buyers, was seen as a negative attribute even though the welfare and economic consequences were arguably positive for the UK. The prospect of growth through foreign investment was seen as needed to build a sector which could become self-renewing. The application of competition law alone to support interventions ignored the fact that rapid technological change was underway and a global market was emerging with unknown effects both in terms of programme production and distribution.

Aftermath

The responses within the UK's remaining vertically integrated companies have been different. The BBC introduced the Window of Creative Competition (WOCC) in 2006 partly in response to the fact that a growing proportion of third-party commissions were no longer eligible as part of the statutory quota as they were produced by 'non-qualifying' producers which had become key players due to the emergence of the 'super indies', as consolidation between independent companies continued[18]. The BBC wished to be able to access programmes from these companies to ensure its schedule remained competitive. In parallel there was an increased focus on the operations of BBC Worldwide and its investment activities reflected a growing realisation of the need modernise the BBC's organisational practices and to address the global market. These changes had been underway at least since the 1990s[19] with the introduction of Producer Choice and major organisational changes to enable the establishment of full programme costings and greater efficiency (Birt 2004; Paterson 1993). With the progressive impact and influence of the market agenda, ten years later these changes resulted in the BBC's decision noted above to effectively commercialise its production arm (as BBC Studios) and become an active investor through BBC Worldwide in other production companies. This was justified in terms of its claim to need to maintain a continuing flow of new programmes to sustain its longstanding position as a major global distributor (BBC 2016: 29). ITV also responded to market changes with a series of strategic changes. These emerged haphazardly after 2004 as the newly-consolidated company negotiated an ever-more competitive fitness landscape but with its ownership now open to foreign takeover as a result of the changes in the Communications Act 2003. Its focus on content in recent years, through the acquisition of companies both in the UK and overseas, has led to a significant rebalancing of its income streams while its distribution arm has been recognised as an important adjunct to its production efforts.

[18] Non-qualifying producers are defined by the level of the shareholding by a broadcaster which is active in the UK market. If this is below 25% the company is still considered legally 'independent'.

[19] In fact, they had been a factor since the 1980s. Investment by BBC Enterprises, BBC Worldwide's predecessor, sometimes had a material impact on the programming. See Paterson (1984) on investment in *Boys from the Blackstuff.*

The market mechanisms introduced into the production sector have led to a changed relationship between broadcasters and producers so that distributors are now a fundamental part of the equation. The growing importance of distribution in securing the finances for high-cost programmes has been overshadowed somewhat by the continued focus on production. There is no lack of competition between distributors in global markets but in the UK, as in production, the distribution sector is now dominated by foreign-owned companies[20] with deficit financing provided through these companies now a very significant factor in high-end production alongside the tax incentive regime[21].

The effect of consolidation in production and an emphasis on global markets has meant that UK television - formerly financially self-sufficient from advertising and licence fee revenues – has had to concede market space. What the regulators have not done - because the legislation doesn't require this and the UK Government seems unaware of its relevance - is look at the competitiveness of the *distribution* sector. Here, the evidence of the film sector's overwhelming dependence on US investment provides a far from optimistic long-term prospect for success.

The creation of a mixed economy of supply may be the most beneficial and indeed preferred outcome but arguably it is of concern if, as has happened, ownership is transferred outside the UK. The danger is that over time this may lead to a reduction in expressions of British culture and result in an impoverished production sector dependent on the whim of foreign conglomerates.

It is concerning that every intervention made since the 1980s has led to a gradual weakening of the UK-owned vertically integrated broadcasters, which until then had underpinned the high standing of British television around the world. This contrasts significantly with the US where, since the 1990s, after a period of separation between production and broadcasting, there has been significant concentration and intensified vertical integration with the merger of the globally powerful studios and the domestically powerful networks. The UK independent sector now proudly boasts of its export achievements. Arguably this is not wholly beneficial, with consolidation and increased foreign ownership of much of it competing on a global stage through US owned distribution companies. And as a consequence the programmes being commissioned are increasingly targeted at a global rather than a British audience. The UK TV drama production sector may be in danger of

[20] There have been significant changes to this sector since Steemers (2004) mapped the UK companies which were operational in distribution in the early 2000s with many not surviving the financial downturn after 2008. See *Broadcast* (2009).

[21] Tax relief for high-end television production was introduced by the UK Government in 2013.

following the pattern of the UK film industry - small and innovative but dwarfed by the US majors, while producing programming in the UK but for global audiences.

The new terms of trade led to rapid consolidation so that foreign-owned ‘super-indies’ emerged acquiring existing production companies with both their human capital and the ownership of the intellectual property inherent in programmes and formats. These developments will be further elaborated in a related working paper. At one level, the global competitiveness of UK-based companies has improved but this was at the cost of the ownership of many companies passing to overseas companies. The UK’s main global competitive body in distribution, BBC Worldwide, became more important in contributing to financing the BBC as the licence fee income came under greater pressure. After 2010, ITV emerged from a decade of decline, beginning to acquire independent production companies both in the UK and USA as well as investing in start-ups with an emphasis on owning content with global potential.

With foreign ownership of all but one (Tinopolis) of the consolidated super-indies (All3Media, Endemol Shine, Fremantle), and ownership of other key production companies by overseas studios (Sony Pictures Television, Warner Bros. TV, NBC Universal, Studio Canal), the *Phillis Report’s* prescription in 2001 of greater foreign investment has been realised. With the emergence of new buyers such as Netflix, Amazon Prime and Sky there is continuing change and Britain’s place as a global centre of production in the market is now increasingly reliant on these foreign-owned vertically integrated companies, particularly the US studios which, after the end of the Fin-Syn arrangements, acquired networks and reinforced their position in global markets. The UK interventions have arguably weakened the domestic industry by making it dependent. They have certainly altered the trajectory from one where, despite talking about the interests of audiences in preparing legislative proposals, there has been a reduction in the public interest legacy and its replacement by market precepts. In short, the firms making the programmes - particularly narrative fiction - are now addressing a global market and frequently are both foreign-owned and reliant on deficit financing from their parent company. The legacy British broadcasters, though still key funders of commissioning and still vertically integrated, have decreasing influence on the world stage. They have been adopting the approach of the super-indies through investment in or acquisition of independent companies to respond to the market conditions and secure commissions.

The issue of scale remains. The over emphasis on start-ups and the clipping of the wings of the UK’s vertically integrated companies of scale has coincided with the increasing globalization of the market for television. There are always choices for administrations and governments as they respond to effective lobbying campaigns which cleverly invoke current political ideologies. Evidence-based policy is supposed to counter such efforts but when the evidence itself fails to take account of the key players in the global value chain, it can lead to faulty prescriptions. When the consequences of the decisions following the 1993 MMC recommendations are reviewed in the light of current economic and political realities they can be seen to have led to a series of decisions which undermined a successful UK-owned sector and, unwittingly, allowed foreign-owned companies to secure increasing advantage. This is justified as inward investment but in fact it is a sacrifice of considerable national autonomy by an industry which is about making culture as well as a profit. It is impossible to put the competition genie back in the bottle but it should be possible to ensure the continued existence of national champions which aspire to represent the UK in all its diversity and to meet the public interest expectations which once dominated. The determined use of competition law has certainly led to multiple business models in the TV production sector and has benefited some producers handsomely as their companies have been acquired by overseas firms. The sector is much lauded but in truth now very fragile and potentially prone to the whims of foreign owners.

The consequences of these changes for the business models and operations of companies producing drama in the UK - its fitness landscape - will be traced in a forthcoming working paper.

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