

VLV/Media Society

The crisis in provision of public service content is not news.

I am just going to deal with three issues: what is happening in the commercial sector, the impact of the BBC, and what can be done.

The terrestrial commercial channels say they are the victims of a perfect storm – audience fragmentation, migration of advertising to the web, and recession. Five will lose tens of millions this year, Channel 4 has been holding out the begging bowl for three years, and ITV has suffered the worst year in its history.

Yet ITV has survived recessions in the past, almost as severe as now. In 2001, its revenue declined 13.4%; 16% is forecast this year. Multi-channel growth has been a steady for 20 years: nothing new there. And half the advertising on the web is search, which is irrelevant to TV channels.

Most of ITV's woe is self-inflicted. Much as it likes to blame regulators, it has actually been allowed by Ofcom to shed some £300m a year of PSB obligations, and will soon dump nearly everything else remaining. ITV lost billions of pounds in the 1990s on digital failures. Last year it lost £2.7bn, including writing off the £1.75bn of cash it paid for the United franchises: how stupid was that? It has net borrowings of over £700m – a nightmarish 14:1 leverage measured against forecast profits of £50m this year. Its pension fund deficit is over £200m, it has abandoned its dividend, its debt has been reduced to junk status, and it desperately needs a rights issue of £500m. Yet its biggest problems are strategic – this is neither a blip nor a storm.

ITV is overwhelmingly dependent on advertising revenue, in a market-place swimming in commercial impacts. The value of these impacts has been declining for five years, thanks principally to ITV's invention of CRR – Contract Rights Renewal, which is the protection it offered up to advertisers in order to win permission for the Carlton-Granada merger. It has already cost ITV over £1bn, but much worse, it has damaged the entire market.

This is what happened. As ITV1's audience fell, advertisers were allowed to reduce the volume commitments to ITV they previously needed to make to win the price discounts they wanted. They then bought the missing impacts at much cheaper rates than the ITV premium price. As a result, the average cost of TV advertising fell – a situation unique to the UK, compared with similar territories like the US, Germany, France, Spain and Italy. There, cost per thousand has steadily risen; here, you can now buy TV airtime at prices last seen in 1988.

But having poisoned the well, ITV decided to drink even more deeply from it. It switched its pay-TV channels to advertising (apparently it now realises this was a mistake). It even switched Friends Reunited to advertising – this is an asset bought for £175m and now worth a quarter of that. Many European equivalents to ITV have reduced their reliance on advertising to 50% or less – in France, in central Europe, in northern Europe, in Sweden, in Finland, and so on. ITV turned down an approach from Virgin Media that would have led to a merged entity less than 40% dependent on advertising. It has made a virtue of its “free-to-screen” identity.

What we are witnessing is weak strategic management hastening what was an inevitable process: ITV will largely cease to be a public service broadcaster by 2012 at the latest. So can we rely upon Channel 4 to provide the balance to the BBC in the PSB system?

Channel 4 has been predicting for three years that declining revenues would force it into deficit well before digital switchover in 2012, unless it jettisoned chunks of its public service content. £100m a year is the figure that was touted by Channel 4. The licence fee, or part ownership of BBC Worldwide's UK media assets, was the preferred solution.

As those prospects have faded, Channel 4 has reverted to self-help as the best option, and not a moment too soon. The truth is that, for all its long run of creative success, Channel 4 has been a basket case in terms of financial management.

Since 1990, the Channel 4 programme budget has risen by 180%, but total revenues by 315% and staff costs by 500%. Since 1990, Channel 4 has accumulated post-tax profits of over £350m. Where did the money go? Mostly on a series of channel and business ventures which have nothing to do with public service content.

Many of these businesses have been closed, written off or sold. Attheraces lost £23m in 3 years before Channel 4 pulled out. The Film 4 production company lost £40m before it was closed. The biggest investment of all has been in the channels business – over £150m, before (according to Channel 4) reaching break-even: more on that in a moment. If you add in corporate costs, re-structuring costs, and losses on businesses sold, the total comes to nearly £300m. Draining this money out of Channel 4 has also cost an estimated £80m in lost interest.

Nor has the flow ended. Last March, Channel 4 bought 50% of a website for £500k, all of it written off by November when its jv partner went bust. Life One Broadcasting, bought for £3.6m in 2007, was written off – Channel 4 just wanted the EPG slots. 51% of OneWorld radio station was bought for £1m and then written off on closure, Ostrich Media absorbed £500k before it was closed, Popworld £200k and Fingertip Software £1.5m. Project Kangaroo cost £6.4m in the last two years before being abandoned. 4Radio was thankfully dumped this year, with undisclosed losses, just in time to avoid spending £10m on a sector – digital radio – where no-one has ever made any money. Nonetheless, hard-up Channel 4 had £29m to spend in 2007 on 50% of EMAP's music channel business: another sector where margins are under fierce pressure.

Are the digital channels making £41m, as last year's accounts showed? In order to make Channel 4 look as if it was losing £7m, the accounts separate out £13m of financial revenue (which was earned by Channel 4) and £9m of rights income (earned by Channel 4), so that neither contributed to that channel's profit and loss account. In addition, under the heading of "other operating expenditure", the costs attributable to all channels are allocated 97% to Channel 4 (£35.3m) and 3% (£1.1m) to the digital channels. With indirect costs and cost of sales, 85% is attributed to Channel 4, even though there are 11 digital channels to compare with Channel 4 and its time-shift.

The balance sheet is even more telling. There we find that the businesses within the Group other than Channel 4 have assets of £7m and liabilities of £64m. When an over-impressed MP congratulated Channel 4 executives on the “phenomenal profitability” of the digital channels, they hastily revealed that those channels owed Channel 4 £92m.

Like ITV, Channel 4 made the strategic error of moving all its new channels from subscription to advertising. This means they are cannibalising the core audience as well as the core revenue stream. For 20 years, Channel 4 averaged a 10% audience share, despite the inexorable rise of multi-channel television. Last year, it achieved its lowest audience share since 1986 – 8.2% - whilst its digital channels surged to 3.7%. Half the recent growth in the digital channels has been at the expense of Channel 4, which is the only one with a public service remit.

Channel 4 calculates that only £153m of its £500m programme budget is spent on core PSB. I calculate that only 2% of Channel 4's portfolio 11.9% audience share is for core public service content. What we have is a small public service dog being wagged by a very large tail. Astonishingly, and scandalously, Channel 4 is actively planning to spend the last of its cash resources buying another 11 wholly commercial channels from Virgin Media, so surrounding its one public service channel with 22 non public service channels. The board must have taken leave of its senses to allow these unaccountable civil servants to contemplate punting another £100m of public money on non-psb activity, when over £300m has already been spent to so little effect.

And these are expensive public servants. The average wage at Channel 4 is over £73k, which for many people is for a 4-day week – Fridays are “flexible”. 80 of the staff earn over £100k. The top three executives cost Channel 4 over £4.8m in the last two years – more than twice as much as the total profit from the entire business. Yet when you look at the breakdown, you see that fewer than 200 staff work on commissioning and scheduling. Where are the other 700? Well, 113 in sales, 41 in press and PR, 43 in IT, 21 in strategy, 65 in finance and HR, over 300 hundred in digital businesses, and 24 in marketing. Channel 4 and its siblings spent over £40m on marketing last year, and £18m on business development and research. £5m was written off on “onerous contracts” and £16m on failed programmes and developments. They are pleading poverty. They are demonstrating profligacy.

One point made in the Channel 4 annual report by its chairman was that the BBC's income this year will be £800m greater than that of all terrestrial commercial TV, with the gap rising to £1bn next year. He warns that this huge guaranteed income will inevitably crowd out commercial activity.

I find it hard to disagree. Ofcom in its 2005 report on PSB printed evidence from McKinseys demonstrating a displacement effect, but chose to ignore it. That Ofcom's regulatory remit largely excludes the BBC makes policy-making on PSB extremely difficult. Commercial radio and local newspapers have long reported the barriers they encounter as they try to monetize their content when faced with a powerful and wealthy competitor giving quality content away free.

In a report I co-wrote five years ago, I said that we would be forced into a situation where PSB provision overwhelmingly came from the BBC unless we grasped the funding nettle. By that I mean progressive transfer of the BBC to funding by voluntary subscription, matched by progressive elimination of the licence fee, to be replaced by a much smaller pot of money provided by the Treasury in the shape of a contestable fund entirely devoted to public service content.

I will not rehearse those arguments here, as they have not changed since my report was published in 2004. What has changed is the speed of ITV's withdrawal from PSB provision, and the deterioration in the governance and management of Channel 4. Channel 4 can easily be fixed; ITV less easily; PSB provision only with an enormous exercise of political will, which is deeply unlikely before the election.

David Elstein