



**Independent advice to BBC  
Management on the potential for  
market impact of the BBC's new on-  
demand proposals**

A report for the BBC by  
Human Capital

# Independent advice to BBC Management on the potential for market impact of the BBC's new on-demand proposals

## Introduction

This paper<sup>1</sup> sets out a preliminary assessment of the approaches likely to be taken in estimating the market impact of the BBC's proposed new on-demand proposals. Its purpose is to inform BBC Management of the issues likely to be addressed in a market impact assessment (MIA). It does not attempt to replicate the detailed contents of a full MIA. Such an assessment will be carried out over a three month period by Ofcom, reporting to a steering group formed jointly by Ofcom and the BBC Governors.

Given the early stage of development of the markets in which the BBC may be operating, and the significant uncertainties about future commercial strategies, it will be difficult for any MIA to provide a definitive and quantifiable analysis of the BBC's likely direct impact on commercial players. This paper therefore describes the ways in which the market might develop, and examines in broad terms how the BBC's intervention could impact on those developments. In particular the paper looks at the different ways in which the BBC might affect the process of competition in these emerging markets.

This paper draws on reach modelling and research undertaken by Human Capital and BBC Management, and on separate background analysis prepared for the BBC by consultants Oliver & Ohlbaum.

## Key points

- It will be particularly difficult to carry out a detailed market impact assessment for the BBC's new on-demand proposals, given uncertainties about how the market will develop, about the plans of commercial players, and about the nature of and the sustainability of commercial business models.
- We suggest, therefore, that the key aim of any MIA should be to assess whether or not the BBC's proposals will have a disproportionate effect on the scope for healthy and dynamic competition to emerge in the commercial markets alongside which it will sit.
- Given this, it is suggested that the MIA assessment should have two parts:
  - An examination, as far as the data allow, of the possible direct impact of the BBC's on-demand proposals on the future incomes of commercial service providers;

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<sup>1</sup> The report is written by Robin Foster, Chief Adviser to Human Capital, with assistance from Professor Martin Cave and Simon Terrington.

- More importantly, an analysis of the impact of the BBC's proposals on the competitive process in the relevant economic markets.
- This paper notes the difficulties inherent in identifying relevant economic markets in the broadcasting sector. It suggests focusing on:
  - First, catch-up TV in general as an extension of free to air broadcast services;
  - More widely, on-demand access to audio and video content delivered over the open internet.<sup>2</sup>
- Early signs are that consumers in the UK will expect limited-period (or “tethered”) catch-up TV to be free or offered at low cost, perhaps as part of a bundle of other services. Commercial catch-up TV services are likely to be funded via advertising revenue and – possibly – a small additional subscription payment. They will compete with the functionality offered by PVRs, which will limit the extent to which they can charge for their service in any event. A free BBC catch-up proposition is unlikely to have a significant direct impact on the emergence and sustainability of such services.
- In a wider on-demand market, a range of paid for on-demand services is likely to develop, including paid-for downloads of individual programmes which consumers will be able to keep for later use and, possibly, own permanently. The BBC's direct impact on this wider on-demand content market is more difficult to assess. A catch-up proposition delivered via the open internet or cable, if it comprises a clearly limited viewing window, is unlikely to encroach significantly on the broader on-demand market. If, however, the BBC proposition is sufficiently flexible to permit users to store and view high value programming over an extended period of time, in a way which is more akin to paid-for downloads and commercially purchased DVDs, it could have more of an impact (especially in the areas of comedy, drama, and children's programming). In general, the more tightly focused the BBC's proposition is, the less commercial market impact it will have.
- Although the BBC's proposals may have some effect on the potential for commercial incomes from on-demand services, they are unlikely to affect the competitive process significantly. There are many other well-funded potential suppliers of on-demand content, from both the UK and overseas, able to enter the UK market, and several different funding models are possible. Entry barriers are in most cases low, and product differentiation means that paid-for content can sit successfully alongside the BBC's free service. A wide and diverse range of content will be available to users alongside that offered by the BBC. In some ways, the BBC's involvement could be argued to be pro-competitive, if it increases user understanding of the market, and contributes to effective platform competition.

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<sup>2</sup> Audio and video content, as noted later, exist in separate markets

- Further consideration may, however, need to be given to the BBC's impact on competition in the following areas: non-DRM audio downloading, where the BBC's market share is likely to be very high in some genres, the precise design of the catch-up TV window, to ensure it does not encroach disproportionately on pay on-demand services, and the terms on which the BBC's proposition will be made available to other platforms (for example IPTV systems).
- The wider impact of the BBC's proposition on the developing broadband market should also be recognised, although it is unlikely to be as dramatic as that experienced in the case of Freeview<sup>3</sup>. The effect of a sharp rise in peer to peer activity on the internet could place pressures on ISPs, although more sophisticated consumer and service provider charging regimes could help to address any capacity concerns.

### ***BBC's new on-demand proposals***

The new propositions being assessed are:

- *Seven day TV catch-up over the internet*: an on-demand catch-up facility, principally organised around a seven day window from the point of original broadcast.
- *Seven day TV catch-up over cable*.
- *Simulcast TV over the internet*: video streaming of existing TV services.
- *Non-DRM downloads over the internet*: on-demand downloads of radio programming outside the seven day window where the rights holders have given agreement.

The three internet-based offerings will be combined to form a new, direct-to-consumer offering, *BBC iPlayer*. The *BBC iPlayer* is designed to unify the BBC's provision of audio and video content on-demand and to make it available to UK audiences over the internet.

The seven day window is defined as follows. Audiences will have seven days from the point at which the programme is broadcast in which to download the programme. They will then have another seven days from the point at which the file is first opened to watch the programme as many times as they like. After seven days from the point at which the file was opened, it will be deleted or permanently disabled. Series stacking will also be offered – whereby all the episodes in a series are available for download from the point at which they were broadcast until seven days after the transmission of the last episode in the series.

This proposition is seen by the BBC as being vital to its future, insofar as it will help maintain the relevance and appeal of the BBC's output in a world in which users

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<sup>3</sup> The BBC's share of total content available in on-demand broadband and cable markets will be much smaller than is the case with Freeview.

increasingly access content through on-demand services, delivered over a variety of fixed and mobile distribution platforms. As well as helping to secure the BBC's reach as linear channels decline in importance, it could also help enhance the BBC's engagement with audiences, and provide new opportunities to influence audience choices through innovative use of navigational tools and user interfaces.

However, it is important also to assess how, if at all, the BBC's new offer might affect the development of commercial services in this emerging market. Active engagement of the BBC in the provision of free on-demand content could help stimulate user understanding of and take-up of broadband services, and hence help expand the overall market size, to the benefit of all players. On the other hand, there may be a risk that the availability of a substantial amount of free on-demand content from the BBC – although benefiting consumers – could dampen the prospects for commercial pay and advertiser-funded on-demand services. The rest of this paper examines these and other possible effects in more detail.

## **The role of market impact assessments**

### The BBC and the market

Most of what the BBC does will have an impact on the commercial marketplace. Indeed, the rationale for public intervention in the broadcasting sector is to guarantee the provision of a range of content and services which aim to deliver important social benefits. Public intervention of this nature is widely supported in the UK, as it is believed that – left to itself – the market would not provide a sufficient amount of high quality public interest content, available to all, free at the point of use<sup>4</sup>.

Public broadcasting, if it is to fulfil its social purposes, should aim to have both reach and impact (which implies a significant effect on audience consumption patterns). If the BBC is successful, consumption of some commercial services will be lower than would otherwise be the case. Of course, the BBC – as has been clearly the case with DTT – might also help expand the overall market, hence benefiting commercial players. Moreover, a reduction in viewing of commercial services does not – at least for advertising funded channels – necessarily translate into a reduction in revenues, so the calculations of the precise impact of the BBC on the commercial sector are sometimes complex<sup>5</sup>.

The existence of the BBC's existing linear broadcasting services has long been factored into market and investor expectations. Advertiser funded and pay broadcasting services have been able to prosper alongside the BBC, and have benefited from a reasonable degree of certainty about the scale of the BBC's on-going impact on the market. Extension of the BBC's activities into new markets, however, raises new issues – especially in markets where commercial prospects are uncertain and investments are risky. The prospect of a significant and unpredictable level of BBC investment in new markets, for example, could deter private sector investment. This is not just a private matter for those businesses involved. To the

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<sup>4</sup> See, for example, the Ofcom report on PSB "Phase 1: Is Television Special?", April 2004, and "A Public Service For All", DCMS, March 2006.

<sup>5</sup> See "Economic Analysis of the TV Advertising Market", PwC, December 2004, for a good discussion of advertising elasticities.

extent that there is a consumer benefit from having access to a thriving, competitive, well funded and dynamic commercial broadcasting market, any significant barrier to the effective development of that market will have adverse consequences for consumer welfare. There may also be effects on the UK creative economy – if the publicly funded BBC is shown to be crowding out potentially successful UK commercial broadcasting and content production, then that would be an important industrial policy concern.

The need to find a sensible balance between the public benefits generated by a BBC able to pursue a range of new and potentially distinctive public services, and the possible disbenefit – ultimately to the detriment of consumers - arising from any significant impact on the commercial marketplace, underpins the White Paper's decision to require a market impact assessment to be carried out for all significant new BBC services<sup>6</sup>.

#### Lessons from previous approaches

The White paper notes that: (para 5.3.9)

“Market impact is a relatively well-understood concept, and the joint steering group will agree a methodology for Ofcom to generate the information required”

In fact, the concept – as demonstrated by previous attempts to carry out market impact assessments<sup>7</sup> is not as well understood as the White paper suggests, and there is still work to be done in designing and agreeing a robust methodology.

Previous assessments have tended to focus on the direct impact of BBC activities on the audience for and, in turn, revenues of close commercial competitors – both at launch and at some stage in the future, when the market is more mature. They have also included in their analysis an assessment, where appropriate, of the impact of the BBC on the wider marketplace (for example the impact on digital TV take up), and on other related activities – such as programme production.

While important to establish a clear sense of the nature and scale of the direct effect of the BBC on commercial rivals, this is only part of the story, and may in some cases be the least interesting part. For example, if (hypothetically) it were concluded that a new BBC children's channel would gain a 5% audience share, while competing commercial children's channels lost 5%, we would be very little wiser as to the overall benefits and costs of the proposal. Consumers (children watching TV) are presumably better off, as they have chosen to watch a channel they enjoy more than those offered by the commercial competitors. The commercial channel operators

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<sup>6</sup> Likewise, the European Community expects PSB funding to be justified in terms of a clear and distinctive PSB remit, and it should not affect trading conditions and competition within the Community to the extent which would be contrary to the public interest. The concept of proportionality is important here – a market impact assessment should look, amongst other things, at the proportionate scale and scope of the market impact, relative to the public benefits likely to emerge.

<sup>7</sup> For example the assessments of the impact of BBC Three and BBC Online.

may be worse off, if their loss of audience translates into a loss of income. How do we compare one effect with the other?<sup>8</sup>

At least as important in reaching a view is an assessment of the impact of any new BBC activity on the overall competitive structure of the market, and the scope for continuing private sector competition, investment and innovation alongside that of the BBC. We understand that Ofcom's more recent thinking on market impact assessments tends to emphasise the latter approach rather than the former. They have suggested using a standard competition economics approach in such assessments – first identifying the relevant economic market in which the new BBC service is operating, then examining whether the BBC service will result in a significant and undue lessening of competition in the longer term. (“undue” is used in the sense that the competition impact has to be weighed against any public benefit produced). Note – this is not the same as assessing whether there will be particular winners or losers in the current or likely future market – rather it focuses on whether the market in the longer run will still sustain a healthy level of competition and investment. The focus is on the process of competition. This sort of approach is likely to be especially useful in new and emerging markets, where there is very little empirical evidence to be drawn on in reaching an assessment of the likely direct impact of any new BBC proposition.

#### A two-part approach

We suggest that a combination of the two approaches should be adopted:

- First, (to the extent that data allow), it is important to assess the direct impact of the BBC proposal on other market players in the short to medium term. This involves identifying the relevant markets within which the BBC will operate. In particular, we need to understand the scale and scope of any BBC impact, and how it is distributed across the different commercial players, in order to take a view about proportionality and fairness. Moreover, this aspect of the analysis is what most commercial rivals will focus on, and it is probably the approach which most casual observers associate with an MIA.
- Second, we need to assess the impact of the BBC's proposition on the competitive process in those relevant markets, including an assessment of the extent to which a competitive and dynamic commercial market can emerge alongside the BBC's activities. This analysis is especially relevant in the case of an emerging market, in which precise projections of future developments are very difficult to make.

In fact, the two parts of the analysis are closely linked. For example, if the BBC's potential direct impact (on commercial audiences and revenues, or on particular commercial companies) is significant, there is a greater likelihood that commercial players will be deterred from entering the market, hence reducing the longer term prospects for competition.

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<sup>8</sup> A complete welfare assessment would also need to consider efficiency issues – both productive efficiency (is the BBC operating as cost efficiently as commercial providers?) and allocative efficiency (are resources being directed to their most productive use from the perspective of the economy as a whole?).

## The main issues

The main issues for this assessment are therefore as follows:

- Defining the relevant markets in which the *BBC's new on-demand propositions* will be operating.
- Assessing how those markets might develop, and the likely direct impact of the BBC's proposals on a range of as yet undeveloped commercial business models in those markets.
- Assessing the impact of the BBC's new offer on the competitive process, and on the longer term market structure.
- Assessing any wider effects – e.g. on broadband take up, but also on the capacity of the internet (and hence on investments that might be needed by ISPs or consumers).

## **The relevant markets**

### Defining the relevant markets

Defining the relevant markets for this assessment is the first stage of the process.

An economic market is conventionally defined as the smallest market within which a monopoly supplier would be free to alter prices or quality significantly, unconstrained either by the actual or threat of entry by new suppliers, or by customers switching to substitute goods or services.

A standard approach to market definition is to use the SSNIP (small but significant and non-transitory increase in price) test – typically a thought experiment which asks whether the hypothetical monopolist would be able to increase profits through a small but non-trivial increase (say 5 per cent) above the competitive price. At the heart of this analysis is an assessment of demand and supply side substitutability – the extent to which consumers can switch to alternative products, or new suppliers can enter the market. Where possible, such thought experiments are supplemented by empirical data, for example consumer research or price elasticity studies. Clearly for this assessment, we do not have access to such research – nor is it likely that the full MIA will have much better data, given the infancy of the markets under consideration. However, we can use this overall framework at least to think about the relevant markets in a structured and systematic way<sup>9</sup>.

### The value chain

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<sup>9</sup> This approach does have its critics. For example, a report by Europe Economics for the European Commission (Market Definition in the Media Sector, November 2002) explains that some economists have expressed concern with the traditional approach, arguing that overly narrow market definitions may be inappropriate in rapidly changing markets. A more recent paper by Luca Di Mauro (Defining the Retail Markets for Audiovisual Products, European Competition Law Review, August 2003) also argues that the standard approach may not be particularly useful, and proposes an alternative framework based on content type and timing of release. A more detailed analysis of market impact would benefit from a thorough review of the different approaches.

The audiovisual content value chain, in simplified form, comprises the following elements:

- Content production/rights acquisition – the BBC’s on-demand proposals will benefit from access to the BBC’s programming and from rights agreements between the BBC and rights owners to allow catch-up and non-DRM protected downloading.
- Distribution (e.g. transmission or transport) – the *BBC iPlayer* will not own or lease a distribution system in the conventional sense, but it will use BBC servers, access to ISP capacity, and peer to peer applications to distribute content, via the internet to end users.
- User interface – the *BBC iPlayer* will use a software package, incorporating Microsoft’s media player, to enable users to download BBC content.
- Content aggregation, packaging and retailing – the *BBC iPlayer* will package and present BBC-funded audiovisual content, on-demand and streamed, and free to the user.

Our primary focus should be on the “retail” markets which are served by the BBC’s proposals, as they will largely determine the scope of the upstream markets. However, it is worth in passing to note a few points about content rights, distribution and the user interface.

Content and rights: Additional rights may need to be acquired by the BBC if a seven day catch-up proposition is to be offered. The PSBs, including the BBC, argue that catch-up rights should be part of the primary rights package or licence which PSBs are entitled to buy from independent producers. Some producers argue that these rights should be acquired separately from the standard broadcast transmission rights. Two contrasting issues may arise here: the scope for the BBC, with access to public funds, to overpay for on-demand rights, hence disadvantaging commercial rivals or, alternatively, the scope for the BBC to use its buyer power to underpay for the rights. Ofcom is currently examining the market for new media rights, and has encouraged broadcasters and content producers to reach a commercial settlement for new media rights, including catch-up.

Distribution: although the *BBC iPlayer* does not own its own distribution system, the issue here is whether by the choices it makes, it might unduly affect competition between different distribution systems, or between different service providers using the same system. The *BBC iPlayer* primarily makes use of one form of distribution – broadband internet- and it will be offered to all ISPs. The BBC will also make similar on-demand content available via digital cable. Therefore, it is unlikely, by its presence, to significantly affect consumer choice between ISPs or between broadband internet (DSL) and cable systems. Further consideration may, however, be needed of any negative impact on other platform providers, (for example IPTV services) if they do not have equivalent access to BBC on-demand content.

The BBC’s activities may, however, have a wider impact on some elements of the distribution market – for example in driving increased usage of high capacity broadband, in turn affecting the extent to which ISPs need to secure capacity from

the telecommunications providers to accommodate the expected level of traffic – we return to this later.

User interface: currently there are several international suppliers of applications software which allow playback of multimedia files. Although there are at least 30 different suppliers in the market, the two main suppliers are Microsoft (Media player) and Real Networks (Real player). However other applications are available for specific purposes – for example Apple’s proprietary iTunes for music, other audio and more recently video content, and Apple Quick Time. The main suppliers have adopted different strategies – Microsoft positions media player as a relatively open system, often bundled with its other software, and its longer term strategy is to position Microsoft as the operating system for the home media hub. Real Networks positions its interface as a gateway into a wide range of different types of digital content, which it supplies either directly or in association with others. Apple’s iTunes is a closed system, which provides access to a wide range of content, which can only be downloaded onto Apple consumer devices. Although there is competition between the various interface suppliers, once users have adopted a particular system, they may face switching costs (for example learning how to use the new system’s features, or because the system is incompatible with certain consumer devices).

Will the *BBC iPlayer*’s choice of media player affect the shape of the UK user interface market? To the extent that a separate market for these applications exists, it seems likely that the *BBC iPlayer* will have little impact on its development. The *BBC iPlayer* will offer, at least initially, only BBC content. Given the vast range of other audio and video content that users will wish to access over the internet, it is clear that the *BBC iPlayer* will be only one of a number of different routes which consumers will need to use to access and download audiovisual content over the internet. However, it should be recognised that if, at a later date, the BBC were to decide to offer third party content via the *BBC iPlayer*, it would then be competing more directly with other user interface providers. Given the BBC’s access to a large volume of UK content, its strong brand name and possible promotional support from its conventional broadcast outlets, this may give rise to gateway control concerns. Further consideration would need to be given to this issue should the BBC decide to pursue such a strategy.

#### Content aggregation, packaging, and retailing

The main part of our analysis focuses on the role of the BBC as a content aggregator/packager.

What then are the relevant markets to use as the basis for our market impact assessment?

Identifying relevant markets in the media sector is not straightforward. At one extreme, the relevant market to consider for the BBC’s on-demand proposals might be the total market for all audiovisual content delivered in the UK over any platform. This assumes that there is a high level of substitutability across all forms of audiovisual content and the platforms used for its delivery. It assumes that comedies and dramas, news and sport, are in the same economic market – and that if a dominant supplier of comedies, for example, tried to increase prices, enough viewers would be able to switch to other types of content to undermine the strategy. It

assumes that enough consumers are willing to and able relatively easily to make the switch between platforms (for example switching from broadband delivered content to DSat or vice versa), that broadcast and on-demand content are interchangeable, and that free to air content is an effective competitive constraint on pay content and vice versa. In this world, even if a single firm, say, is dominant in the provision of on-demand content over broadband, its market power would be significantly constrained by content offered on linear broadcast channels, or broadcast for storage in PVRs.

While this may indeed be the longer term outlook, in the short to medium term, it is more likely that the audiovisual content sector consists of a number of separate markets, defined perhaps in terms of payment method, platform, access mode (linear channel or on-demand), and even genre. For example, broadcast content may be a poor substitute for content accessed over a PC in the office. On-demand access to a recording of a soccer game is unlikely to be a good substitute for a live broadcast of the same game.

Our preliminary analysis suggests that there are two plausible options for defining the relevant market for the BBC's on-demand proposals..

*Option 1:* Extension of the free TV market. The catch-up element of the BBC proposition could be argued to most closely resemble free to air TV, supported by home recording capability. Consumers have long expected to be able to record programmes free of charge in the home – the catch-up service provides them with a more effective means of doing so, although with more limited recording capacity and time limited storage. The growing use of PVRs in conjunction with broadcast TV would arguably constrain the development of any commercial market in catch-up services – and early pilots of catch-up appear either to provide the service free, or for a modest additional monthly subscription, bundled with premium pay services. Precedents set by previous competition cases suggest that there are separate markets for pay and free to air TV<sup>10</sup>. The pay market has grown significantly, despite the availability of free to air TV. Pay TV typically offers greater channel choice and more niche channels. Although free TV competes for viewer attention, it does not compete for viewer cash.

*Option 2:* All on-demand audiovisual content, whether free or pay – for example, downloads to PCs, iPods, and possibly DVD sales etc. DVD sales, which have grown rapidly, despite the parallel expansion of linear broadcast content, suggest that there could be a separate market – at least in some genres – for on-demand access to content. A YouGov survey commissioned by Pact indicates that even if consumers decide to take advantage of pay on-demand services, their viewing of linear channels will be relatively unaffected. A variety of charging models exist for on-demand content – from free (advertiser supported) to pay per view, to subscription. However, evidence of consumption patterns in households with personal video recorders (PVRs) suggests that there is a significant amount of displacement of live broadcast viewing by recorded programming (in effect, an on-demand service), and as viewers become more used to the availability of on-demand content, there may well be greater substitution of live by on-demand viewing more generally, especially for

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<sup>10</sup> For example, The OFT investigation of BSkyB's wholesaling of premium pay TV rights, and a number of decisions taken by the European Commission (1994 – 1999)

catch-up purposes. Recent developments might suggest that the boundaries between free and pay/subscription elsewhere are disappearing, moreover, as more content is made available free to air, and basic pay channels compete more directly with free advertiser supported channels. (Although certain types of premium pay content may remain in a separate market to the rest of TV.) These developments suggest that the payment method might be less relevant now for market definition purpose<sup>11</sup>.

Alongside these options, distribution platform and programme genre might both play a part in market definition.

Although in principle consumers can choose to obtain content from different platforms (cable, Dsat, DTT, broadband etc), the costs of switching between platforms can be significant, and they are used in different ways. For example, broadband content tends to be delivered to PCs, which are used for individual consumption at work or, when at home, in the study or bedroom. Broadcast distribution – by satellite, cable or DTT – tends to be aimed at the main TV receiver at home, offering opportunities for family viewing on large screens.

Content genres could also be important. Competition authorities have so far identified separate markets for premium sports and for premium movies, but have stopped short of any further genre based market definitions – arguing that at least for broadcast TV, viewers are prepared to view a range of different genres, depending on what is available in the schedules that day. Sales data for DVDs, however, which show a heavy concentration on dramas and comedies, suggest that – at least for paid for on-demand content – it may be important to consider some genre- based markets.

A related issue is that of the *origin* of the content – is there a separate market for UK originated content? Certainly there is a strong audience preference for UK content on broadcast television and radio, and in some areas (for example news and current affairs provision, presenter-led programming) it is unlikely that UK tastes and interests would be well served by foreign programmes. Likewise, UK comedies and dramas tend to be more successful in audience ratings than US or other overseas-produced programmes, suggesting that there is a strong cultural preference for UK stories, settings and actors.

#### Conclusions on relevant markets

This discussion has hinted at the complexities involved in considering market definitions in the media sector. There are many different ways of cutting the analysis in what is a market characterised by a high degree of product differentiation but at the same time is competing for consumer time and attention within a much wider entertainment and leisure sector.

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<sup>11</sup> See Europe Economics report, cited earlier. They note the difference between commodity markets and highly differentiated media markets to explain why even “free” TV programming does not prevent the emergence of parallel pay TV markets. But they go on to argue that the market definition question can be assessed in terms of substitution between alternative viewing patterns and note that the issue is in many ways like that of free newspapers competing with paid for newspapers.

For this assessment, we conclude that we need to consider the impact of the BBC's on-demand proposals across at least the following market dimensions:

- First, as an extension of free to air broadcast TV viewing – catch-up in many ways most resembles the existing free to air market, and could be argued to be separate from pay TV and other on-demand content.
- Second, as part of a wider (free and paid for) on-demand market – accepting that increasingly the line between free and paid for content is becoming blurred, and that there may be an overlap between the two.

Within this second definition, we should also consider whether the different platforms might constitute separate markets – for example, IPTV services may be perceived and used very differently to content accessed on PCs via the public internet. We should also consider whether the catch-up service should be thought of differently to the wider non-DRM protected service, and the effect on our conclusions, if any, of changing the catch-up parameters.

### **How these markets might develop**

The big challenge here is that no-one knows for certain how these markets might develop. The best we can do is to plot out some plausible scenarios, and look at available evidence from the UK and elsewhere – especially the US.

The key point to note is that almost without exception, commercial players are experimenting with a wide range of options for charging for and delivering audiovisual content in this new world. No-one really claims to know what the successful business model will be, but no-one wishes to be left behind.

### Developments so far

Although on-demand and broadband markets are in their infancy around the world, there are many examples of content providers and broadcasters experimenting with different models. Background analysis prepared for BBC Management by Oliver & Ohlbaum describes the key developments, which are summarised below:

*Figure 1*

<b>In the US:</b>
<ul style="list-style-type: none"><li>• Digital cable offers a type of catch-up version of some of the key broadcast channels, either at no charge, or for a small extra subscription (e.g. HBO for an extra \$4.95 a month).</li><li>• The network broadcasters are offering downloads of some key programming shortly after first transmission – either via intermediaries like AOL and Apple, or via their own websites. Typically, a new episode of a popular drama, like CSI would be offered for \$1.99 (without ads) or \$0.99 (with ads) and most recently, ABC has announced it will offer streamed access to programmes free of charge, but with advertisements included in the streamed content.</li><li>• Broadband sites, such as AOL's In2TV are offering access to a wide range of archive</li></ul>

programming – In2TV's streamed shows are free but contain 2 minutes of ads

- Push video technology is being introduced by the digital cable and satellite services, by which programmes are transmitted over the air and stored in the PVR for later on-demand usage.
- Google is developing a video search tool, which will allow online access to a huge range of audiovisual content, much of it free and user generated
- Managed IPTV services are being introduced by some of the major telcos – for example AT&T.
- Universal and others are experimenting with permanent downloading of movies, at DVD price points.

#### **In the UK:**

- BSkyB has launched Sky by Broadband – with on-demand access to certain types of content, currently offered free as part of the premium Sky subscription package.
- Home Choice offers a range of streamed and on-demand content using a managed IP service.
- BT Vision plans to launch a hybrid DTT/broadband on-demand service later this year, which will offer paid for on-demand content, alongside the free to air TV broadcasts, with a PVR capability in the set top box.
- ITV and Channel 4 have announced plans for a mix of advertiser-funded and pay on-demand content. MTV plans a service that will be funded by short advertising breaks. In both cases, consumers will not be able to skip the advertisements.

#### *Music industry:*

O&O also note potentially relevant developments in the music industry, where several different models have developed and now appear to co-exist successfully:

- Free and paid for.
- Per track and subscription models.
- Streamed and downloaded.
- New releases alongside access to extensive back catalogue material.
- Proprietary and open systems.

#### Possible market developments in the UK

Based on their analysis, O&O conclude that we might expect to see a mixed model emerge in the UK, with a combination of free to air conventional broadcasting, and a range of on-demand services – with their precise nature depending on the content genres and platforms involved. The strategic dynamics are such that all the major commercial operators will be playing in this sector, whatever the BBC decides to do, but their ambition is more likely to be about retaining customers and reducing churn through offering a value-added service, than about generating significant new revenues.

For example, alongside conventional linear broadcast channels, we might see:

- A range of free or low cost catch-up versions of programming from network and niche channels, funded by embedded advertising, or included as part of a bundled subscription package, with “tethering” – typically for 7 days
- Individual episodes of leading network TV drama and comedy programming available on a catch-up basis for a fee per download, but with restrictions on copying
- The development of largely premium content on-demand services for (e.g. for big movies, concerts, dramas and possibly comedies) – with simultaneous on-demand and DVD release, possibly prior to any broadcast transmission.
- Archive and niche material – broadband distribution enabling exploitation of the “long tail” of content which would not until now have been viable for commercial release.

Consumers will most likely see catch-up as being simply an extension of their current free broadcast services. “Free” PVR/home storage capability in many homes will reduce the scope for commercial catch-up services – and commercial experiments so far appear to expect only modest charges for catch-up, if any at all. However, too extensive a free catch-up service could start to undermine the commercial value of the pay market for premium and near to first run DVD/on-demand releases of popular programming. We may therefore see (quite time limited) catch-up being offered as part of a bundle of services – e.g. as part of a premium pay channel package, with some experimentation around pay per view catch-up for key programmes (along the lines of the US \$1.99 model). Research in North America has suggested that only 3% of online consumers are willing to pay for current TV programmes online, however, which indicates that the pay market for such services could be limited<sup>12</sup>.

On-demand services will be supplied in broadly three ways:

- Using push technology – broadcast to the storage capability of next generation PVRs
- Via managed IPTV services – such as that planned by BT
- Over the public internet – quality considerations suggest that this will be focused more on downloaded material than streaming.

Ultimately all three services will converge in the sense that content delivered via each system will be available for viewing on all screens within the home. Over the first few years of development, though, the third (public internet route) is likely to remain focused on the PC.

Taking the above market analysis as our base, we can begin to comment on the possible direct impact of the BBC's proposed service on the consumer take-up and revenues of competing commercial services, and also its impact on the wider competitive process.

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<sup>12</sup> Forrester, *The Real Potential of Internet Video*, September 2005

## **The direct market impact of the BBC's proposition<sup>13</sup>**

If we assume first that the relevant market is in the main an extension of existing free to air broadcasts, the BBC's catch-up service is most likely to be competing against other conventional broadcasters - principally ITV, Channel 4 and Five. Based on evidence from the US, reported in the O&O analysis, and our analysis of likely consumer expectations, we would expect to see those other broadcasters offering catch-up as a matter of course – either as a free add-on to their broadcast channels, (perhaps funded by advertising) or for a modest additional subscription. ITV's recently announced plans suggest that it will begin by providing a mix of the two. If viewing patterns for catch-up are similar to those for broadcast channels, the BBC's catch-up offer might account for around 30% of usage of such services in the UK.

How might the BBC's presence affect commercial incomes? If commercial catch-up providers opt for an advertising funded model, the answer is probably not very much. As with current broadcast channels, the BBC competes for audiences but not directly for revenues. Indeed, given the many different opportunities that advertisers have to reach customers over the internet, the BBC's presence alongside commercial broadcaster catch-up services will have only a marginal impact on the extent to which they can attract advertising spend. It is competition from other advertising outlets on the internet, not the BBC, which will determine their success or failure.

### The wider on-demand market

If we take a wider view of the market, and extend it to all on-demand content, not just an extension of free TV, then the BBC's direct impact may be greater.

There is a potential commercial market for access to and ownership of – for repeated viewing – of programmes for some months after they have been first transmitted. There is also a potentially exploitable market for access to programme archives. This demand is currently served largely by DVDs, but in future will be served as well by on-demand downloads over broadband.

The current UK market for TV DVDs is estimated to be around £450m a year, half of which is UK produced material. Comedy takes by far the biggest share, followed by drama (figures from Oliver & Ohlbaum). The value of DVD rights to producers should not be under-estimated – although small in relation to the total cost of productions, they can be high relative to the profits margins made on productions.

If the BBC's seven day catch-up offer allows extensive downloading and usage of premium BBC dramas and comedies, then it could begin to encroach on the commercial value of this new market. The ultimate commercial potential of on-demand downloads of premium content to keep may be greater, but also the BBC's influence at the start of an emerging market, and given its extensive output, might be

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<sup>13</sup> In the following sections, we first assume that the alternative to the BBC's proposition is that the BBC would not offer a catch-up service of any form. We later consider the effect on the conclusions of a counterfactual in which the BBC offers a commercially funded catch up service.

greater, too.<sup>14</sup> At the margin, more viewing of BBC on-demand content will reduce the potential for paid for on-demand services.<sup>15</sup>

The impact will be mitigated by first, the extent to which consumers perceive tethered catch-up as being a very different proposition to paid for on-demand downloads, possibly allowing permanent ownership, and second by the high degree of product differentiation in the TV sector – audiovisual programming is not a commodity, which means pay services and paid-for downloads can successfully co-exist with free to air broadcasts and catch-up<sup>16</sup>.

### Overall impact

Overall, the direct impact of the seven day catch-up element of the *BBC iPlayer* on the development of commercial catch-up services seems likely to be small. Most viewers already expect such services to be free or provided at a low incremental price. If commercial broadcasters pursue an advertising funded approach, then the BBC's presence will make little or no difference to their incomes. If they opt instead for an individual programme catch-up strategy, to the extent that the BBC's programme are free, there may be some substitution of BBC for commercial programming at the margins – but strong programme preferences will limit the extent of that substitution, and the overall size of the market will not be great in any event.

### Other elements of the BBC's on-demand proposals

The other elements of BBC on-demand proposals will need to be assessed for their market impact in a similar manner to the above analysis.

Most straightforward is likely to be the assessment of the impact of streaming the BBC's TV channels over the internet. It is hard to see how this can have any additional significant impact on commercial broadcasters than do the BBC's existing broadcast transmissions.

More problematic may be the plans for non-DRM downloads of audio content, particularly if these moved beyond programmes which have been broadcast that week (i.e. catch-up) into a more extensive on-demand offer.

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<sup>14</sup> A 7 day window for catch up seems to make intuitive sense – most programmes in a series, for example, will feel out of date once 7 days have expired and the next programme in the series has been aired. The BBC's current plans which allow for a 7 day download window and then 7 days to watch the programme, plus a series stacking option, could be argued to have moved some way beyond this intuitive or common sense view of catch-up.

<sup>15</sup> The impact of catch-up services in general (i.e. not just the BBC's) might not be evenly distributed. Smaller niche channels, which rely largely on UK and US archive programming, might be hardest hit. If catch-up is, as seems likely, offered by all the main free to air networks, the niche channel's share of viewing may decline, as audiences are able to watch new material more readily than at present.

<sup>16</sup> The O&O analysis estimates that around 10-15% of broadband households might use pay on-demand services on a regular basis. It also quotes from a YouGov survey which suggests that 37% of those who said they would be very interested in a pay on-demand service said they would be much less likely to use it if there were a comprehensive free catch up service available.

## Competitive market structure

We can now examine the *BBC iPlayer's* possible impact on the competitive process, using the two main market definitions suggested earlier – either an extension of free to air TV, or part of a wider on-demand content market. Although the BBC's new service may divert demand from competing commercial providers, the key issue here is whether overall there would be a significant adverse impact on the competitive process in what is a very new market. Particular concerns would be raised if the BBC were, through its actions, to foreclose market entry, or significantly lessen competition through its actions.

For example, the White Paper identifies a number of relevant competition concerns regarding the BBC's activities:

- Excessive cross promotion between different platforms.
- Exclusivity of BBC content which results in an undue distortion of competition.
- Improper use of proprietary technology to distort competition e.g. in downstream content services.
- Undue discrimination in the supply of non replicable content e.g. archive programming.

In addition, as we are talking about a fledgling/emerging market, the BBC needs to pay special attention to the scale of its activities and investment compared with the early years size of the market, and to the transparency of its plans – otherwise there could be a major risk to private investment.

### Catch-up as an extension of free TV

If we take the view that the relevant market is an extension of existing free to air TV, then it is hard to see how the BBC's new service will have any more impact on the competitive process than do its current broadcast services. In some ways, the impact could be less.

First, the BBC's proposition is unlikely to prevent the emergence of competing free catch-up services:

- Free catch-up, as the O&O analysis notes, is likely to become a standard part of most existing broadcasters' services, as they seek to meet rising consumer expectations;
- Competing platforms such as IPTV and broadband will see catch-up as an essential part of their proposition, both in the battle for triple play customers, and to meet the competition from broadcast services coupled with PVR functionality.

Second, although a significant market intervention, the BBC's catch-up service is proportionate to its overall remit as a wide ranging PSB:

- The BBC proposition is based on making available its current range of services – agreed to be a necessary part of its PSB remit;

- Commercial broadcasters in the UK understand and have planned on the basis of a continuing significant publicly funded supplier in the market.

Third, to the extent that other free catch-up services will be funded by advertising, the BBC's proposition will not directly compete for revenue with those services.

In conclusion, as far as the free catch-up service is concerned, it is the provision by another means of content which is already part of the BBC's existing service. This is a market intervention that has significant public support, and has been in place for many years. Future commercial investment decisions can therefore be made against this clear and certain background – unlike in other cases where the BBC has been considering new content services.

In some ways, it could be argued that the BBC's proposition might be pro-competitive:

- (if, over time, it makes the catch-up service available via all distribution platforms) – by ensuring that no single platform has an advantage over any other, through access to the BBC's content;
- By acting as a discipline on the pricing policies pursued by what might otherwise be a small number of powerful vertically integrated commercial suppliers;
- By helping promote the use of broadband and other platforms, which in themselves remove old barriers to market entry;
- By helping consumers understand the new technologies and enabling them to make more informed choices.

#### A wider on-demand content market

If we take the view that the *BBC iPlayer* will operate in a wider market for pay on-demand content, which will be funded via a variety of different models, the picture becomes slightly more complex.

At a broad level, there are several strong reasons why the BBC's proposals are unlikely to significantly lessen competition in this particular case:

- First, the evidence we have so far suggests that significant markets for premium pay content can co-exist with time limited catch-up – consumers want both, The same is true for archive and niche programming – there will be substantial scope for commercial players to exploit on-demand content in a variety of ways, alongside even free catch-up.
- Second, the new on-demand markets are characterised by much lower entry barriers than in conventional TV (no spectrum scarcity, direct routes to users via the public internet etc).
- Third, there are many well funded players interested in investing in this emerging market around the world, There are global rather than UK competitors – well funded operators ranging from Yahoo and AOL to Google and Microsoft. It is unlikely that their investment in on-demand content services would be threatened by the prospect of facing a free catch-up

service from the BBC. There is also scope for non-traditional players to enter in certain genres with scope to share costs across their different activities e.g. newspaper publishers as suppliers of news and current affairs content.

- Fourth, these are fast changing markets, with rapid advances in new technologies and service propositions, and with high international growth potential. It will be hard for any player, even one of the size of the BBC in the UK, to close down the competitive process, when the market parameters are moving quickly, and many new players are developing completely new business models.

However, some concerns may need to be addressed if we take a more disaggregated view of the on-demand market.

First, an assessment will be needed of the extent to which the BBC's catch-up proposition might encroach significantly on some aspects of the potential pay on-demand market:

- The current catch-up proposition does allow limited storage and later playback of premium BBC content, beyond the seven day distribution window, and allows series stacking.
- This capability might be used by some consumers to build their stores of potential high value comedy and drama series, which might start to have a more serious impact on commercial downloads and possibly DVD sales.

The O&O analysis refers to survey results which suggest that free catch-up services could reduce customers' willingness to pay for pay catch up services. The more comprehensive the free catch-up service is, the more effect it is likely to have. But O&O still predict a mixed model of free and pay catch up/on-demand services in the UK. That is, the competitive process is still expected to be healthy, with new service providers emerging and serving customer needs alongside free BBC material.

Second, free catch-up in general might have a disproportionate impact on the (relatively new) IPTV providers. They face the challenge of making significant investment in delivery systems and set top boxes in order to enter a competitive TV market, and may rely on a commercial on-demand component in their business models, which could be adversely affected by a significant free catch-up proposition. However, as noted in the O&O analysis, free catch-up TV will develop even without the BBC's participation. Moreover, at least in the early years of any such offer, it is likely that consumers will think of content available over the public internet (as offered by the BBC and others) as being in a different market to that served by IPTV providers, who will offer a managed TV service, of guaranteed quality, to the main TV screen in the home.

Third, there may be a particular concern if the BBC's audio download proposals moved beyond programmes which have been broadcast that week (i.e. catch-up) into a more extensive on-demand offer:

- The BBC is by far the largest UK producer of audio content (especially speech radio) and has a unique archive of content that could be exploited through audio downloading.
- Any new entrant trying to produce and sell new UK content would face real challenges should the BBC decide to make an extensive amount of both new and archive audio content available for downloading free to users.
- Even the threat that the BBC might at some stage decide to release large volumes of new and archive audio content for free downloading may be enough to discincentivise potential commercial entrants.

The BBC will need therefore to design its Non-DRM download service carefully to take account of these risks to commercial players. Clarity about the BBC proposition and the limits of its proposed activities will help reduce uncertainty in the commercial market place, and hence help private sector investors to make properly informed decisions. It is also worth considering the different potential sections of the audio download market, for conditions and hence risks will vary across different genres. For example, provision of news content is arguably both most central to the BBC's PSN remit, and a genre in which other large organisations such as newspaper publishers can leverage resources from existing operations into new media, hence ensuring more of a level playing field than – for example – in some entertainment genres.

#### The counterfactual

As noted earlier, we need to identify a counterfactual, against which the impact of the BBC proposition can be assessed.

Although we understand that no view on this has been taken by the BBC, the two main counterfactuals are:

- a) The BBC does not introduce a catch-up service, and closes down its non-DRM protected audio download service.
- b) The BBC makes its content available via a commercial version of the *BBC iPlayer*, or, perhaps through making its content available on a commercial basis to other suppliers.

The above discussion assumes that (a) is the counterfactual – that is, the BBC withdraws from catch-up and non DRM downloads. However, in practice, the option of the BBC staying out of the catch-up and on-demand market seems unlikely to be in the long term public interest. It would mean ignoring fundamental changes in the way in which users wish to access content, would close off a potentially useful source of extra income, which could be invested in content, and it would risk further decline in BBC reach and impact.

If the BBC were to pursue on-demand and catch-up commercially, (option b) would it seek advertiser funding or direct consumer payment? For this paper, we assume that it would choose some form of direct payment – given the potential disadvantage of associating the BBC brand with on-screen advertising, and the uncertain longer term outlook for TV spot advertising.

If the BBC were to offer a direct payment service, there may be two effects, working in different directions:

- There could be a modest benefit to the commercial market, as consumers would become more accustomed to the concept of paying for catch-up, rather than getting it free or as part of a bundle of services – and if the BBC could be persuaded to be part of a package, it might be possible to market a single monthly subscription for all catch-up.
- On the other hand, the BBC would be competing in the same pot as commercial broadcasters for a relatively limited pool of income, hence reducing the gains to individual commercial broadcasters.

A more detailed MIA would need to pay particular attention to the counterfactual, as it could materially affect the outcome of the analysis.

### Conclusion – competitive process

In conclusion, our preliminary analysis suggests that the impact of the BBC's proposal for TV catch-up on the longer run competitive process could be relatively modest, especially if it is accepted that the relevant market is an extension of free to air TV. Even if we consider a wider on-demand market, the nature of that market suggests that the competitive process will not be significantly affected at a broad level by the BBC - fast changing technology, innovative business models, and interest from a range of well-funded international players will almost certainly combine to ensure consumers will continue to see the benefits from innovation and competition in the production and delivery of on-demand content. There are risks in some more focused areas, however, which the BBC could address by the careful design of its proposition. On current plans, for example, the market impact of the BBC's on-demand proposals could be greatest if series stacking and the 7 day window combine to permit consumers to build a store of potentially high value content, and if free non-DRM audio downloads compete directly with commercial providers of similar content.

### **Wider impact**

In addition to the effects described in the preceding two sections, the BBC's on-demand proposals could also have several wider impacts, which need to be considered in any final market impact assessment.

### Overall market development

The BBC's proposition could have a positive effect on market development, to the extent that:

- The availability of the BBC's content in an on-demand service helps to stimulate broadband take up (or indeed, take up of other platforms such as cable and IPTV services).
- (See above) the BBC helps to improve consumer understanding of broadband and new media, and helps consumers make more effective use of the new technologies.

*How significant an effect is this likely to be?*

There is no doubt that the BBC can be a powerful promotional force for new media (as shown by the DTT experience). Similar promotional support for the *BBC iPlayer* would almost certainly have some positive effect on the broadband market:

The first wave of broadband growth (taking us to around one third of all households) has been driven by a mix of price competition and the enhanced capabilities of broadband of up to 2mb/sec.

The “second” wave of growth – to take us from here to around two thirds take up (which appears to be the consensus forecast for the 10 year horizon) – will most likely be driven further by the enhanced features, content and applications offered by higher speed broadband. Such enhancements will attract existing users to higher speed connections, but may also bring the next wave of users into the broadband universe.

The BBC can certainly play a positive role in this second wave growth – but it is unlikely to be as significant an effect as the DTT model:

- There are many more potential content suppliers who – even without the BBC – will be helping broadband to attract new users.
- Content is only part of the story – many other features, and continuing price competition, will be part of the consumer decision to upgrade or enter the market.
- Broadband is increasingly likely to be bundled with other services (in triple or quadruple play packages) which will diminish the impact of any single factor in driving take-up.

Nevertheless, BBC backing – especially with a high level of promotion, and the availability of high quality UK content services – should contribute to further growth.

Could the BBC help push broadband take up to the final third? This is less likely to be the case. This group is likely to be formed mainly of older and less well off households. They are ultimately more likely to rely on cheaper conventional broadcast services (e.g. DTT) for their content. It is hard to see the existence of the BBC’s on-demand service making any significant difference to their purchasing decision.

#### Impact on ISP capacity and consumer internet fees

Finally, a wider impact assessment would need to consider carefully the effect of a successful BBC on-demand proposition on the capacity of the internet and ISPs to deliver to increased consumer demands. Some doubt has been expressed already in the US about the capacity of the internet to cope with widespread video streaming. At some stage capacity constraints will need to be addressed – which will mean higher costs incurred by ISPs and, in turn, consumers or service providers.

There are some factors which suggest this might not be such a big issue in the short to medium term:

- The projected usage levels for the BBC's proposition are quite modest in its early years.
- Many ISPs cap consumer internet usage on a monthly basis.
- Some of the BBC usage is likely to replace existing peer to peer traffic, which is driven by other audiovisual content downloading and file sharing.

And in the longer term:

- The incremental effect of the BBC proposition should not be overstated – use of broadband to access on-demand will develop, whether or not the BBC is involved.
- It is economically efficient for ISPs to move to charging systems which reflect costs imposed on the network: i.e. high users should pay more.

Nevertheless, the costs incurred by ISPs to carry the levels of BBC download traffic implied by the PVA reach modelling are likely to be non-trivial. It is probable, given the tight margins in the market, that this extra cost will eventually be passed on to consumers, or met by the content providers/packagegers in the form of delivery charges levied by ISPs - although at this stage it is hard to predict in what form or how it will be distributed across different customer groups.