The Communications Market

August 2005 Quarterly Update

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1: Key facts

Radio

- Local commercial radio listening fall to a new low share of 33.9% in Q1 2005 (although there was a rise in Q2 2005)
- Emap's acquisition of SRH would mean the creation of the second largest commercial radio group in the UK by number of stations, and would bolster Emap's position as second largest group by listening hours
- The number of community radio licences awarded has quadrupled from five to 20

Telecoms

- Total retail telecoms revenues in the 12 months to March 2005 were £36.6 billion, 5% higher than over the previous 12 month period
- Mobile spend in Q1 2005, at £3.3 billion, is some 17% higher than the same quarter in 2004
- BT Fusion, which launched a commercial trial in June 2005, is the first demonstration of fixed-mobile convergence
- Over 35% of UK fixed lines are now connected to non-BT service providers

Television

- Freeview now reaches over 5 million households
- 30% of all TV viewing is to multichannel services
- Shopping, interactive services and pay-per-view accounted for a fifth of digital channels' revenues in 2004
- Direct consumer spending now accounts for over 60% of all TV industry revenues, with advertising accounting for less than 40%

2: Introduction

This is the third in a series of quarterly supplements to Ofcom's annual Communications Market reports, the latest of which was published in July 2005. This update covers the first calendar quarter of 2005 (January-March).

The Communications Market supports Ofcom's objective to provide best-in-class research to which stakeholders have regular access. It aims to give a comprehensive picture of the radio, telecommunications and television sectors, with a round-up of recent developments and the latest available data on:

- Industry size, structure and financing;
- Availability, penetration and use of products and services; and
- Consumer attitudes and behaviour.

In addition, we take a closer look at some emerging themes in each sector:

- Focus on BBC radio;
- Mobile content; and
- The multichannel market

Note that the information set out in this report does not represent any proposal or conclusion by Ofcom in respect of the current or future definition of markets and/or the assessment of licence applications or significant market power for the purposes of the Communications Act 2003, the Competition Act 1998 or other relevant legislation.

Ofcom welcomes comment on the content and style of the Communications Market to help inform future publications. Suggestions and queries should be sent to: market.intelligence@ofcom.org.uk.

3: Executive summary

3.1: Radio

Consolidation continues to reshape the UK radio industry. Emap's proposed takeover of Scottish Radio Holdings would create the second largest radio company in the UK by the number of licences owned (Emap is already has the second largest share of radio listening). Following the creation of GCap and the acquisition of The Wireless Group by UTV, a number of operational changes are starting to emerge from the new organisations.

Community radio has received a boost in recent months with the 15 new licences bringing the total number awarded to 20. In addition, three more commercial radio licences were awarded in Manchester Norwich and Ballymena.

Q1 2005 saw local commercial radio see its share of radio listening fall to its lowest level although Q2 figures showed an improvement.

3.2: Telecoms

Broadband continues to be the lead story in the telecoms sector. By June 2005, there were a record 8.1 million broadband connections in the UK. The growth in broadband connections has driven the uptake of products and services that are either unique to broadband, or that provide a far more satisfying user experience at faster broadband speeds. BT's competitor DSL ISPs have been rapidly gaining market share over the past two years, to a point where they now comprise 47% of all broadband connections, and the cable companies have a combined 28% market share of broadband.

BT's Fusion fixed-mobile product is expected to be only the first step in the convergence of fixed and mobile platforms. A number of key enabling factors will facilitate development of fixed-mobile convergence, notably:

- the emergence of handsets with multiple transmission protocols (GSM/WCDMA/Wi-Fi/WiMax)
- the growth of voice over IP (VoIP) offerings over fixed broadband and Wi-Fi platforms
- a move towards all-IP transmission of voice and data over mobile networks

Revenues in the mobile sector continue to power ahead; mobile spend in Q1 2005, at £3.3 billion, is some 17% higher than the same quarter in 2004, and now constitutes over a third of all telecoms revenues. In contrast, revenues from fixed calls and access continue to fall, chiefly as a result of price competition.

3.3: Television

Structural change in the TV sector is ongoing, with the transition to digital continuing to have wide and diverse impacts:

- BSkyB announced record profits, and restated its commitment to launch high-definition and enhanced PVR services in 2006. BSkyB expects revenues from its SkyBet service to exceed its advertising revenues in 2006

- RTL's agreement with UBM to let the former take complete control of Five is expected to allow Five to compete more aggressively with growing digital competition. RTL's strategy is to develop and strengthen its families of channels in each market, and there was speculation that if the deal goes through it would seek to launch more channels in the UK or acquire other channels as they become available;

- Telewest purchased the outstanding shares of sit-up Ltd that it did not already own, valuing sit-up at £194 million; and

- ITV's proposed deal to acquire SDN, one of the digital terrestrial multiplex operators was under review by the Office of Fair Trading

- Advertising revenues earned by multichannels exceeded Channel 4's for the first time in the second quarter of 2005

The BBC's 2004-05 Annual Report also focused on the governors' assessment of the BBC's performance in an increasingly competitive digital market. The governors praised BBC ONE's revitalised Saturday night schedule, and recognised the BBC's digital channels' success in increasing their audience. However they also acknowledged a number of audience concerns about quality, set a goal to reduce the level of repeats in BBC ONE and BBC TWO's peak-time schedules, and suggested that BBC THREE's news output should be overhauled.

Advertising spend grew in the first quarter of 2005, according to the Advertising Association, with Internet advertising the fastest growing medium. Overall growth in TV advertising in the UK is expected to be a little over 2% in 2005. However, one widely reported study from Zenith Optimedia suggested that the long-term future of TV advertising was uncertain; it predicted that TV's share of the global advertising market would fall this year, and that this might mark the start of a long-term decline.

No doubt partly in response to these concerns, many channels have developed alternative sources of revenue, including premium rate telephony services, interactive services and advertising, pay-per-view and TV shopping. In total these new and alternative revenue sources generated £235 million for digital channels in 2004, excluding channels operated by vertically integrated broadcasters, who do not report channel revenues separately.

The digital multichannels continue to take an increasing share of viewing, with 30% of all viewing to multichannels in June 2005. ITV1's share fell to just 20%. Its peak-time share also declined in the second quarter, to reach 25.4% in June 2005 – just half a percentage point greater than BBC ONE and 2.6 percentage points greater than the combined multichannels. However, the decline in ITV1's share has been partly offset by the strong performance of ITV2 and ITV3, with the result that the total share for all ITV channels was fairly stable over the first five months of 2005 at around 22%.

4: Radio market developments

4.1: Consolidation continues

At the end of June Emap and Scottish Radio Holdings announced that they had agreed terms under which Emap would acquire the shares in SRH that it did not already own. The deal is subject to regulatory approval, but would create the second largest radio group in the UK were it to go ahead. The details of the transaction are discussed in more detail in the Industry Structure section below.

The Local Radio Company has acquired Bath FM, a locally-oriented music and information service, whose primary target audience will be 25-54 year olds. This increases to 27 the number of stations it now controls.

Following the creation of GCap, the Radio Magazine has reported operational changes at the new entity through their creation of “The One” – a network of stations that combined GWR’s “The Mix” and the Capital FM network. In addition, The Storm – a digital-only GWR station available on DAB, cable and satellite – has become part of Xfm.

UTV has applied to de-list The Wireless Group from the London Stock Exchange following the completion of its acquisition. At the start of July 2005 a number of staff changes took place, including the appointment of a new CEO.

4.2: Licensing continues with community radio increasing fourfold

The increase in radio licence awards continued in Q1 2005 with 15 new community licences awarded, taking the total number to 20. In addition, in June commercial radio licences were awarded for Manchester, Norwich and Ballymena. The Manchester licence was won by Xfm, Norwich by Crown FM and Ballymena by Ballymena Broadcasting Ltd (broadcasting as Seven Towers FM).

4.3: Radio links up with mobile and internet

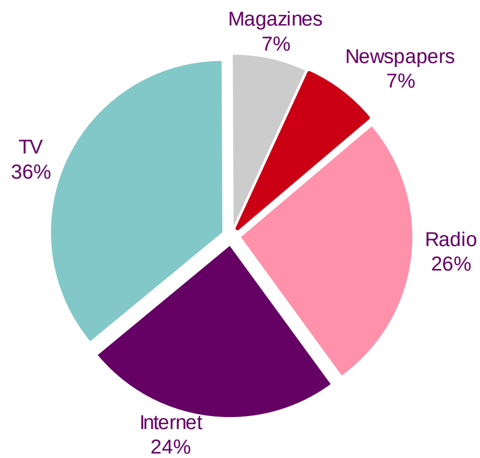
Chrysalis has announced a deal with Enpocket to run a series of mobile music promotions and services. It intends to use the Enpocket Marketing Engine to drive interaction with listeners through personalised text and multimedia messages.

At its preliminary results presentation in August 2005, Sky announced the introduction of the 'Sky Gnome', a portable and wireless device that will enable customers to listen to the audio output from digital TV and radio channels throughout the home. The company claims it is compatible with all Sky boxes and has a wireless range of over 100ft.

In July 2005 the Radio Advertising Bureau (RAB) and the Internet Advertising Bureau published joint research looking at how radio listening and internet usage interact and the implications for advertisers. The report noted that 20% of respondents would listen to the radio while using the internet. It also quoted research from the BRMB Internet Monitor which showed that around a quarter of average weekday media time among broadband using survey respondents, was spent listening to radio (Figure 1).

Radio

Figure 1: Share of media time amongst broadband users



Source: BRMB Internet Monitor. August 2004

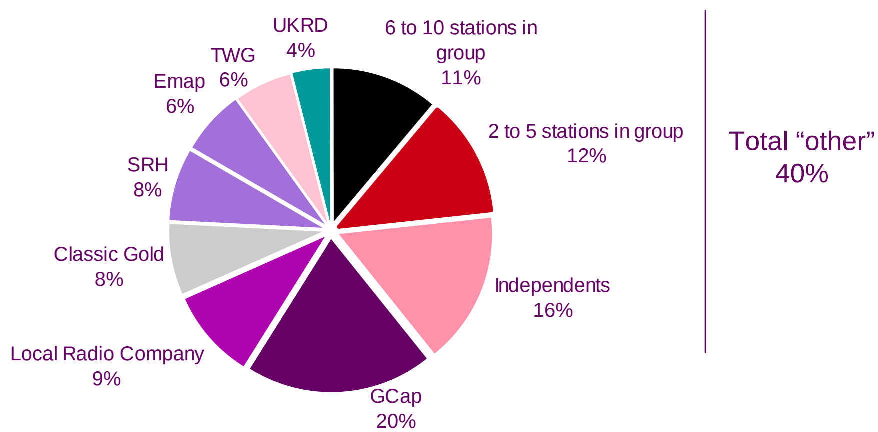
5: Industry Structure

5.1: Emap could become second largest UK commercial radio company

On 21 June 2005, Emap plc and Scottish Radio Holdings plc (SRH) announced that they had agreed the terms of a recommended cash offer by Emap for the entire issued, and to-be-issued, share capital of SRH not already owned by Emap. The offer is for 1,088 pence per SRH share, valuing the entire issued share capital of SRH at approximately £391m. On 9 August 2005 Emap's offer for those shares was made wholly unconditional.

After carrying out its statutory assessment of the takeover, Ofcom concluded that the local digital multiplex ownership rules and the local digital sound programme service (DSPS) rules would be breached. This did not prevent Emap from proceeding with the takeover, but required it to take actions following the completion of the takeover. Specifically, the local digital multiplex ownership rules would be breached in respect of the Glasgow and Ayr multiplexes, and the DSPS rules would be breached on the Aberdeen, Ayr and Dundee/Perth multiplexes. Emap has a number of different options open to it in order to ensure compliance, however it is for Emap to decide how to proceed. The transaction was cleared by the OFT on competition grounds.

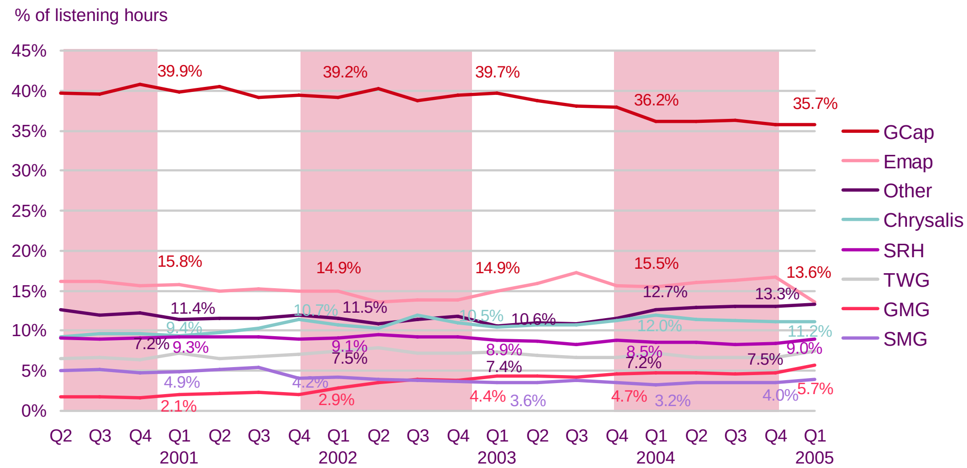
Figure 2: Number of stations owned by commercial groups



Source: Ofcom
Note: These percentages are derived from a universe of stations rather than licences

The acquisition would create the second largest commercial radio company in the UK by number of licences owned (Figure 2Figure 2:). Emap is already the second largest radio company in terms of listening share (Figure 3), and based on Q1 2005 figures this would rise to over 20% of all commercial hours if the acquisition goes ahead as planned. GCap and the combined Emap-SRH would then take over half of all commercial hours.

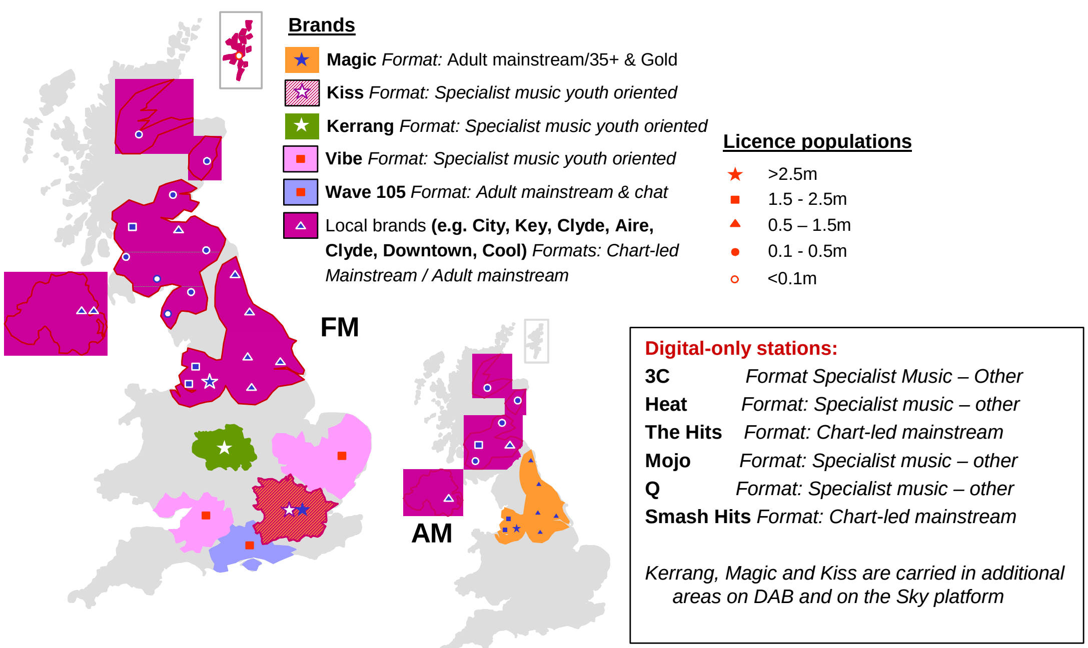
Figure 3: Share of commercial hours



Source: RAJAR

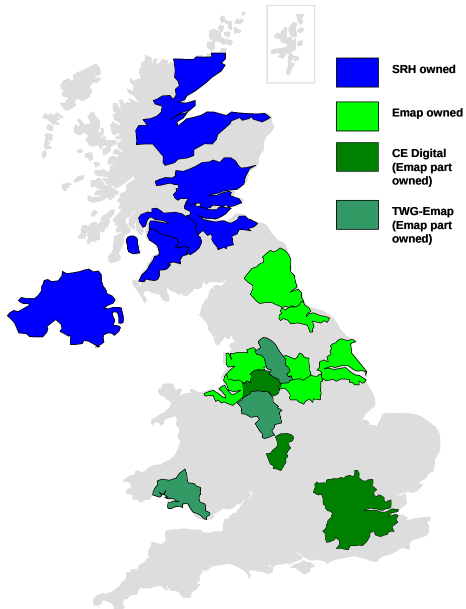
The group would have 41 wholly owned, and two partly owned, local analogue services, interests in 19 of the 46 local DAB multiplexes and a significant number of digitally broadcast stations (Figures 4 and 5).

Figure 4: Analogue coverage of the combined group



Source: Ofcom

Figure 5: Digital coverage of the combined group



Source: Ofcom

In addition to its radio holdings, SRH owns a regional press business, Score Press, comprising 45 local newspaper titles in Scotland, the Republic of Ireland and Northern Ireland. When Emap announced the intended SRH transaction, it also stated that it had entered into a conditional agreement to sell Score Press to Johnston Press for £155 million.

Emap gave context to the SRH acquisition by expressing its belief that the radio industry was going through a period of structural transformation driven by two key issues: consolidation and audience fragmentation.

- It thought that commercial radio companies need to invest in brands and programming in order to grow audience share and thus increase advertising revenues. Consolidation of broadcasters would create the scale to enable this investment to take place.

- It also noted that the media buying sector had been consolidating, with five companies now representing 88% of the market. Emap believed that its customers want a “one stop shop” from which to source national advertising and that their choice of media partners would increasingly be driven by advertising scale, audience reach and strength of brands.

- The company also stated that it thought the accelerating take-up of digital broadcasting would result in audience fragmentation and that scale, strong brands and distribution capacity across a wide variety of platforms would enable the combined radio business to compete more effectively in an environment with more listener choice.

- Emap stated that it considered the combination of the Emap and SRH businesses would create a radio group with the ability to reach all major conurbations in the UK, together with a strong position in the Republic of Ireland.

- Emap believes that the acquisition of SRH will generate annualised cost savings of approximately £5m by the third full year of ownership, at a cash cost of approximately £5m, and that the acquisition will be immediately earnings-enhancing on a normalised basis.

5.2: Further Ofcom commercial radio licence awards

In June 2005 Ofcom awarded the new FM licences for Manchester, Norwich and Ballymena as detailed below.

Figure 6: New FM licence awards

Date of award	Area	Station name	Ownership
December 2004	Blackburn	The Bee	Two Boroughs Radio Ltd (32.5%) (a 100% subsidiary of The Local Radio Company), The Radio Business Ltd (32.5%), and 8 individuals
December 2004	Edinburgh	Dunedin FM	The Wireless Group plc
January 2005	Ashford	KM-FM Ashford	Kent Messenger Ltd (67%), Barretts Ltd (10%), Hobbs Parker Partnership (7.5%)
February 2005	Kidderminster	ACE FM	MNA Broadcasting Limited (wholly owned by Midlands News Association Ltd)
March 2005	Cornwall	Atlantic FM	Atlantic Broadcasting Ltd (Tindle Radio 47%, Camel Media 47%)
March 2005	Belfast	U105	Ulster Television plc
April 2005	Durham	Durham FM	The Local Radio Company
May 2005	Banbury	The Bear	CN Group
June 2005	Manchester	Xfm	GCap Media plc
June 2005	Norwich	Crown FM	Tindle Radio Holdings (Provincial Radio Ltd) and Town and Country Broadcasting
June 2005	Ballymena	Seven Towers FM	Alpha Newspaper Group, and Irish News Ltd.

The FM local commercial radio licence for Manchester was awarded to Xfm Manchester Limited, owned by GCap Media plc. This was a difficult decision for the Radio Licensing Committee (RLC) in light of the very large number of applications, 19 in all, proposing a wide variety of formats. Xfm will broadcast a wide range of specialist music programmes (45 hours per week), together with commitments to live sessions and comedy shows. This will include a large proportion of locally-made programming and news, with at least 20 hours of each day's programming produced and presented in Manchester.

The FM local commercial radio licence for Norwich was awarded to Crown FM Limited. This licence attracted five good applications, however, the Radio Licensing Committee (RLC) chose Crown FM on a balance of the criteria. Crown FM's major shareholders are Tindle Radio Holdings (Provincial Radio Ltd) and Town and Country Broadcasting.

Crown FM's Format promises 24 hour local news and two extended weekday bulletins, and also a mix of popular music to appeal to its slightly more mature core target audience. The station will be locally produced and presented 24 hours per day, and its Format includes commitments to deliver a wide range of local material.

The FM local commercial radio licence for the town of Ballymena and the immediately surrounding area received four applications, and was awarded to Ballymena Broadcasting Ltd ('Seven Towers FM').

Seven Towers FM is owned by two established Northern Ireland media owners – the Alpha Newspaper Group, publisher of the Ballymena Guardian, and Irish News Ltd. The station will be locally produced and presented 24 hours per day. The Format will include seven-day local news provision, music, live sports commentary and plans to broadcast half-hour special interest programmes.

A statement setting out the key determining factors for the award of the June licences is available on the Ofcom website[1]. All of the stations are expected to begin broadcasting at the earliest opportunity, and must do so no later than two years from the award date.

In addition to the three June licence awards, there are currently applications for Solent, Torbay, Barrow-In-Furness and Swindon. The applicants are listed below (Figures 7,8,9 and 10).

Figure 7: Applicants for Solent

Applicant	Major shareholders	Proposed station name
Children's Radio UK (Solent) Ltd	HIT Entertainment plc (47.5%) GWR Group plc (47.5%)	106 Fun FM
Chrysalis group	Chrysalis Group plc (100%)	106 The Arrow
allTALK FM Solent Limited	The Wireless Group plc (100%)	AllTALK FM Solent
Emmis Atlantic Radio Solent Limited	Emmis International (75%) Atlantic Radio Limited (25%)	C106
Emap Performance Ltd / Solent Radio Ltd	Emap Performance Ltd	Kerrang 106
Solent Regional Radio Ltd	The Local Radio Company (50%)	Melody 106
CanWest Media Works UK Ltd	CanWest Global Communications Corp (95%)	Original 106
Saga Radio South Ltd	Saga Group Ltd (100%)	SAGA 106
Smooth Solent (Real Radio Ltd)	GMG Radio Holdings (Guardian Media Group plc) (100%)	Smooth Solent
Solent Life Ltd	CN Group Limited (100%)	Solent Life 106FM

[1] http://www.ofcom.org.uk/radio/ifi/rl/commer/ar/lapr/awards/

Applicant	Major shareholders	Proposed station name
South Coast Radio Ltd / Scottish Radio Holdings plc	Scottish Radio Holdings plc (100%)	South Coast Radio
Celador Radio Broadcasting Ltd	Celador Radio Broadcasting Limited (90%) (Complete Communications Corporation Ltd).	The Coast 106
London Media Company (LMC) Ltd / Sunrise Radio Ltd	London Media Company Ltd (100%)	Tide FM
Virgin Classic Rock Limited	SMG plc (100%)	Virgin Radio Classic Rock

Source: Ofcom

Figure 8: Applicants for Torbay

Applicant	Major shareholders	Proposed station name
Palm FM Ltd / London Media Company Ltd	London Media Company Ltd (60%) Palm Radio Ltd (40%)	Palm FM
Torbay Local Radio (TLR)	Laser Broadcasting Ltd (27.32%) Peninsula Media Ltd (14.36%)	Riviera Radio
Torbay 106.8 FM Ltd	The Wireless Group plc (100%)	Torbay 106.8FM
Torbay Radio Ltd	Provincial Radio Ltd (100%) (Tindle Radio Holdings Ltd)	Torbay Radio
Your Radio Ltd	Devon Radio Investments Ltd (63%) South Hams Radio Ltd (32%)	Your Radio (Final name to be decided by local poll).

Source: Ofcom

Figure 9: Applicants for Barrow-In-Furness

Applicant	Major shareholders	Proposed station name
Barrow Broadcasting Company Ltd	The Radio Business Ltd (35%) The Local Radio Company Ltd (35%) CN Group Ltd (30%)	Abbey FM
Barrow Local Radio Ltd	Associated Radio (20.52%) Regent Media Services (13.68%)	BLR

Source: Ofcom

Figure 10: Applicants for Swindon

Applicant	Major shareholders	Proposed station name
Moonraker FM		Moonraker FM
Ridgeway Radio Ltd		NOW FM
Radio Swindon Ltd		Radio Swindon
Swindon FM		Swindon FM

Source: Ofcom

Note: Full details of each application are available on the Ofcom website[2]. The above summaries are provided for indicative purposes only and should not be taken as reflecting fully all aspects of each application.

5.3: Twenty community radio licences now awarded

Community radio licensing took a major step forward in June 2005 as 15 more community radio stations were awarded five year licences (Figure 11).

Figure 11: Community radio licences awarded

Station	Area	Description
Unity 24	Southampton	Unity 24 aims to provide a community radio service for those living in deprived communities, in particular Asian and ethnic minority communities, in Southampton.
Skyline Community Radio	Hedge End, Botley and West End, Hampshire	Skyline will provide a community service for the three villages of Hedge End, Botley, West End and surrounding areas of the southern parishes of Eastleigh, Hants.
Express FM	Portsmouth	Express FM will provide access to the airwaves for the learning community of Portsmouth enabling school, college and university students, and other volunteers, to make their own radio programmes; giving voice to young people, the city's education

[2] http://www.ofcom.org.uk/radio/ifi/rl/commer/ar/lapr/ifmapps/?a=87101

Station	Area	Description
		providers and the wider community
Angel Radio	Newport, Isle of Wight	Angel Radio plans to provide a radio service specifically aimed at people aged over 60 living around Newport, Isle of Wight. It will provide an entertainment-based format focusing on the music and memories of 1900 to 1959, as well as up to date information of relevance to the target community.
Awaz FM	Central Glasgow	Awaz FM will serve the Asian (Indian sub continent) population in Glasgow, delivering entertainment, community information, local, national and international news broadcasting in Urdu, Punjabi, Hindi and English. It will be the voice of Glasgow's ethnic communities and their respective faiths. Awaz FM is one of the pilot access/community radio services and began broadcasting in April 2002.
VIP On Air	West End of Glasgow	VIP On Air will provide blind and partially sighted people with news and information in an accessible format, presented in an informative and entertaining manner. Programming is broadcast and produced by and for blind people
Sunny Govan Radio	Govan, SW Glasgow	Sunny Govan Radio aims to be pro-active in encouraging participation from the local diverse community. It will develop learning opportunities, promote equality, creativity, volunteering, and community empowerment, "giving a voice to people who are seldom heard"
Revival Radio	Cumbernauld, Kilsyth and Kirkintilloch	Revival Radio will broadcast locally-produced programmes from a Christian lifestyle perspective to Cumbernauld, Kilsyth and Kirkintilloch.
Radio Faza* – Asian Women's Project	Nottingham	Radio Faza aims to empower individuals within the South Asian community through the provision of education, training, advice and information in several community languages, and contribute to building an enterprising community which values its people.
Faza FM* – Karimia Ltd	Nottingham	The station will provide a platform from which social, economic and religious issues of concern to the Muslim Community (Pakistani, Kashmiri, Bengali & Indian) will be addressed. The service aims to promote the regeneration and confidence building of the community through entertaining, inspiring and educational programmes.
NBC Live	Nottingham	NBC Live is aimed at the African Caribbean community and the wider community in Nottingham. It aims to combat discrimination, connect communities and foster a cohesive environment.
Radio Ikhlas	Normanton, Derby	Radio Ikhlas plans to target the Asian (primarily Pakistani) community and the growing population of asylum seekers in the Normanton area of Derby.
Takeover	Leicester	Takeover Radio is for children and young people. It

Station	Area	Description
Radio		is characterised by the involvement of the young people they serve, who receive training and produce programming with energy, enthusiasm and originality. Takeover Radio currently operates one of the pilot access/community radio services and began broadcasting in March 2002.
Harborough FM	Market Harborough, Leicestershire	Harborough FM aims to provide a sustainable, informative, entertaining and relevant community radio service for the Market Harborough area.
The Eye	Melton Mowbray, Leicestershire	The Eye will broadcast to the rural community of the Vale of Belvoir in the heart of the East Midlands

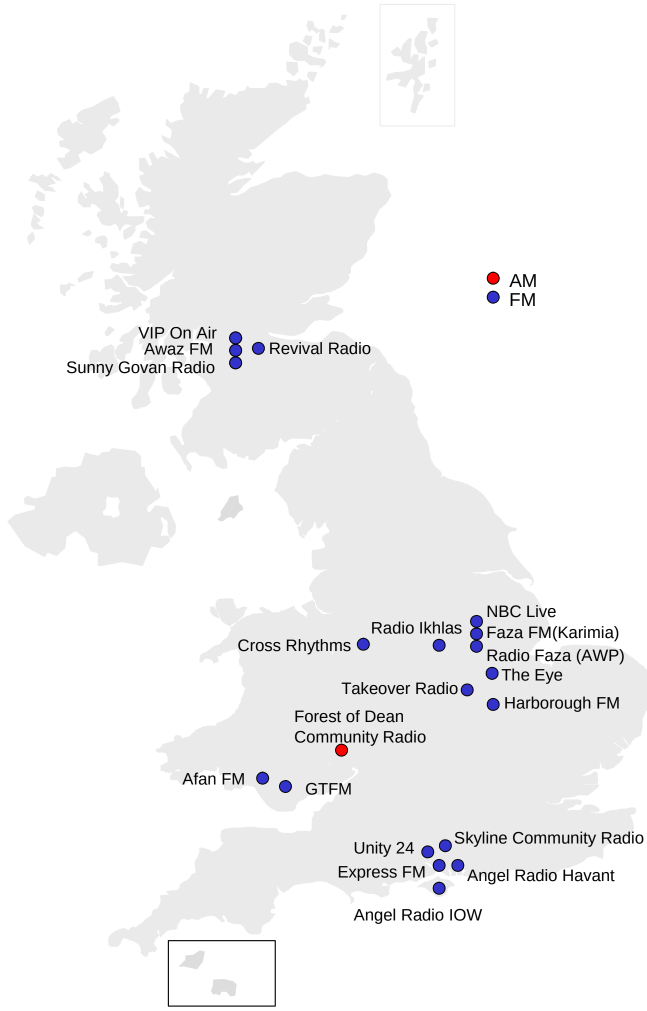
Source: Ofcom
** The Asian Women's Project and the Karimia Institute currently jointly operate one of the pilot access/community radio services and began broadcasting in March 2002. They have now successfully applied to run separate services.*

There are currently 14 pilot community radio stations operating around the UK. Given the large number of applications received, Ofcom decided to assess them in order of priority by first considering those for areas where the 14 pilot community radio stations are currently broadcasting. This involves over 70 applications and includes cities such as London, Manchester and Glasgow.

Ofcom is aiming to make decisions in these areas by early autumn, before moving on to look at applications for areas not involved in the pilot scheme. Ofcom expects to complete this round of the community radio awards process in late autumn 2005.

The additional 15 licences have brought the total awarded to 20. The locations of these are shown in Figure 12.

Figure 12: Map of community radio licences awarded



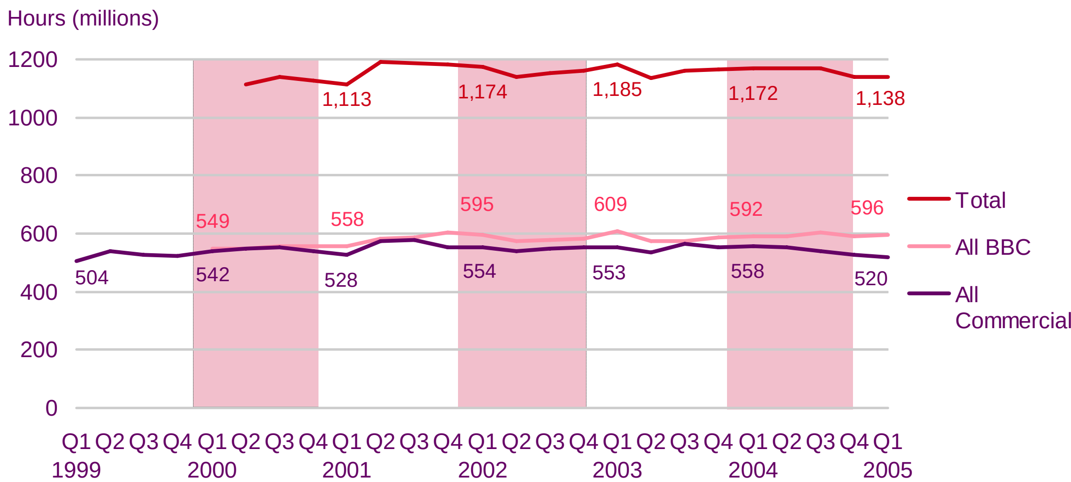
Source: Ofcom

6: The radio listener

6.1: Little change in total listening hours

Total listening was broadly flat between Q4 2004 and Q1 2005, although this concealed a small rise of 2 million hours for the BBC and a fall of 7 million for commercial radio.

Figure 13: Total listening hours – BBC and commercial radio

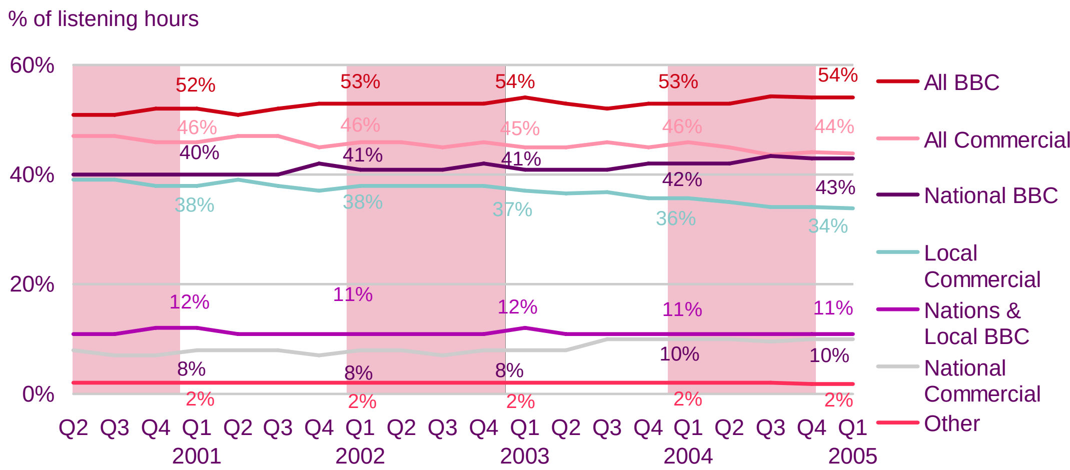


Source: RAJAR, all listeners

Share of listening hours stayed broadly constant between Q4 2004 and Q1 2005. However, despite the small increase in local commercial radio share of listening hours in Q4 2004, Q1 2005 saw a further fall in share for this group of stations. At 33.9%, this is the lowest ever share of listening for local commercial radio. At the individual station level the two most listened to radio stations in the UK in Q1 2005 were still BBC Radio 2 (16.5% of all listening hours) and BBC Radio 4 (11.4%)[3].

[3] RAJAR, Q1 2005 All adults

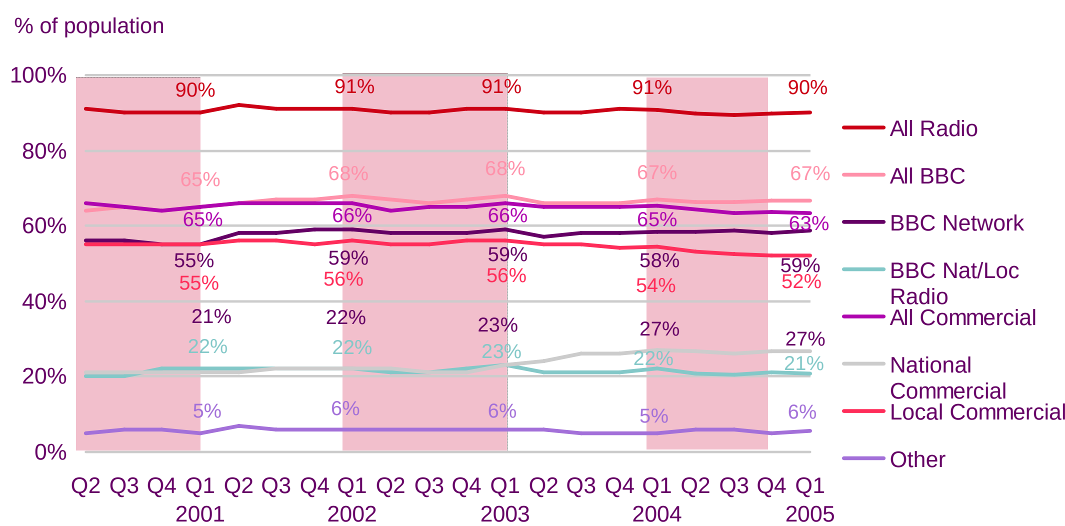
Figure 14: Share of audience hours – BBC and commercial radio[4]



Source: RAJAR, all adults

Having dipped below 90% during the previous three quarters, radio reached over 90% of listeners again in Q1 2005. Overall the BBC has reached slightly more listeners than commercial stations since the end of 2000 – the BBC's reach is currently 67% whereas commercial radio's is 64% (Figure 15).

Figure 15: Audience reach – BBC and commercial radio



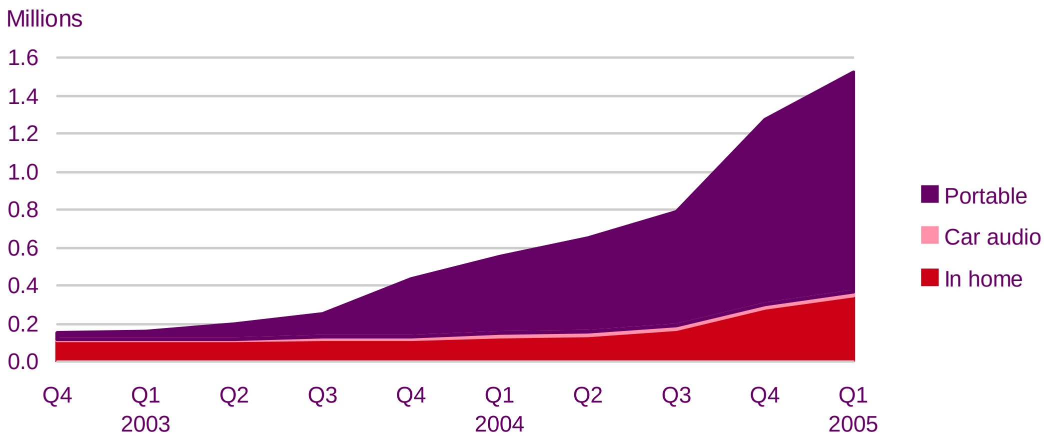
Source: RAJAR, all adults

4 "Other" audience hours include listening to stations not defined as either commercial or BBC, for example very small commercial stations, pirate radio stations and community radio stations.

6.2: DAB sales had the second highest ever volume during Q1 2005

DAB digital radio continued its growth over the last quarter with total sales now over 1.5 million. At the same time prices have generally stabilised after a fall in the run up to Christmas 2004. Although sales of sets have not continued at the same rate as in the run up to Christmas, Q1 2005 saw the second highest volume of sales of DAB sets to date.

Figure 16: Number of DAB sets sold



Source: GfK

7: Focus on the BBC

7.1: Introduction

The BBC is the biggest player in the UK radio market. In both analogue and digital it has more national stations than any commercial radio group. With 46 local and nations stations it is also a major player in the local radio market. This section examines the remit, output and audiences for BBC radio in more detail.

7.2: What does BBC radio provide?

The specific remit for each of the BBC networks is shown in Figure 17. As the corporation announced in Building Public Value, it will be adding detail to these remits when service licences are put into place. BBC Radios 1, 2, 3, 1Xtra and 6 Music have output predominantly focused around music, and each offers live (or 'as live') sessions or concerts. Although these services cover a broad range of musical tastes, additional specialist genres tend to be more widely available in the commercial sector. BBC Radio 4, Five Live, Five Live Sports Extra and BBC 7 are pure speech networks while BBC Asian network has a mixed output with around 40% music and the rest speech in various forms.

Figure 17: Remit of the BBC networks

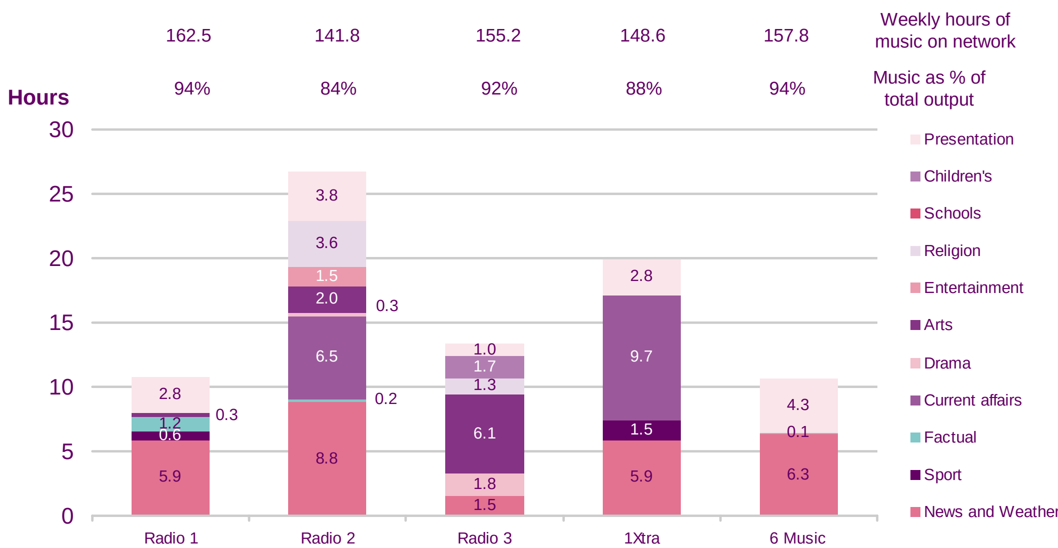
Network	Remit
BBC Radio 1	BBC Radio 1 aims to offer an exciting, high quality service for young audiences. It is committed to playing the best new music and delivering a comprehensive range of live studio sessions, concerts and festival broadcasts. The network aims to cover all the significant youth music genres with a wide-ranging playlist and a diverse team of specialist DJs. It also delivers tailored speech output – including news, documentaries and advice campaigns, with integrated online and interactive services.
BBC Radio 2	BBC Radio 2 aims to bring listeners a broad range of popular and specialist music, with particular support for new and established British artists; live music, through concerts and studio sessions; and song-writing. The network also offers news, current affairs, documentaries, comedy, readings, religious output and social action, designed to appeal to a broad audience.
BBC Radio 3	BBC Radio 3 is centred on classical music and also aims to provide a broad spectrum of jazz, world music, drama and arts programmes. It focuses on presenting live and specially recorded music from across the UK and beyond, including contributions from the BBC performing groups.
BBC Radio 4	BBC Radio 4's remit is to use the power of the spoken word to offer programmes of depth which are surprising, searching, revelatory and entertaining. The network aims to offer in-depth and thoughtful news and current affairs and seeks to engage and inspire its audience with a unique mix of factual programmes, drama, readings and comedy.
BBC Radio Five Live	BBC Radio Five Live broadcasts live news and sport 24 hours a day, aiming to present events as they happen in a modern, dynamic and accessible style. It sets out to cover national and international subjects in depth, using wide-ranging analysis and debate to inform, entertain and involve news and sports fans of all ages, with particular emphasis on 25 to 44 year olds. The network also provides extensive live events coverage, supported by the BBC's global news gathering operations and

Radio

Network	Remit
	portfolio of sports rights.
BBC Five Live Sports Extra	BBC Five Live Sports Extra is a part-time extension of BBC Radio Five Live, aimed at bringing a greater choice of action to sports fans. It extracts more value for licence fee payers from sports rights already owned by the BBC by offering alternative commentaries to those provided on Five Live.
1Xtra	1Xtra aims to play the best of contemporary black music, with a strong emphasis on delivering high-quality live music and supporting new British artists. 1Xtra also brings listeners a bespoke news service, regular discussion programmes and specially commissioned documentaries, plus information and advice relevant to the young target audience, particularly – although not exclusively – those from ethnic minorities.
BBC 6 Music	BBC 6 Music aims to engage with lovers of popular music, offering them current releases outside the mainstream, new concert and session tracks and music from the BBC sound archive. It concentrates on music and artists that are not well supported by other radio stations and is committed to providing context for the music it plays, through music news, documentaries, debate and stimulating interactive content.
BBC 7	BBC 7 is a speech-based digital radio service offering comedy, drama and readings, mainly from the BBC archive. The network is zoned around types of programmes so people know that at a certain time of day a particular type of output will always be available. BBC 7 also aims to be the home of children's speech radio, with regular live programming for children.
BBC Asian Network	BBC Asian Network aims to offer challenging debate, informed journalism, music, sport, entertainment and drama to audiences of British Asians from different generations. The network broadcasts primarily in English but also in a range of languages spoken by UK Asians. It aims to be the main broadcast forum for debating the issues preoccupying British Asian communities.

Source: BBC Annual Report and Accounts 2004-2005

Figure 18: Average weekly hours of output from BBC music focused networks, 2004-2005



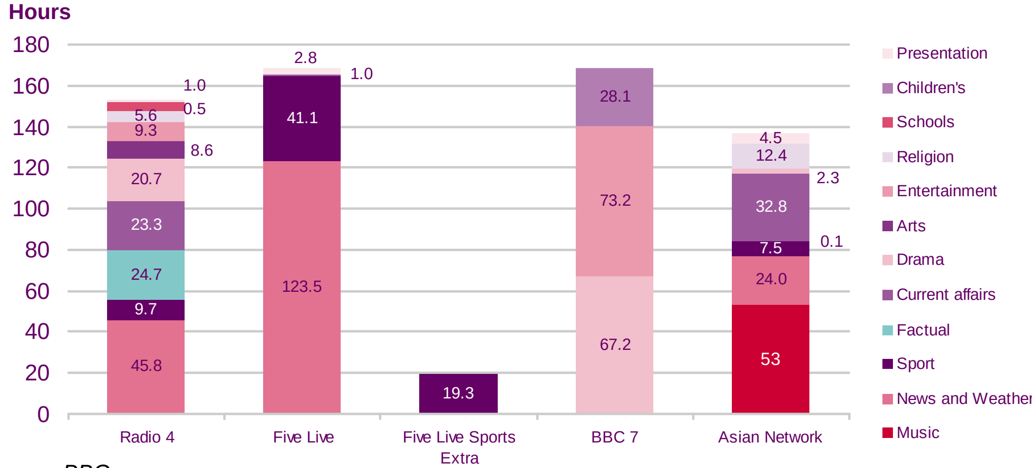
Source: BBC

Despite its focus on music, BBC Radio 2 provides content across all genres except sport, schools and children's programming (Figure 18). All of the music focused networks offer news and speech, but 1Xtra provides almost ten hours per week of current affairs in addition to nearly six hours of news, more than any BBC network other than Radio 4 and the BBC Asian Network. Presentation is a key feature of BBC 6 Music with 4.3 hours a week, more than any other network besides the Asian Network (with 4.5 hours).

Of the speech networks, Radio 4 covers the widest range of different genres, although the BBC Asian Network also has a wide mix of output (Figure 19). This may reflect its origins as a BBC local radio station as its output covers the majority of BBC genres. However, as it is targeted at a specific ethnic group, the output may be an attempt to ensure that content is available for as wide a range of British Asian communities as possible.

Children are catered for almost exclusively by BBC 7 which, on average, provides over four hours of dedicated programming every day. In addition to the half hour a week targeted at children, Radio 4 provides on average four hours a week of schools programming. BBC Five Live offers a rolling news and sports service, although Five Live Sports Extra concentrates on sport.

Figure 19: Average weekly hours of output from BBC speech and mixed networks, 2004-2005



Source: BBC

7.3: BBC digital radio spending has increased significantly since 2001/2

In July 2005 the BBC Annual Report and Accounts set out the programme related spend on each of the BBC radio stations. This has risen for all stations over the last four years, although not simply in line with inflation.

Spending on the national, regional and local BBC stations is up 22% since 2001/2 with the rise last year attributed, in part, to the opening of new radio facilities and increased spending on sport. With the BBC having announced its desire to launch a number of new local radio stations, spending in this area may also be set to increase.

Spend on the BBC's digital stations has also increased as the BBC has invested in programming. Absolute expenditure on those networks is lower than on any of the analogue stations, although digital spend as a proportion of total radio has risen from 1.5% in 2001-2003 to 10% in 2004-2005.

Figure 20: Programme-related spending on BBC Radio

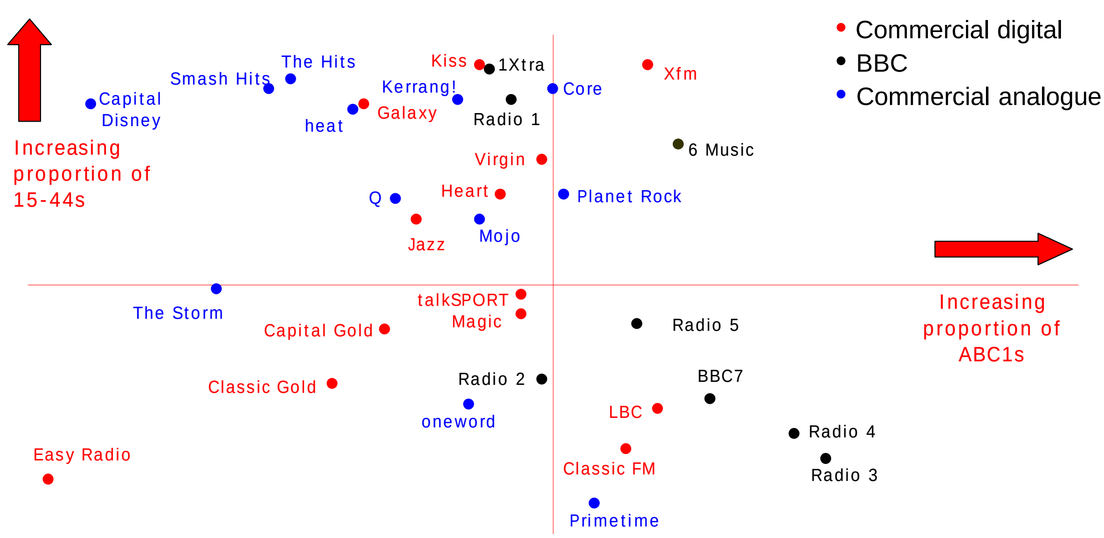
Station	Programme related spend (£m)				
	2004/5	2003/4	2002/3	2001/2	% change 2001/2 to 2004/5
BBC Radio 1	17.8	17.6	17.2	16.8	6%
BBC Radio 2	23.8	21.7	21.6	21.8	9%
BBC Radio 3	32.0	32.1	30.2	31.0	3%
BBC Radio 4	71.3	69.9	64.8	62.5	14%
BBC Radio Five Live	53.8	51.5	53.8	50.3	7%
BBC Five Live Sports Extra	1.6	1.7	1.7	0.7	129%
1Xtra	5.7	5.1	4.0	n/a	n/a
BBC 6 Music	4.5	4.1	4.0	0.2	2150%
BBC 7	4.8	4.3	2.2	n/a	n/a
BBC Asian Network	5.4	4.1	3.1	1.8	200%
National, Regional and Local Radio	142.2	133.4	130.8	116.1	22%

Source: BBC annual report and accounts 2004-2005 and 2002-2003

7.4: The BBC networks do not have significant listening from C2DEs

Radio 3, Radio 4, 6 Music and BBC 7 appear to have a higher proportion of ABC1 listening than any commercial station or network. The audience that listens to Radio 3 and 4 in particular appears to have little alternative available from the commercial radio sector. 1Xtra and Radio 1 and, to a lesser extent 6 Music, provide a service for younger listeners. However, no BBC station achieves a high C2DE listenership compared to the majority of the commercial sector.

Figure 21: Positioning of all national radio stations

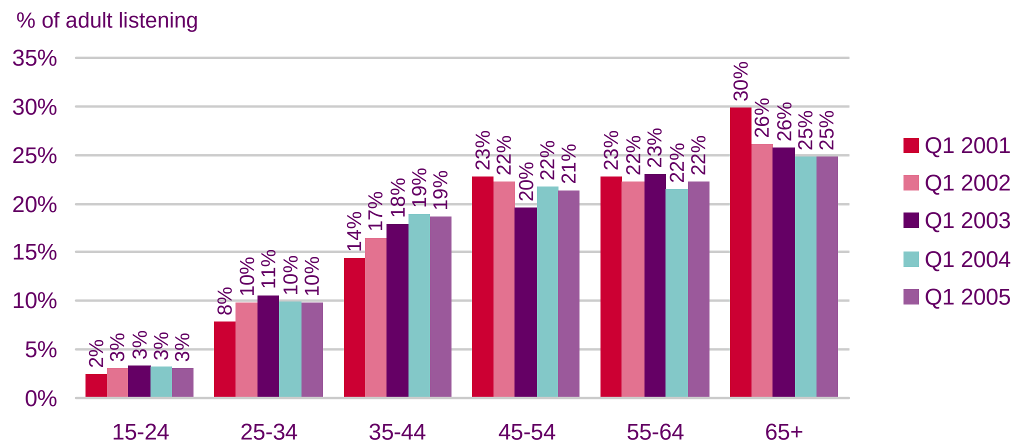


Source: RAJAR Q1 2005, RAB
Note: Due to the relatively small audiences of some of the national stations their position from quarter to quarter may change significantly

7.5: Who is BBC Radio 2's audience?

BBC Radio 2 continues to be the most listened to radio station in the UK. The proportion of Radio 2's adult listening by 45-64 year olds has slipped from 46% in Q1 2001 to 43% in Q1 2005. Although a quarter of Radio 2's hours are listened to by people aged 65+ (making it the single largest demographic for the station), this has fallen five percentage points since Q1 2001. In contrast, the share of listening hours by 35 to 44 year olds has increased five percentage points to 19% in the same time.

Figure 22: Listening to Radio 2 by demographic

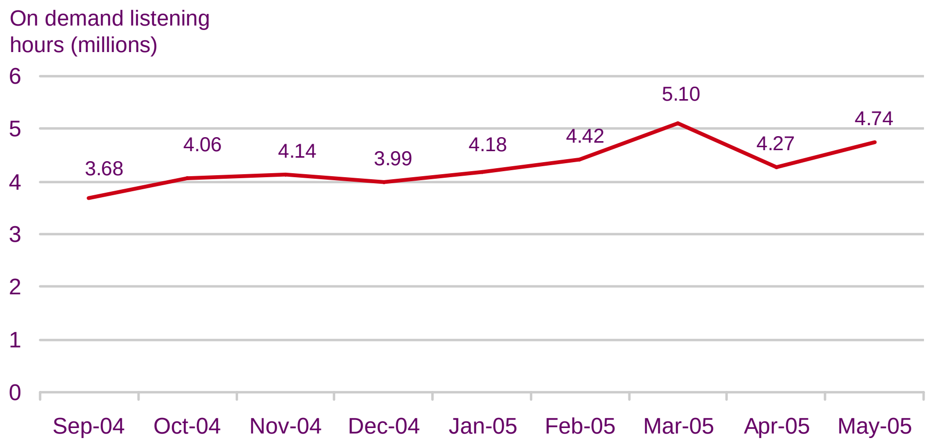


Source: RAJAR

7.6: BBC on-demand listening increases by almost 1/3 in eight months

Listening figures for the BBC radio player, the BBC's on-demand service which allows listeners to access streamed programmes up to seven days after the initial broadcast, have been published since September 2004. These show that monthly on-demand listening hours have risen 29%, to 4.74 million hours in May 2005 (Figure 23). As awareness of the service and broadband penetration increase, this percentage is widely expected to rise further. In addition, the BBC has been broadcasting its radio stations live across the internet for a number of years, and is trialling downloads and podcasting for a number of programmes.

Figure 23: BBC on-demand listening hours



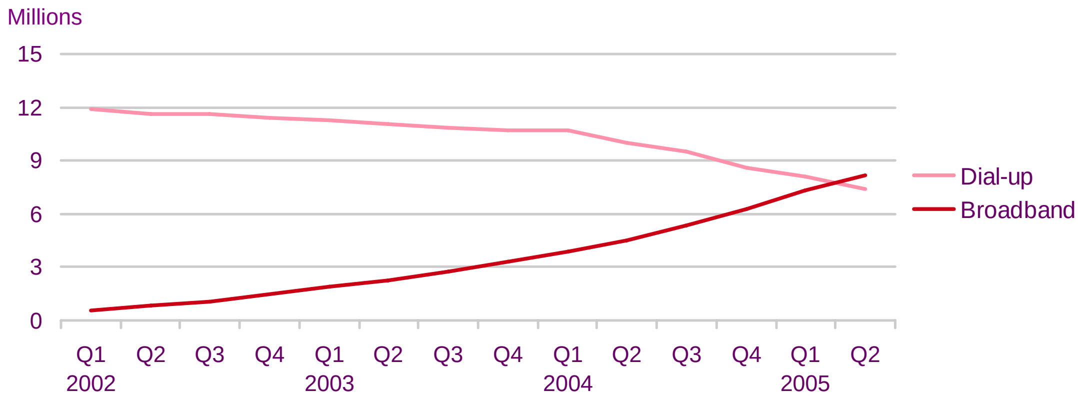
Source: BBC

8: Telecoms market developments

8.1: Broadband passes dial-up

As of June 2005, the total number of broadband connections in the UK exceeded the number of dial-up accounts for the first time, marking a significant milestone for the UK communications market. As shown in Figure 24, there are now 8.1 million broadband connections to homes and businesses across the UK, compared with 7.5 million narrowband dial-up subscriptions.

Figure 24: UK internet connections



Source: Ofcom / ONS

Figure 24 shows that a large proportion of the growth in broadband connectivity has been matched by a decline in narrowband subscriptions. This suggests that most new broadband subscribers are former narrowband internet users who have switched to higher bandwidth, always-on connections.

A more complete analysis of the UK internet market is given in section 9.7. However, the point of crossover between broadband and narrowband warrants highlighting, as it reflects a fundamental shift in the way consumers can use the internet.

The growth in broadband connections has driven the uptake of products and services that are either unique to broadband, or that provide a far more satisfying user experience at faster broadband speeds. An example of content unique to broadband is streaming TV, while the surge in audio file downloading has undoubtedly been driven by the vastly reduced time needed to download a music track over broadband compared to narrowband dial-up.

Another example of a service where mass adoption has only become a real possibility with high broadband penetration is voice over IP (VoIP). Technically, VoIP has been possible for years over narrowband, but broadband always-on connectivity means that VoIP now has better quality, more reliability, and 24/7 connection (especially important for incoming calls). All these improvements mean that for the first time VoIP can be marketed as a realistic alternative to the traditional PSTN fixed-line voice network.

The next step change in the internet market will be more subtle, as average DSL broadband speeds gradually increase from the basic 512 kbit/s, through the increasingly commonplace 2 Mbit/s, up towards 5 Mbit/s and possibly as high as 10 Mbit/s over the next couple of years. Already, speeds of 8Mbit/s are being offered in selected areas using ADSL over unbundled local loops. Improvements in ADSL technology may mean that transfer rates down copper wires from local exchanges may reach up to 20 Mbit/s by the end of the decade.

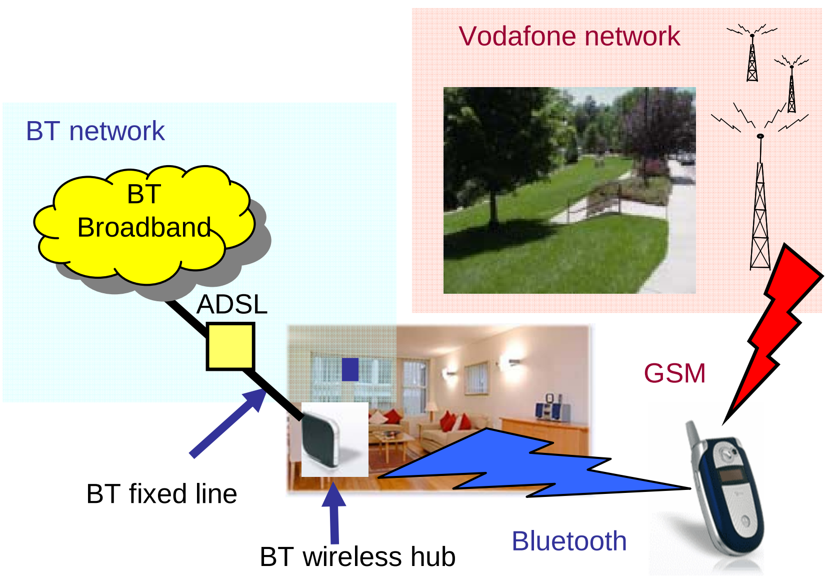
The increase in availability and uptake of ever-faster broadband will facilitate the introduction of significant new products and applications. The most important of these new services will be high-quality delivery of TV and video over broadband, which will provide broadcasters with a major new delivery platform. TV over DSL/cable modem will also offer fully-interactive capabilities that would, for example, enable true video-on-demand.

8.2: BT Fusion – Fixed-mobile convergence arrives

In June 2005, BT launched a trial of its long-awaited fixed-mobile product under the brand name of BT Fusion (previously known as Bluephone). After initial testing with 400 users, full launch of the residential product is scheduled for September. A business version is expected shortly afterwards.

BT Fusion uses a GSM/Bluetooth-enabled Motorola handset, capable of switching a call between Vodafone's GSM network and BT's DSL broadband network without interruption. The product currently uses Bluetooth technology to connect to a wireless hub in the customer's home, which routes calls over broadband when the handset is within range. Outside of the home, the handset sends and receives calls over the GSM network. This is illustrated in Figure 25:

Figure 25: BT Fusion call paths



Source: Ofcom / BT

Incoming calls are charged at mobile rates, regardless of whether the call is routed over the GSM or fixed broadband network. However, outgoing call charges to standard landline numbers are lower over DSL than over GSM. BT Fusion customers also have to pay BT fixed line rental charges and a BT broadband internet subscription.

A Wi-Fi version is expected in 2006 when consumer-ready Wi-Fi handsets become available – this will enable customers to switch from GSM to fixed wireless broadband when they are in range of a BT Wi-Fi hot spot. In addition to the handset used in the trial, Motorola's fashionable RAZR range will be available on BT Fusion in the autumn. Nokia and Samsung are also working on compatible devices for next year.

BT Fusion is expected to be only the first step in the convergence of fixed and mobile platforms. A number of key enabling factors will facilitate development of fixed-mobile convergence, notably:

- the emergence of handsets with multiple transmission protocols (GSM/WCDMA/Wi-Fi/WiMax)
- the growth of voice over IP (VoIP) offerings over fixed broadband and Wi-Fi platforms
- a move towards all-IP transmission of voice and data over mobile networks

France Telecom has already announced that it plans to launch an offering similar to BT Fusion through its Orange (mobile) and Wanadoo (DSL broadband) platforms. Fixed-mobile convergence may also herald a degree of convergence between broadband internet service providers (ISPs) and mobile operators or mobile virtual network operators (MVNOs).

8.3: Ofcom reaches proposed settlement with BT over local access

In June 2005, Ofcom published proposals for a new regulatory approach for the UK's fixed line telecommunications market for consultation with stakeholders. Informed by the work carried out in the second phase of the Telecoms Strategic Review, Ofcom concluded that a new approach to telecommunications regulation is needed in the long term.

This new approach is based on real equality of access to parts of the fixed network which BT's competitors cannot fairly replicate – chiefly the critical "last mile" that connects customers to the local exchange. Ofcom has concluded that it is neither economically nor commercially viable for BT's current or prospective competitors to invest in fixed local access infrastructure. The proposed settlement is therefore designed to address this enduring bottleneck in network access, and has six objectives:

- To drive down the price of calls, connections and services for consumers and businesses
- To support more innovation through the growth of competitive products and services, such as faster broadband, television, voice over IP (VoIP) and video-on-demand, from a range of credible companies
- To provide regulatory certainty for providers and investors so that they commit to developing, marketing and extending these products and services for UK consumers and businesses

- To re-focus regulation where it is truly needed, with swifter remedies to tackle anti-competitive behaviour and a structure which delivers equivalence to a timetable with real penalties and incentives

- To remove regulation wherever competition is effective and the consequence of open markets – rather than regulatory intervention – ensures the delivery of choice, value and quality for consumers

- To ensure the necessary level of consumer protection through a combination of codes, sanctions and effective consumer information

The approach is based on BT's agreement to legally-binding undertakings in lieu of a reference under the Enterprise Act. The following summarises the key points of the proposed settlement:

Enforceability
The undertakings are legally binding. In case of a breach, Ofcom – as well as third parties affected by the breach – can take matter to the High Court, in which case BT Group would be responsible for ensuring compliance with a Court order. The undertakings sit alongside Ofcom's existing regulatory powers.

Branding and identity (Separate Access Services business unit)
The proposed undertakings offered by BT will stipulate the setting up of a new – and operationally separate – business unit, provisionally entitled Access Services, but with a distinct new brand and identity. This new unit will be staffed by around 30,000 employees presently responsible for the operation of BT's local access networks (forming around one third of BT's total current workforce), and will have separate physical locations for management teams, separate incentive schemes for staff, new branding emphasising operational separation from BT Group (these first three undertakings exclude operations in Northern Ireland), as well as separate operating and trading systems.

Product equivalence (Equivalence of Input)
The new business unit will be required, through a set of formal rules on governance and separation, to support all providers' retail activities (including those of BT Retail) on a precisely equivalent basis, which Ofcom terms "Equivalence of Input". Equivalence of Input will mean that all providers will benefit from the same products, with equal opportunity to contribute to their development; the same prices, offered to all providers equally; and the same processes, to ensure all providers are able to order, install, maintain and migrate connections for their customers on equal terms.

Products and services
The new business unit will offer a universally available product and service set, including Local Loop Unbundling, Wholesale Line Rental and Backhaul.

Next Generation Networks
The proposed undertakings will also set out a number of clear principles which BT Group plc should follow in the design, procurement and build of its next generation 21st Century Network. These principles will help ensure that other providers, who will depend upon interconnection with BT's 21CN, do not suffer competitive disadvantage.

Board and governance

BT Group plc and the new Access Services business unit's compliance with the proposed undertakings will be monitored by a new Equality of Access Board (EAB), which will also oversee the delivery of other legacy regulated products not directly delivered by the new business unit. The proposed undertakings from the Board of BT Group plc require BT Group plc to act swiftly upon the recommendations of the EAB. The EAB will be a compliance Board consisting of five members, three of whom will be independent of BT Group and appointed in consultation with Ofcom. The EAB will meet between six and ten times during the first year of operation, and produce a regular published summary report of its activities. It will have extensive powers to seek access to information from wherever in BT Group plc it deems necessary to do its work.

The proposed settlement has been welcomed by the majority of stakeholders and hailed as a regulatory innovation by a number of commentators. The consultation on the proposals commenced on 30 June for six weeks (ends 12 August).

9: The telecoms industry

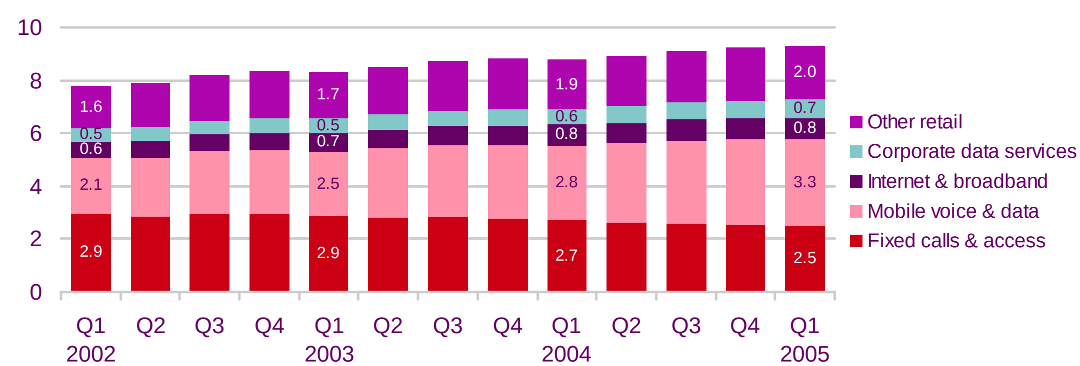
9.1: Mobile revenues now over one third of total telecoms spend

Overall retail telecoms service revenues in the three months to March 2005 were £9.3 billion – 0.7% higher than the previous quarter, and 5.8% more than the corresponding period a year ago (i.e. Q1 2004). Total retail revenues in the 12 months to March 2005 were £36.6 billion, 5% higher than during the previous 12 months.

Figure 26 shows the breakdown of revenues from each of the main categories of telecoms service. Revenues in the mobile sector continue to power ahead; mobile spend in Q1 2005, at £3.3 billion, is some 17% higher than the same quarter in 2004. In contrast, revenues from fixed calls and access continue to fall, chiefly as a result of price competition. Note that the "other retail" revenues figure comprises telecoms services which are not regulated by Ofcom, such as mobile handset and other hardware sales.

Figure 26: Revenues from main telecoms services

Revenues (£bn)

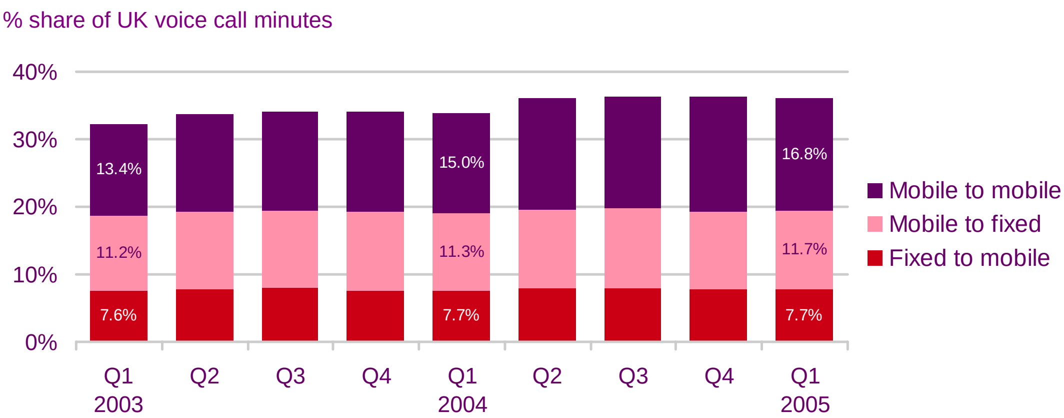


Source: Ofcom / operators / IDC
Note: includes revisions to previously published information; some internet access revenues are incorporated in corporate data services

9.2: Over 36% of all UK call volumes are to, from, or between mobiles

Most of the growth in mobile revenues came as a result of increased mobile voice traffic. Voice calls either originating or terminating on mobile networks now account for 36% of all voice calls in the UK (compared with 34% in Q1 2004), with mobile-originating voice calls accounting for over 28% (Figure 27).

Figure 27: Share of total UK voice call volumes



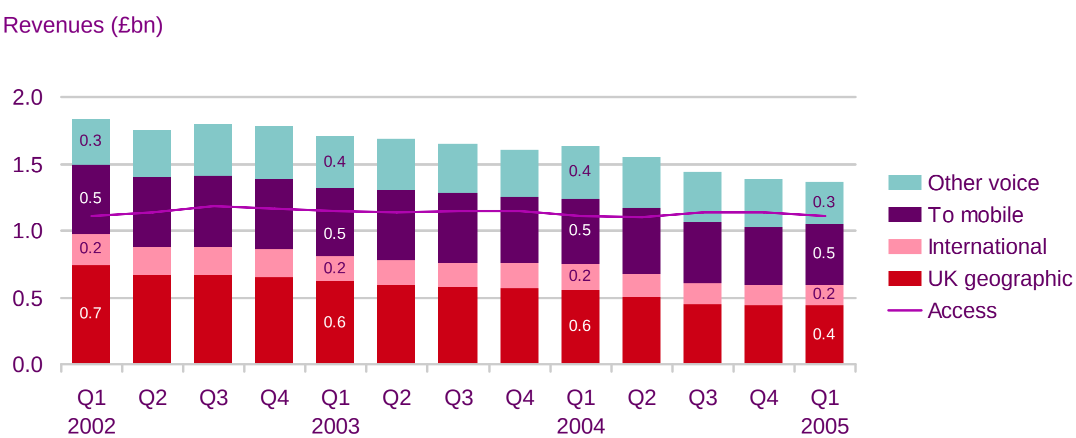
Source: Ofcom / operators
Note: Excludes international, data, and non-geographic voice traffic

This shift in balance from fixed to mobile traffic has also been affected by the continuing reduction in dial-up internet traffic, reflecting the acceleration in broadband take-up.

9.3: Fixed-line call revenues continue to fall

Whilst fixed-line access (rental and connection) revenues have remained flat over the past 12 months, revenues derived from calls have continued their steady decline. As shown in Figure 28, practically all of this reduction in call revenues has come in calls to UK geographic numbers – revenues from this sector are some 50% lower than in the corresponding quarter in 2004.

Figure 28: Fixed voice telecoms revenues



Source: Ofcom / operators
Note: revenues exclude metered internet calls

This fall in revenues derived from UK geographic voice calls can be explained in part by the underlying pattern of price reductions, driven by increasing competition from alternative operators using carrier pre-selection (CPS). However, two other factors are underpinning the reduction:

- The increasing use of non-geographic numbers (08- prefix) by businesses for customer service and enquiries, which have a number of distinct advantages for businesses (multi-line, re-directable to any location, share of revenue with the telecom operator)

- The increasing tendency for fixed-line operators to offer either a bundle of UK geographic calls within the “line rental” subscription, or variations of free unlimited local/national calls included as part of the tariff

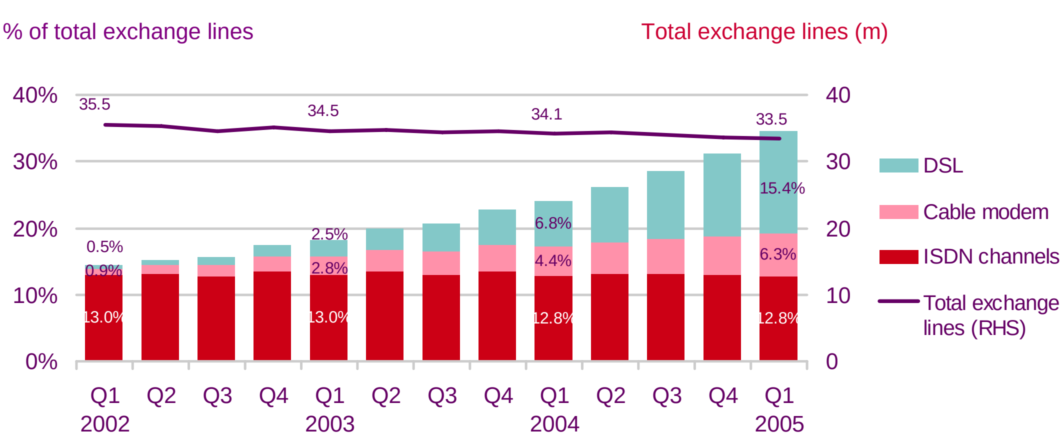
As such, fixed-line call revenues have undergone a re-balancing, as per-second charging has started to give way to a flat-fee “all you can eat” structure, underpinned by a monthly subscription. The notable exceptions are calls to mobile and to non-geographic numbers, which are currently relatively high-margin services for operators. The growth of VoIP in the consumer market will place further pressure on traditional charging structures in fixed-line telephony, as will the increasing convergence of fixed and mobile platforms.

9.4: PSTN lines continue to decline, DSL connections surge forward

The total number of fixed exchange lines in the UK continues its slow decline, falling by over 600,000 over the past 12 months. This decline reflects continued growth in mobile-only homes and a reduction in the number of second lines for dial-up internet access.

In tandem with the decline in dial-up, there has been significant growth in the number of DSL connections, which comprise the most popular platform through which consumers can access broadband internet services. Figure 29 shows that DSL broadband connections now account for over 15% of total UK exchange lines.

Figure 29: Fixed telecoms lines

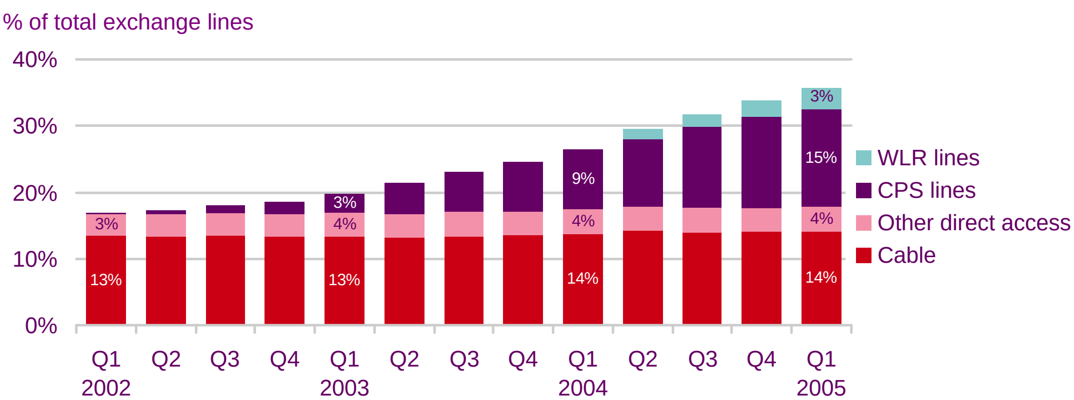


Source: Ofcom / operators

9.5: BT's competitors accelerate growth in market share of access lines

The past 12 months has seen a sharp rise in the number of non-BT access lines in the UK. The number of carrier pre-selection (CPS) lines now represents over 15% of all UK exchange lines; together with existing direct access competition (mainly cable), over 35% of lines now use services from non-BT providers (Figure 30).

Figure 30: Non-BT share of lines

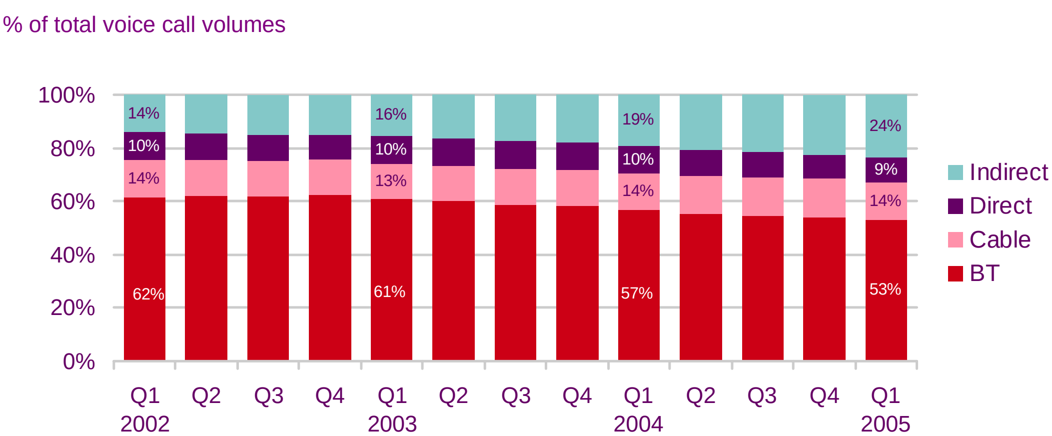


Source: Ofcom / operators

9.6: BT share of fixed voice carries on falling

The continued growth of competition in fixed-line access has fed through to further declines in BT's share of fixed-line call volumes. In the 12 months to March 2005, BT's share of UK fixed-line calls fell by 4% to 53% (Figure 31). Most of this lost market share is being redistributed to carrier pre-selection (CPS) operators and other indirect access telcos. Cable's market share has remained noticeably flat at 14% over the past three years.

Figure 31: Fixed voice call volume market share



Source: Ofcom / operators
Note: Includes UK calls, international calls and calls to mobile only

9.7: Broadband drives internet growth

As previously mentioned, broadband connections have now surpassed narrowband dial-up subscriptions. As of June 2005, there were a total of 15.6 million internet connections in the UK, of which 8.1 million were broadband and 7.5 million were narrowband.

Further breakdown of broadband internet access platforms shows that the majority of growth has come via ISPs using BT's wholesale product set (Figure 32). BT is still the UK's biggest broadband ISP, but competition is expected to accelerate over the coming year, aided by the proposed regulatory settlement with BT over local access discussed in section 8.3.

Figure 32: UK broadband connections

000s

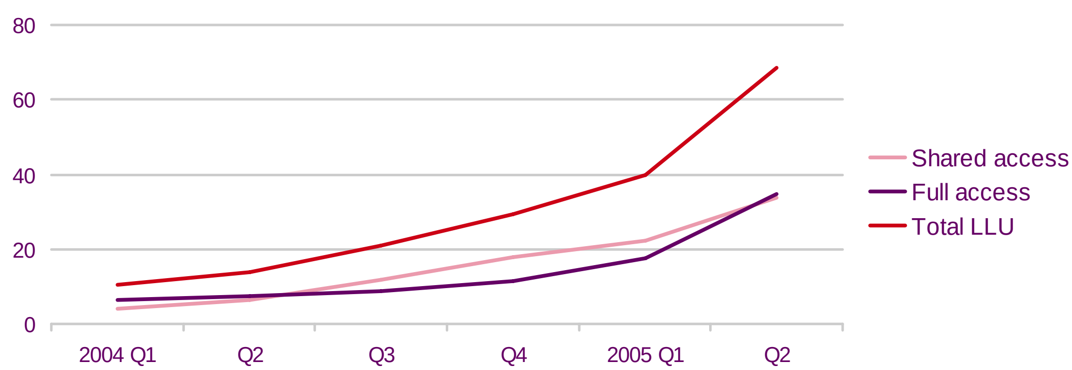
	Jun 04	Sep 04	Dec 04	Mar 05	Jun 05
BT retail	1,102	1,283	1,491	1,752	1,940
BT wholesale	1,585	2,011	2,616	3,180	3,658
Other DSL: LLU & Kingston	29	38	53	71	106
Cable	1,625	1,781	1,950	2,119	2,262
Other: Satellite & FWA	9	9	9	9	9
Total	**4,350**	**5,122**	**6,188**	**7,273**	**8,096**

Source: Ofcom / operators

The anticipated new clarity of regulation should also drive growth of local loop unbundling, which has up to now been slow to take off. There are signs that the level of unbundling is picking up, as alternative operators become more confident of a stable regulatory regime and can forecast a return on investment. Figure 33 shows how LLU is starting to pick up.

Figure 33: UK unbundled local loops

000s



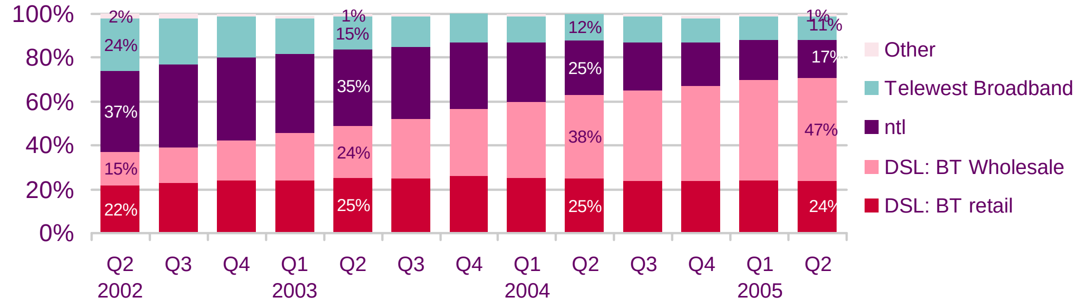
Source: Ofcom / operators

9.8: Competition in DSL is growing fast

Figure 34 shows clearly how BT's competitor DSL ISPs have been rapidly gaining market share over the past two years, to a point where they now comprise 47% of all broadband connections.

Figure 34: Broadband market share

Share of total broadband connections

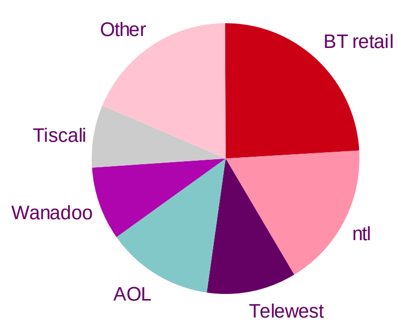


Source: Ofcom / operators

Market share split of broadband connections by individual ISP is shown in Figure 35. The three main competitor ISPs over DSL – AOL, Wanadoo and Tiscali – now have a combined market share of over 25%.

Figure 35: Broadband retail market shares

% market share

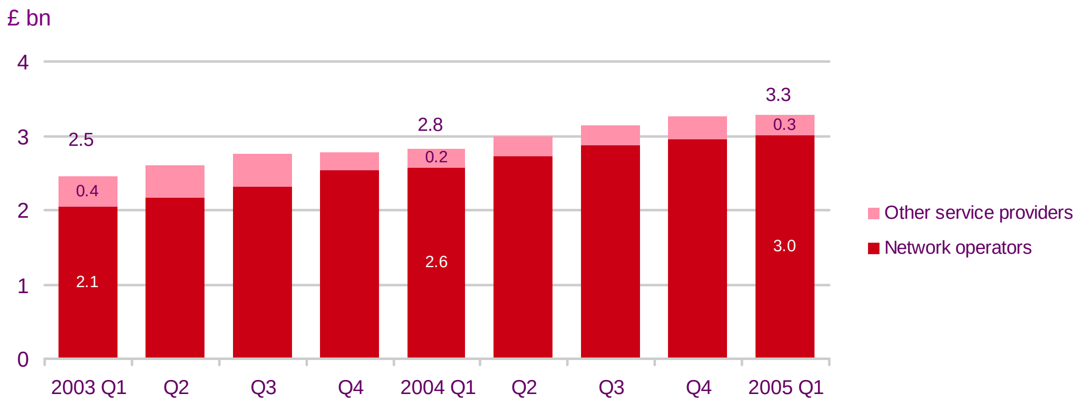


Source: Ofcom / operators

9.9: In mobile, revenues continue to rise…

Total revenues for mobile telephony services in Q1 2005 were £3.3 billion (Figure 36) – a rise of 17% compared with the same quarter in 2004. Annualised mobile revenues for the 12 months to March 2005 were £12.7 billion.

Figure 36: Mobile retail revenues

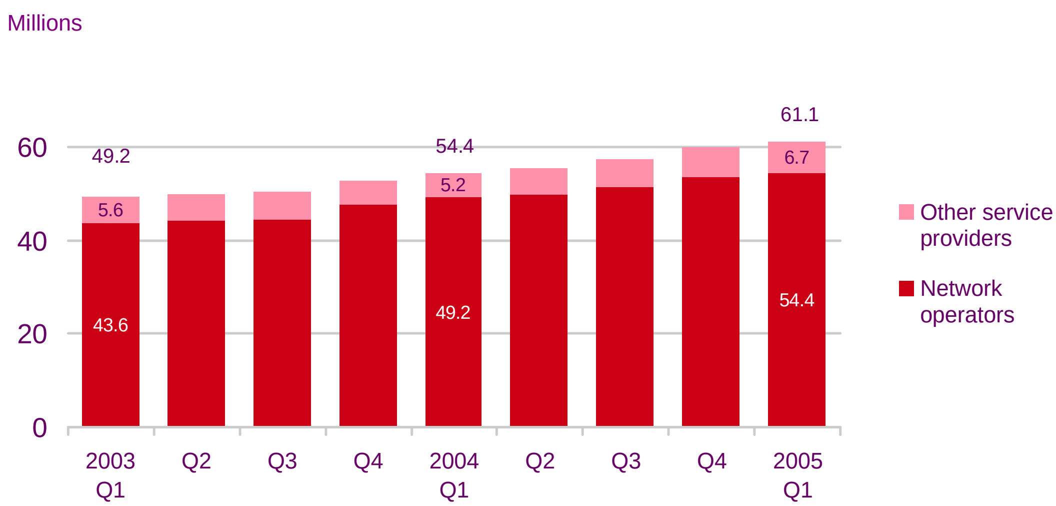


Source: Ofcom / operators
Note: based on network operator reported figures; likely to overstate activity in reference quarter; includes estimates where Ofcom does not receive data from operators

9.10: …fuelled by the ever-growing number of subscriptions

Most of this revenue growth has come from a continuing increase in the number of mobile subscriptions. At the end of March 2005 there were an estimated 61.1 million active mobile subscriptions in the UK, of which almost 90% were held directly by the five mobile network operators (Figure 37). Mobile virtual network operators (MVNOs), while still relatively small in customer terms, are growing fast – customers of MVNOs and other independent service providers grew by almost 30% over the past year to 6.7 million.

Figure 37: Mobile active subscriptions



Source: Ofcom / operators
Note: based on network operator reported figures; likely to overstate activity in reference quarter; includes estimates where Ofcom does not receive data from operators

It is worth noting that research suggests that the number of mobile subscriptions in the UK does not equate to the number of individual subscribers. Ofcom research shows that actual adult penetration of mobile services currently stands at 80% (Q1

2005). This implies that a significant number of UK mobile subscribers have more than one subscription (i.e. more than one mobile SIM card), and that they switch between SIM cards for different purposes, or to take advantage of tariff offers.

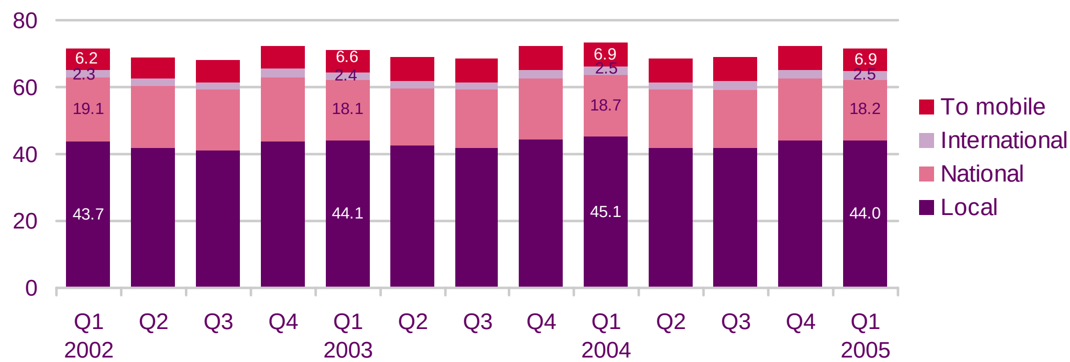
10: The telecoms user

10.1: Residential consumers keep using fixed-line services

Ofcom's residential tracker surveys show that household usage patterns for fixed-line telephony are remaining fairly constant, implying a high degree of inelasticity of demand. Households typically make around 70 minutes of calls per week from their fixed line, over 60% of which are to local numbers (Figure 38).

Figure 38: Average use per residential fixed line

Minutes per week (four quarter rolling average)

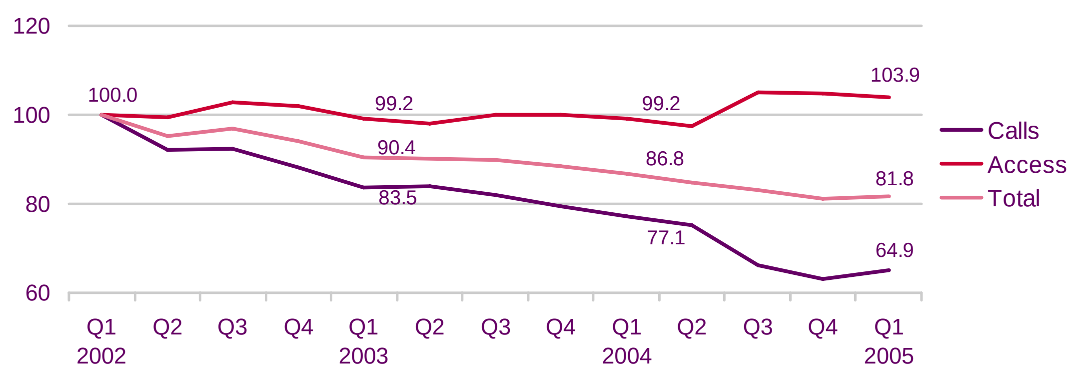


Source: Ofcom / operators

Demand has remained constant despite substantial drops in fixed-line call charges over the past 18 months. There has been a marked shift in fixed-line tariff structures towards a "bundled" approach, where the monthly rental/access charge entitles the subscriber to a defined (or sometimes unlimited) number of "free" minutes to certain call destinations. This has resulted in a degree of rebalancing of tariffs from call charges to access/line rental, as shown in Figure 39.

Figure 39: UK residential fixed voice price trends

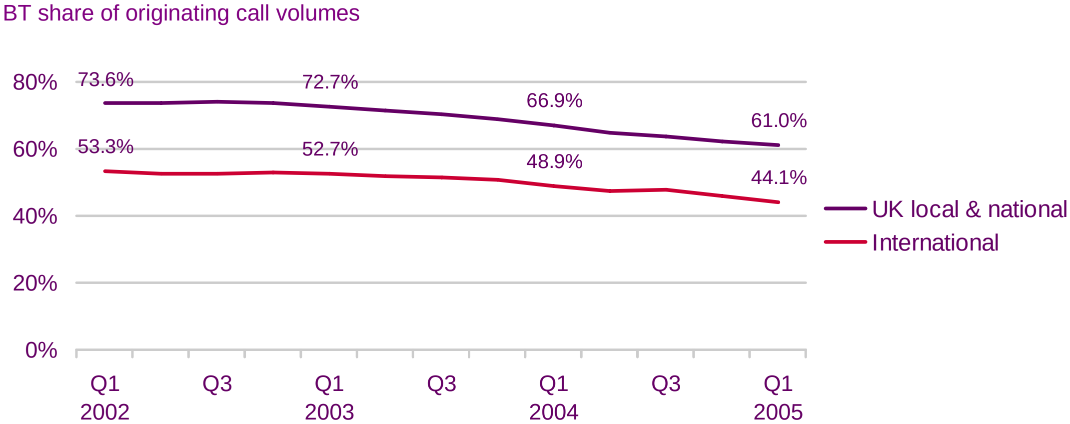
Index (2001 Q3=100)



Source: Ofcom / operators
Note: Figures based on calls to UK only fixed and mobile numbers

Increased price competition continues to contribute to a decline in BT's market share. Over the last year BT's retail share of total UK residential voice call volumes has fallen from 67% to 61% (Figure 40).

Figure 40: BT share of residential voice calls

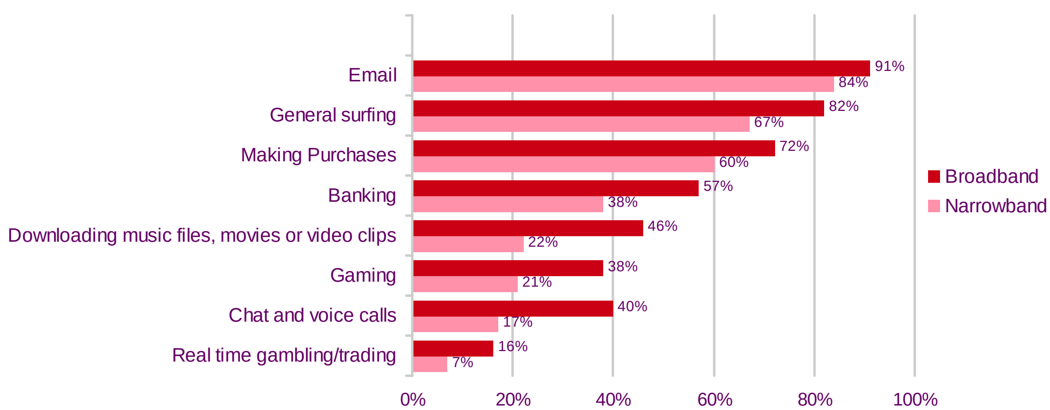


Source: Ofcom / operators

10.2: Broadband consumers are starting to use the internet for voice

Ofcom's latest consumer research indicates that internet-based voice/messaging services and applications are becoming increasingly commonplace amongst consumers with broadband connections. Figure 41 shows that 40% of broadband users engage in voice or chat applications (as opposed to only 17% of narrowband dial-up users).

Figure 41: Online applications used by broadband and dial-up users



Base: Consumers who have and use internet in the home (n=1188 unweighted)
Source: Ofcom research, Q1 2005

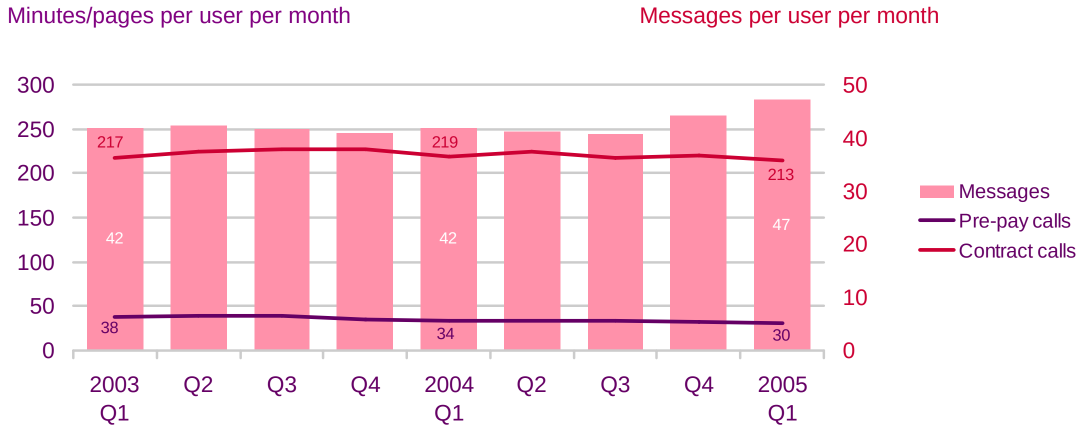
10.3: Mobile voice usage is falling, but messaging is growing

Mobile voice call volumes per customer have been marginally declining over the past two years, as shown in Figure 42. At the same time, the past two quarters have seen a sharp rise in the average number of SMS messages sent per user per month –

from fewer than 41 in Q3 2004, to over 47 in Q1 2005. The chart also shows the wide disparity in call volumes between pre-pay and contract (post-pay) customers; contract subscribers spend over 7 times as much time on voice calls as pre-pay users.

In addition, use of SMS declines with age – from 99% amongst mobile customers aged 15-24, down to 41% amongst those aged 65+. While three-quarters of the youngest age group say they send or receive text messages daily, in total a fifth (19%) of mobile customers never use SMS.

Figure 42: Average use per mobile customer

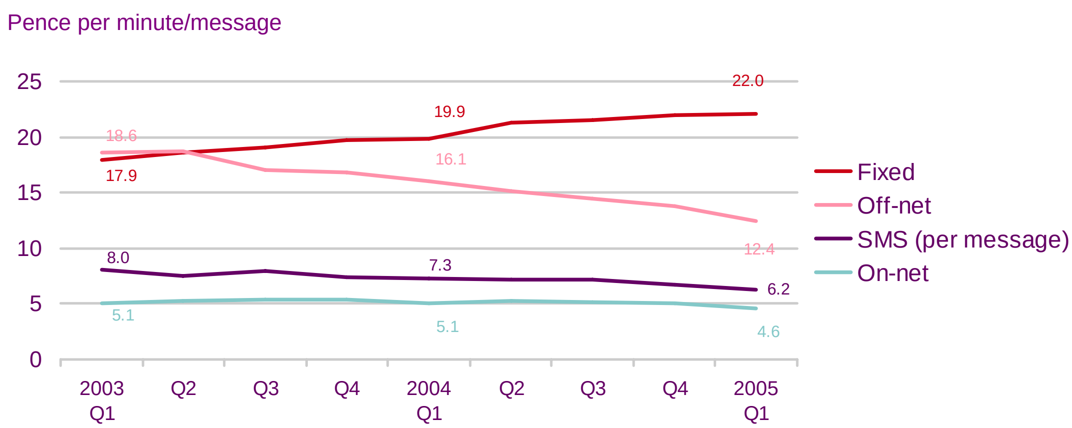


Source: Ofcom / operators

10.4: Mobile call charges to fixed lines rise, while off-net charges fall

Most mobile call charges are showing a slight decline on a quarterly basis, with the notable exception of calls to fixed lines (including line rental), which have risen by more than 10% over the year to March 2005 (Figure 43). This rise could be explained in part by the ever-increasing trend among mobile operators to bundle a number of inclusive call minutes with the line rental charge.

Figure 43: Average mobile unit charges



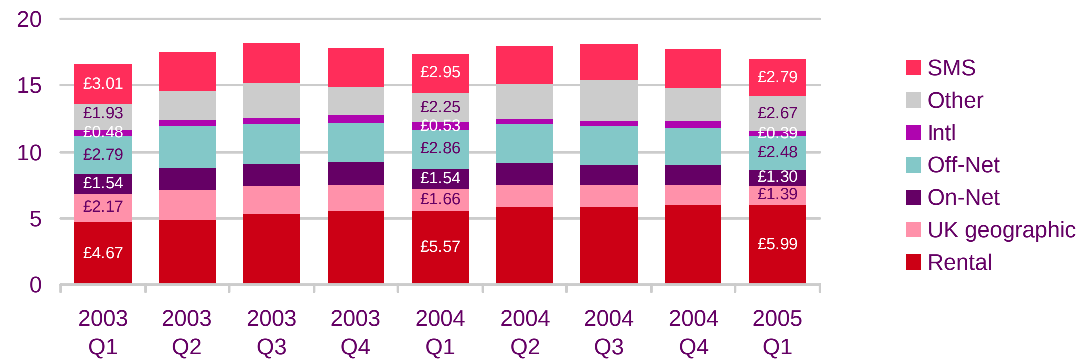
Source: Ofcom / operators

10.5: Mobile revenue per subscriber is on the decline

Mobile subscribers are now spending less per subscription than during the previous two quarters. Figure 44 shows how average revenue per active subscription per month has fallen slightly to around £17 per month, of which £6 is line rental (obviously not applicable for pre-pay users).

Figure 44: Monthly spend of average UK mobile user

£

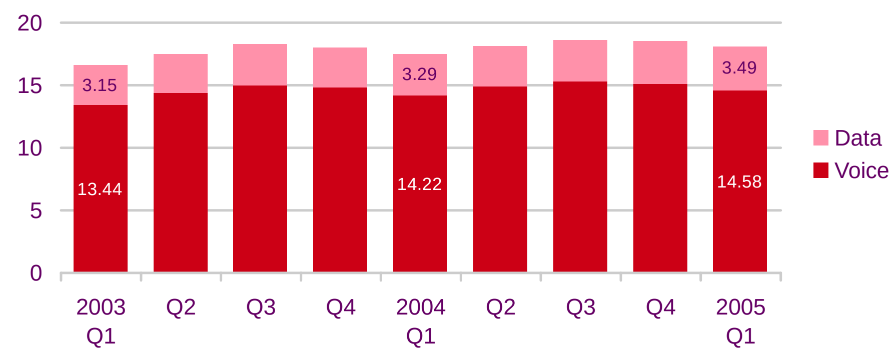


Source: Ofcom / operators
Note: Excludes 3UK

Data revenue per subscriber has been marginally growing, mainly owing to continued growth in SMS text messaging. However, voice ARPU is being edged down, mainly due to price reductions and tariff bundling by operators (Figure 45).

Figure 45: Mobile ARPU split by voice/data

£ per month

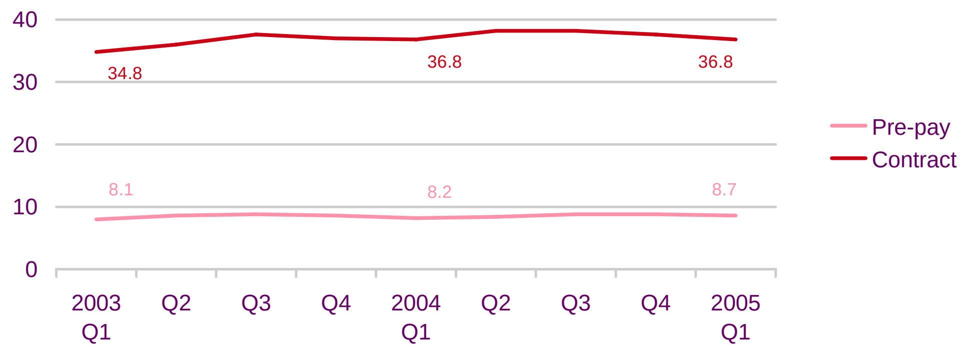


Source: Ofcom / operators

The marked difference between contract (post-pay) and pre-pay ARPU is illustrated below in Figure 46. Contract subscriptions generate on average over four times the revenue per month of a pre-pay subscription. This is due to a number of factors, including the fact that virtually all business mobiles are on contract, and most high-spend residential customers have a contract service (as a corollary, pre-pay is predominant amongst lower-spending teens and occasional users).

Figure 46: Mobile ARPU split by contract/pre-pay

£ per month

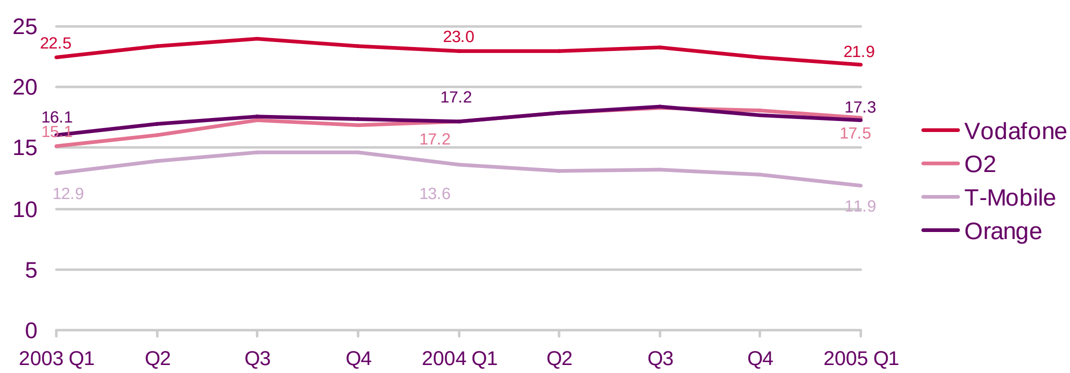


Source: Ofcom / operators

An analysis of ARPU split by operator reveals that Vodafone sits comfortably ahead of its peers – generating some 35% higher ARPU than any other mobile operator (Figure 47). This could be due to the high mix of higher-spending business customers in Vodafone's portfolio; certainly a price analysis reveals that Vodafone's rental and call charges are in line with the market.

Figure 47: Mobile ARPU split by operator

£ per month



Source: Ofcom / operators

11: Theme – mobile content

11.1: Mobile content shows mass-market potential

The first half of 2005 saw signs of mobile content services finally gaining mass-market appeal. The combination of newer, feature-rich handsets and intense marketing of new content and applications served to dramatically increase consumer awareness and uptake.

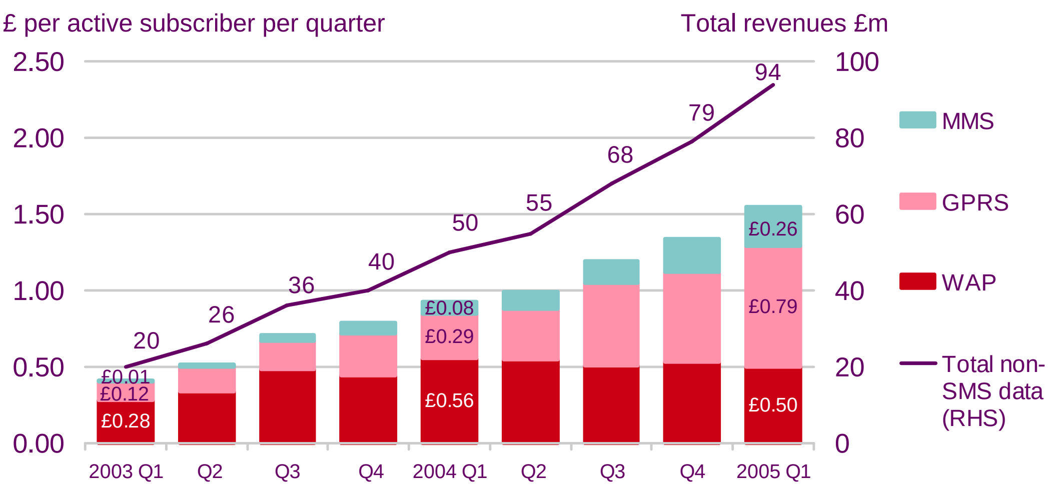
Perhaps the most visible example of the recent success of mobile content is the Crazy Frog phenomenon. What started on the internet as a cult animated frog character with an annoying "riding a spluttering motorbike" noise, quickly gained a wider audience once it was picked up by mobile ring tone market leader Jamster! The company identified Crazy Frog as a ring tone and mobile wallpaper with potential mass appeal, and conducted a saturation advertising and marketing campaign to sell Crazy Frog mobile products.

As a result, the ring tone has sold over 11 million copies across Europe, and has earned Jamster! an estimated £10 million in revenues in the UK alone. In addition, a tie-in "Crazy Frog vs Axel F" single went to number 1 in the UK singles charts, mainly on the strength of downloads. Total UK ring tone revenues were estimated to be around £120 million in 2004 – over twice the size of the CD single market.

11.2: Multimedia messaging and mobile internet usage start to climb

Over the past 12 months, revenues derived from non-SMS data services have started to rise sharply. While still small in comparison to SMS and mobile voice, it is clearly a growing market, as shown in Figure 48:

Figure 48: Non-SMS data revenues



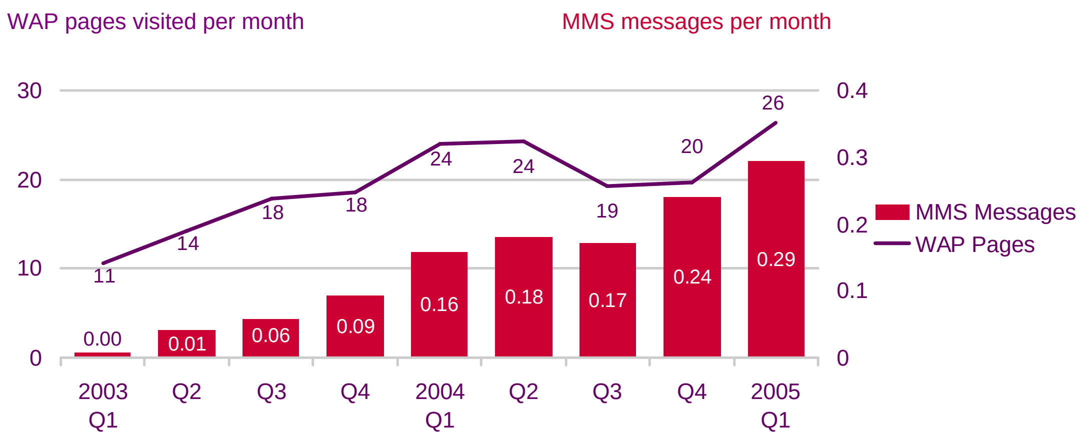
Source: Ofcom / operators

Estimated revenues from non-SMS mobile data for Q1 2005 were £94 million – 19% higher than during the previous quarter, and almost 90% higher than the corresponding quarter in 2004. Access to the mobile internet via GPRS has provided most of this growth; an estimated average of 79 pence was spent on GPRS services per active subscriber during Q1 2005 – more than double the amount spent per user in Q1 2004.

As expected, the rise in revenues is mirrored by a rise in usage of MMS and WAP services, shown in Figure 49. On average, mobile subscribers sent 0.29 MMS messages per month in Q1 2005 – a rise of 23% over the previous quarter and some 86% higher than during the same period last year. Similarly, WAP viewing (over 2G and 2.5G GPRS) rose to an average of 26 page impressions per month in Q1 2005. The Mobile Data Association reported that a record 1.82 billion WAP pages were viewed in March 2005.

This increase in usage of mobile devices to view the World Wide Web has led to the creation of a specific ".mobi" web suffix by the Internet Consortium for Assigned Names and Numbers (ICANN) – the body that manages the registration of internet domain names.

Figure 49: Average MMS and WAP use per active mobile customer



Source: Ofcom / operators / MDA

11.3: More mobile content and applications available than ever before

A vast variety of content and applications is now available to consumers on their mobile phones. This content ranges from the now-conventional ring tones and mobile wallpaper, through to the growing areas of mobile music, video and game downloads. Recently added to these are innovative services such as radio over 3G, mobile soap operas, video-blogging and speed-dating.

This year has seen an explosion in cross-media and inter-company deals to offer mobile content services, often involving various elements of the mobile value chain. A notable example is the recent T-mobile deal with Robbie Williams – claimed to be the World's first between an artist and a mobile operator – which will enable his fans to download album tracks, live tracks and concert footage to their mobile handsets. In another landmark deal, Virgin Mobile, Motorola and Apple have announced a link-up which will offer Apple's iTunes service over Virgin mobile's network, so that users can download music to a suitably-equipped Motorola handset.

11.4: TV over mobile takes its first faltering steps

The provision of high-quality TV signals to mobile devices is an area of focus for virtually all the mobile operators. Orange launched the UK's first mobile TV service over its 3G network in May this year, priced at £10 a month (after an initial free 3 months). Initially, the service offers nine channels, including ITN News, CNN, Cartoon Network and extreme sports, as well as dedicated Big Brother and Celebrity Love Island channels. Vodafone has also announced plans to launch mobile TV later this year.

Various trials are also ongoing to explore alternative method of TV broadcasting to mobiles using radio spectrum:

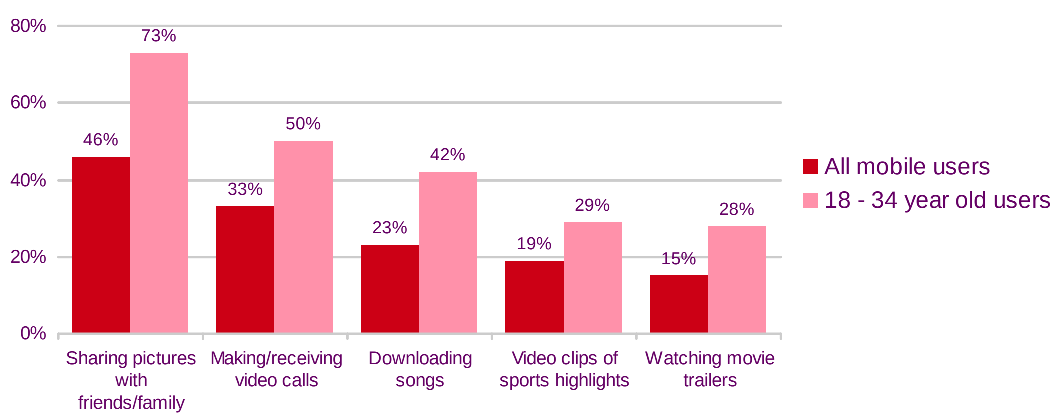
- **BT Livetime and Virgin Mobile** are trialling mobile TV using DAB (Digital Audio Broadcast) spectrum. Trial participants get access to Sky Sports News, Sky News and Blaze, a dedicated mobile music channel and more than 50 digital radio channels, as well as UK's first mobile Electronic Programme Guide..

- **O2 and NTL Broadcast** are due to start a mobile TV trial in September. The trial will provide 16 channels to 350 O2 customers in the Oxford area, using the DVB-H (Digital Video Broadcast-Handheld) signal standard, designed to deliver mobile TV services complementary to existing GPRS and 3G TV transmission methods.

11.5: Younger mobile users have more interest in mobile content & data

According to research carried out by Enpocket, 18-34 year olds show markedly higher levels of awareness of, and interest in, all areas of mobile content and other data services (Figure 50). Its research suggests that among this age group, interest in various areas of mobile content – from sharing pictures to watching movie trailers – is consistently 30-45% higher than for the mobile market as a whole (i.e. across all age ranges).

Figure 50: Level of interest in mobile content services

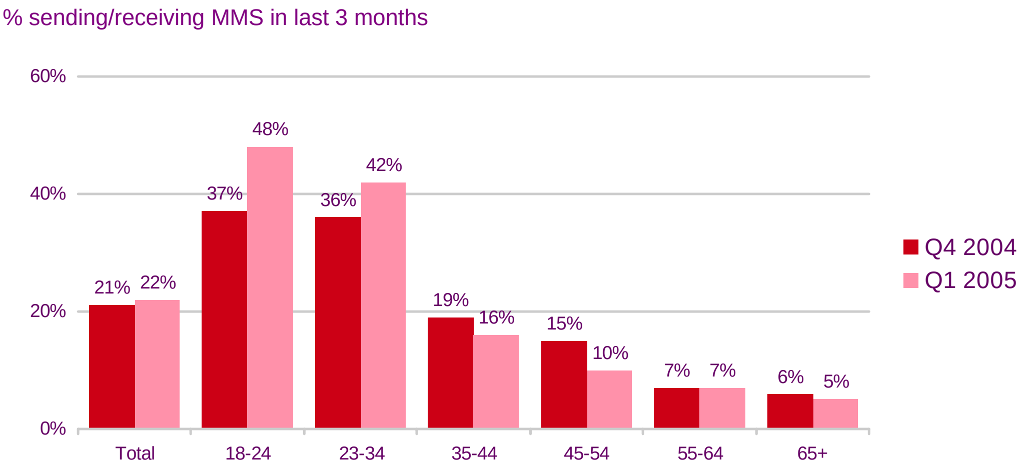


Source: Enpocket

11.6: And younger mobile subscribers use more mobile content & data

Unsurprisingly, the same research suggests that usage of various mobile content and data services is higher amongst the younger age groups. Figure 51 shows 18-24 year olds (and, to a slightly lesser extent, 23-24 year olds) are using multimedia messaging (MMS) services far more than older age groups. The chart also shows a significant rise in MMS usage in these age brackets over the past quarter.

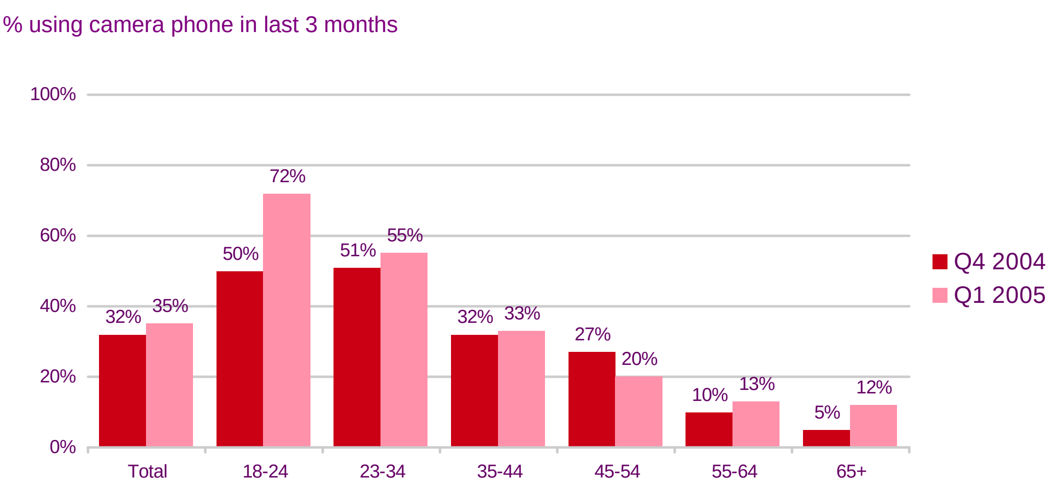
Figure 51: MMS usage by age group



Source: Enpocket

Similarly, the 18-24 age group shows a far higher usage pattern of mobile camera applications. Figure 52 indicates that 72% of users in this age bracket have used their mobile camera in the past three months; again, there is a significant (22%) rise in reported usage compared with the last quarter of 2004.

Figure 52: Camera phone usage by age group



Source: Enpocket

11.7: But the mobile content market is still nascent

Despite these encouraging signs of early growth in uptake of mobile content services and applications, the overall market reach of these services is still relatively low. For example, a recent study by Olista has found that fewer than a quarter (23%) of mobile users have ever downloaded content using mobile phone.

Whilst this of course indicates, on the one hand, room for growth, at the same time it points towards a number of important challenges that have to be resolved in order for mobile multimedia to become truly mass-market. These include:

- **Pricing:** According to research by mm02, perceived expensiveness and lack of pricing transparency are the main barriers for consumer take up of mobile content. Indeed, according to a recent price survey by Informa, image-based mobile services such as screensavers, wallpaper and logos in the UK are among the most expensive in Europe. For example, the average cost of wallpaper from UK operators is more than twice the average price in Spain and Portugal. Moreover, current pricing models are complex, with various charging methods used by operators – including bundles, per-minute charges, per-megabyte charges and monthly subscriptions, as well as pay per view or download.

- **Consumer awareness:** There is still relatively little awareness of advanced mobile services among consumers.

- **The structure of the value chain:** This is still in its infancy and it is uncertain where the value resides in mobile content and applications. This issue in itself may be hampering investment, since returns are difficult to forecast.

- **DRM:** The issue of digital rights management is common across the wired and wireless internet. A number standards and technical solutions will need to evolve to ensure that rights fees are managed properly.

- **Devices:** Mobile handset manufacturers have only recently begun to produce devices that suit usage of rich multimedia applications. Content-enabled devices are increasingly becoming commonplace – Ofcom's latest research from Q2 2005 shows that 57% of consumers now have a content-enabled mobile phone, including handsets that allow WAP internet access, photo-messaging and 3G devices. However, issues such as alphanumeric key entry and navigation tools have yet to be adequately addressed. By definition, mobile devices must be small enough to be portable, with an appropriate battery life. This places severe limitations on the form factor and screen size of such devices and the challenge for handset manufactures is to balance all these factors.

- **Consumer security and privacy:** Issues such as consumer protection, authentication, fraud prevention and privacy will all need to be addressed over the coming 1-5 years, as will the overarching regulatory environment in which mobile content services are provided.

Despite these challenges, the increasing popularity of mobile content during the first half of 2005 is a significant development, which indicates the potential for future mass-market adoption. With an increasing base of 2.5 and 3G devices in use, as well as mounting attempts by industry players to encourage uptake of new services, mobile content is likely to become an increasingly important part of the UK's communications market in the next years.

12: Television market developments

12.1: Mergers, acquisitions and changes of control in prospect

The second quarter saw several mergers, acquisitions or other changes of control either proposed or completed. In the biggest deal, RTL Group, Europe's largest broadcaster, set out its plans to take complete control of Five. It announced in July 2005 that it had agreed with United Business Media (UBM), Five's other shareholder, that it would acquire the 35.4% of Five it did not already own for £247.6 million. The deal is subject to regulatory approval.

RTL was one of the founding shareholders of Five, initially with a 29% share. It subsequently increased its holding to 35.4% and then 64.6%. UBM had indicated earlier in 2005 that it was seeking to focus on its core assets, and has subsequently announced its intention to sell its minority stakes in ITN and the Press Association. If the deal with RTL goes through, it is expected to enable Five to compete more aggressively, particularly in key areas such as acquisitions of US shows. RTL's strategy is to develop and strengthen its families of channels in the markets in which it operates; there was press speculation following the announcement of the deal that it would seek either to launch more channels in the UK or acquire other assets as they became available.

In May 2005, Telewest announced that it reached an agreement with sit-up Ltd to purchase all the sit-up shares that it did not already own. The exact terms of the deal were not disclosed, but Telewest said that the deal valued sit-up, owner of several channels including bid tv and price-drop tv, at £194 million. Sit-up earned pre-tax profits of £11.2 million on revenues of £206 million in 2004.

Shortly before our last annual review, *The Communications Market 2005*, was published, ITV plc announced a deal to acquire SDN, one of the digital terrestrial multiplex operators, for £134 million. The Office of Fair Trading (OFT) subsequently indicated its intention to review the deal for potential competition concerns. It invited comments and at the time of writing was considering its response.

12.2: BBC aims for fewer repeats

The BBC published its 2004-05 Annual Report on 12 July 2005, detailing the governors' assessment of the performance of the corporation's services during the year, on 12 July 2005. The report was the first produced under new governance arrangements designed to preserve the independence of the governors, rigorous stewardship of public money, accountability to licence fee payers and clarity of governance and executive roles.

In this year's report governors sought to identify the achievements and strengths of the BBC, such as the revitalisation of the Saturday night schedule on BBC ONE with *Strictly Come Dancing* and *Doctor Who*. BBC ONE reached more viewers than any other channel, while BBC TWO had moved away from entertainment and lifestyle programmes and increased its output of arts and current affairs programmes. The governors recognised that the BBC's digital channels had increased their audience and welcomed BBC FOUR's "unashamedly literate, intelligent and demanding" schedule. In addition, the BBC's coverage of major news and events including the Asian tsunami and the Athens Olympics also received praise.

However, the governors also identified a number of audience concerns about quality, and sought to take account of this in setting their objectives for management for 2005-06 by including one reducing the level of repeats in the peak-time schedule. BBC chairman Michael Grade said that peak hours could become a “repeat-free zone” on BBC ONE and BBC TWO – although this could take up to ten years to achieve and would depend on having the necessary funds to deliver only new programming.

The report also set an objective of reducing the number of makeover and lifestyle programmes on BBC ONE. BBC TWO needed to do more to arrest its decline in viewers, particularly among younger audiences, without endangering its distinctiveness, while BBC THREE’s news output should be overhauled. And despite the success of *Little Britain*, the BBC’s sitcoms were generally felt to be too ‘middle-class’ and ‘suburban’.

Much of the press coverage of the report focused on controversy over bonuses awarded to BBC executives, worth on average 25% of their salaries. At a time when thousands of BBC staff face redundancy under efficiency plans, Director General Mark Thompson waived his right to a bonus. Michael Grade announced that the bonus scheme would be cut back next year so that no executive would be able to claim more than 10%, although it was reported that the loss would be mitigated by a separate scheme to review executives’ salaries to bring them in line with market averages.

12.3: Value of analogue broadcasting is declining

One of the economic impacts of the growing take-up of digital television was clearly illustrated by the outcome of Ofcom’s review of the Channel 3 and Channel 5 licence terms, published on 29 June 2005. The terms define the basis for calculating payments the ITV1 licensees and Five make to the Treasury in return for holding their licences, which include a range of obligations and benefits including the right to broadcast on scarce analogue spectrum.

Since previous reviews in 1999-2001, and 2003 for Five, the value of access to the analogue spectrum has declined significantly, with under 40% of UK households relying solely on the analogue service for their television viewing. As homes continue to migrate from analogue to digital, the share of advertising derived as a result of access to the analogue spectrum will continue to decline and the net benefit of holding a licence will reduce. Ofcom has taken account of these trends, alongside the licensees’ public service broadcasting obligations and changes in the television advertising market, in setting the new terms.

Although Ofcom does not publish individual licensees’ payments, the expected net effect of the review is considerable:

- in 2003, under previous licence terms, annual payments to the Treasury for all Channel 3 and Channel 5 licences combined were around £270 million;

- in 2004, this fell to £230 million, primarily due to growth in digital households;

- in 2005, under previous licence terms, Ofcom expected that licence payments would have fallen to around £180 million; and

- as a result of the new licence terms, taking into account the expected completion of digital switchover in 2012, licence payments in 2005 are expected to fall to around £90 million.

The actual level of future payments will be dependent upon advertising revenue and digital take-up during the year.

Ofcom noted that this decision was the last in a series taken over the past two years, including the review of public service broadcasting requirements, the replacement of existing licences with Digital Replacement Licences and the proposed timetable for digital switchover.

12.4: BSkyB's growth continues

BSkyB announced record profits for the 12 months to 30 June 2005, with profits after tax up 32%, to £425 million on turnover of £4.048 billion. By the end of June it had 7.8 million direct-to-home (DTH) subscribers, adding 83,000 in the final quarter of the reporting period. It added slightly over 400,000 subscribers during the course of the year and said it remained on track to reach its target of eight million subscribers by the end of the calendar year. Churn was down slightly in the most recent quarter, but remained fractionally above its long-term target of 10%.

New and alternative revenue streams grew in importance, with SkyBet revenues up 37% over the previous year at £261 million. BSkyB said that it expected SkyBet revenues to exceed advertising revenues (which were £329 million in the 12 months to June) in 2006. However, Sky Active revenues were down slightly, from £116 million in 2004 to £92 million in 2005. BSkyB reaffirmed its commitment to launch high definition services in "early 2006", incorporating enhanced PVR capability as well as high quality pictures.

There were 888,000 Sky+ households by the end of June, more than double the previous year's figure and representing 11% of all DTH subscribers. Multiroom households – those with subscriptions on more than one set in the home – have also more than doubled, to 645,000.

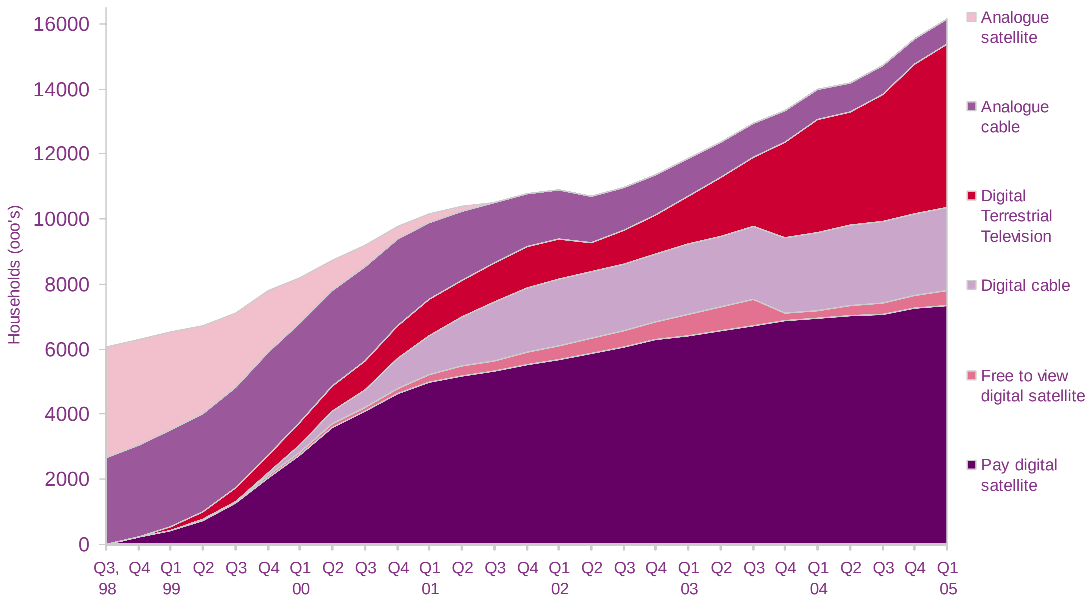
13: The television industry

13.1: Freeview reaches five million mark

By the end of March 2005, Ofcom estimates that digital TV penetration had reached almost 62% of households – up from around 53% in March 2004.

By the end of March there were more than 16 million multichannel households in the UK (Figure 53). Freeview, the free-to-view digital terrestrial service, was once again the largest contributor to growth in take-up in the first quarter, with more than 5 million digital terrestrial-only homes by the end of March. Ofcom estimates that Freeview added just over 466,000 households in the quarter, compared to around 117,000 new pay TV households (including both digital cable and digital satellite).

Figure 53: UK multichannel penetration



Source: Ofcom / platform operators

13.2: Advertising spend picks up

All media sectors saw year-on-year growth in advertising spend in the first quarter of 2005, according to the Advertising Association, with overall expenditure up 5.3% in Q1 2005 compared to Q1 2004 (at constant prices).

Internet advertising was again the single fastest growing medium, up by over 51% year-on-year to reach £209 million in Q1 2005. Further growth is expected throughout the year. Press advertising remained steady, increasing slightly by 1.4% to £1742 million, but still remains the overall largest area of expenditure. Other gainers included cinema, up by over 21% to £34 million and outdoor, up by nearly 14% at £213 million. Radio meanwhile showed a slight increase of 1.4% to £140 million. The only area to show a drop was direct mail, down by just over 7% to £636 million (Figure 54).

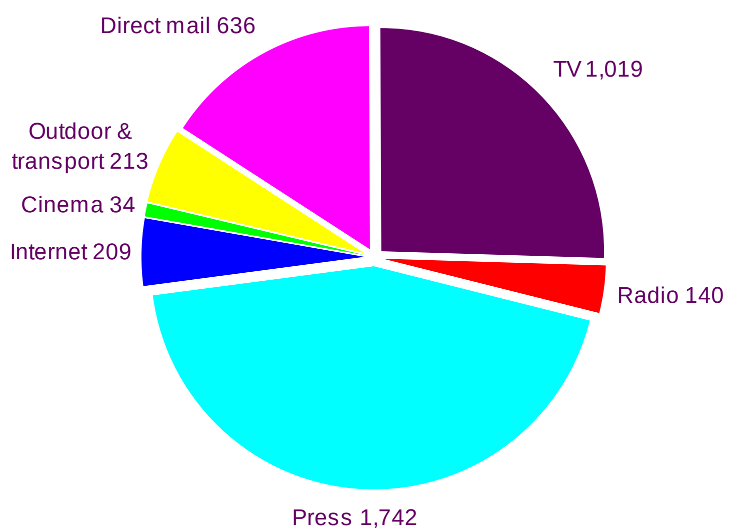
Television

TV advertising expenditure also showed an increase to reach £1,019 million in Q1 2005, a gain of 13.7% on the previous year. Advertising Association figures currently predict overall growth in TV advertising spend in the full year 2005 to be a little over 2%. However, TV advertising growth is forecast to be slower in Q2 and Q3 2005 and recent reports have raised questions on whether growth can be sustained in the longer term as the TV sector adapts to a changing market environment and competition from other media. There are a number of factors currently facing the TV sector which could threaten its long-term share of advertising expenditure: a general world economy slowdown, leading to companies reducing their advertising budgets, as well as new technologies such as PVRs allowing viewers to skip adverts. Given increasing audience diversification and a growing number of multimedia services competing for users, available audiences for TV advertising may decline substantially over the next few years.

At the same time, developing sectors such as the Internet are increasing their share of advertising as more users go on-line and increasing broadband availability means more time is spent on-line. According to the Internet Advertising Bureau spending on on-line advertising increased by 60% during 2004. The outdoor sector is also increasing its share of advertising revenues. As TV audiences become more fragmented, the outdoor sector could offer some advertisers a more stable and economical environment.

For these reasons, Zenith Optimedia predicts that TV's share of the global advertising market will fall this year, possibly marking the start of a long-term downward trend.

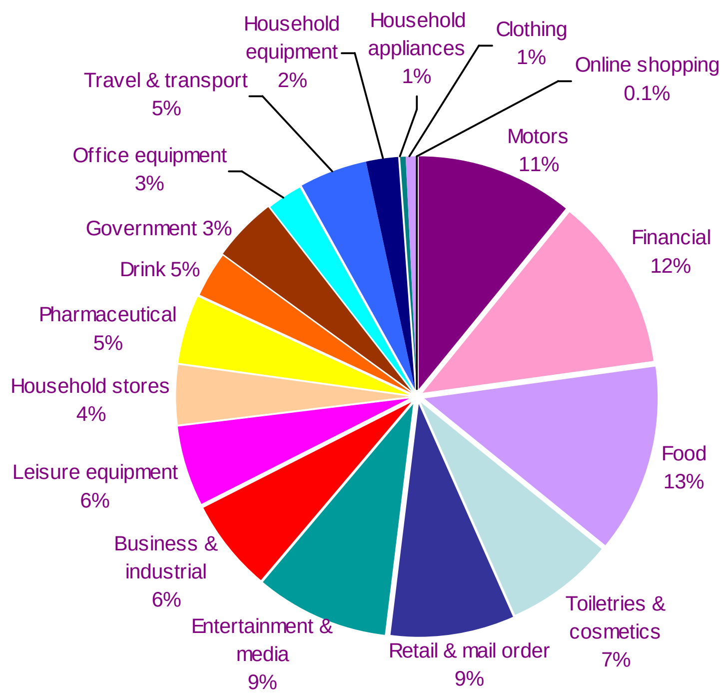
Figure 54: Q1 advertising expenditure by medium (£ million)



Source: Advertising Association

Figures released by the Advertising Association provide a breakdown of TV advertising spend in the first quarter of 2005 for different consumer market sectors (Figure 55). The automotive industry, financial services, food, toiletries and cosmetics, and retail and mail order account for over 50% of the market.

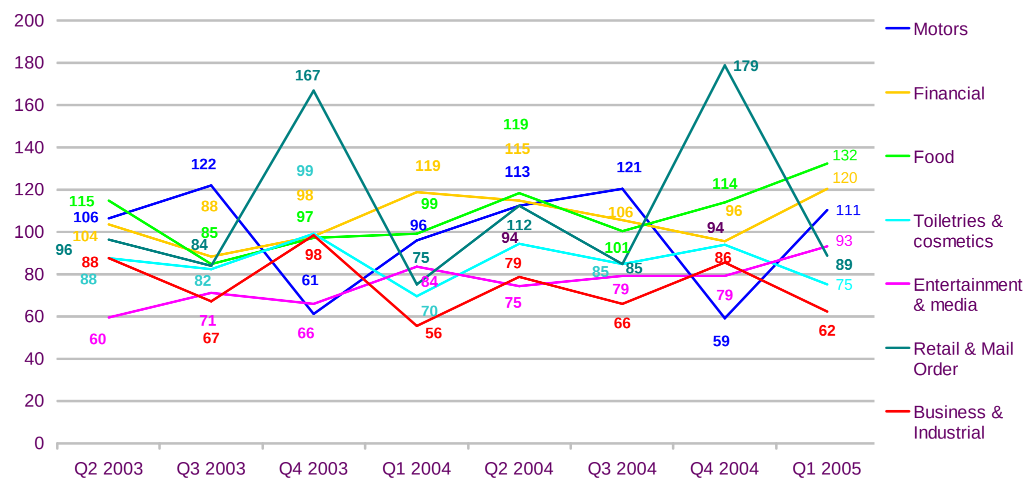
Figure 55: Q1 TV advertising expenditure by sector (% share of market)



Source: Advertising Association

Leading sectors' expenditure on advertising has continued to fluctuate over the last couple of years (Figure 56), mainly related to the seasonal peaks for many sectors and their associated products. Most sectors increase expenditure in the run-up to Christmas in the fourth quarter; retail and mail order in particular illustrates this trend. The motor sector is the exception, generally quieter in the fourth quarter and steadily increasing expenditure throughout the year. All sectors show a higher expenditure in Q1 2005 than on the corresponding quarter last year.

Figure 56: Q1 TV advertising expenditure in leading sectors (£million)



Source: Advertising Association

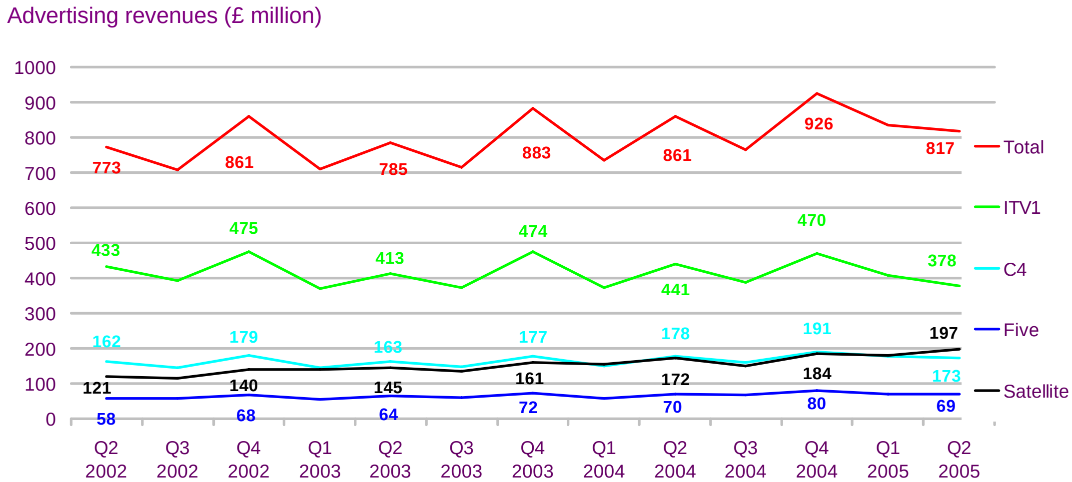
13.3: Multichannel advertising revenues exceed Channel 4's

According to Mediatel market estimates, television net advertising revenues dropped in the first half of 2005 after reaching a high of £926 million in the pre-Christmas fourth quarter of 2004. Total revenues for the second quarter of 2005 were also estimated to be down 5% on the corresponding quarter last year, at £817 million (down from £861 million in Q2 2004).

The commercial multichannels have seen the only growth so far in 2005, up from £184 million in Q4 2004 to £197 million in Q2 2005, a rise of 7% in six months. Over the last 12 months multichannel revenues are estimated to have grown by almost 13%. The multichannels had a 24% share of overall advertising revenues in Q2 2005. Q2 also saw the multichannels overtaking Channel 4 revenues for the first time; Channel 4 was expected to be down slightly on 2004, at £173 million in Q2 2005. Channel 4's share of total advertising revenues was estimated to be 21% in Q2.

ITV1 saw the biggest drop in estimated advertising revenues in the first six months of 2005, falling from £470 million in Q4 2005 to £378 million in Q2 2005, a drop of 19.6%. ITV1's revenues were also estimated to be down by over 14% on 2004's Q2 revenues of £441 million. ITV1 was estimated to have 46% of all advertising revenues in the second quarter. Five also saw a drop to June, down from £80 million in Q4 2004 to £69 million in Q2 2005, but this was only slightly down on Q2 last year's total of £70 million. Five's share of total ad revenues was 8.4% in Q2.

Figure 57: Estimated TV network advertising revenue



Source: Mediatel

14: The television viewer

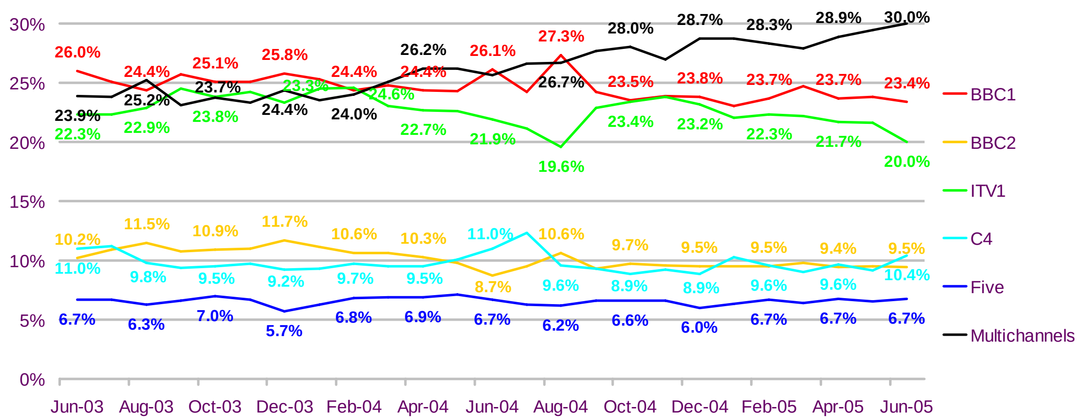
14.1: Multichannels account for 30% of all TV viewing in June

The digital channels combined have taken a greater share of viewing than any of the main five channels and have continued to increase this lead throughout the year (Figure 58). In June 2005 the combined digital channels achieved a 30% share of the entire audience, over six percentage points higher than the BBC ONE share of 23.8%. ITV1 has seen the biggest loss of audience share falling by over three points since December 2004 to 20% in June 2005.

Audience share for BBC TWO (9.5%) and Five (6.7%) has remained stable during 2005, whilst Channel 4 has shown a steady increase after dropping to 8.9% in December 2004 and in June – supported by *Big Brother* – it delivered 10.4% share.

Figure 58: Channel audience share – all day (all homes)

Share of audience, all individuals 4+ (%)



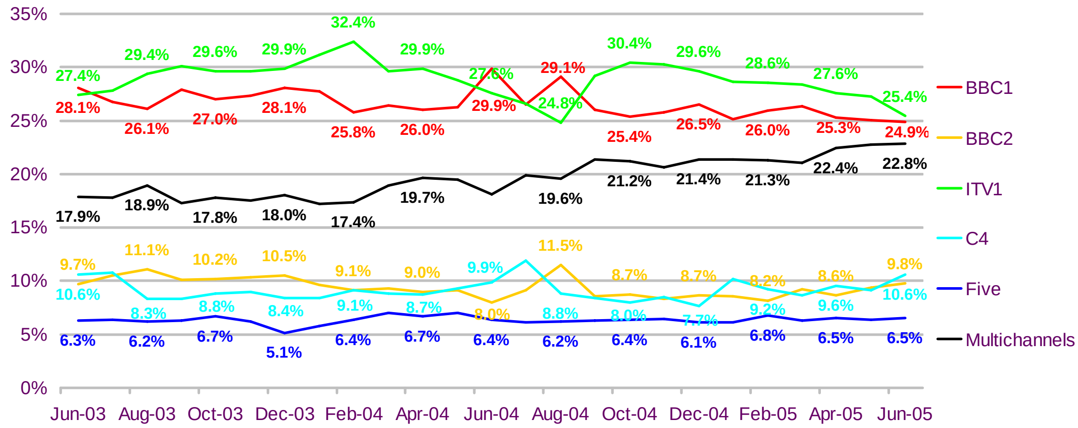
Source: BARB

ITV1 and BBC ONE both lost share in peak time (6pm – 10.30pm) during the first quarter of 2005 (Figure 59). ITV1 showed the biggest drop, and although it still has the highest share of peak-time viewing, it is now only 0.5 percentage points higher than BBC ONE in peak hours. Having previously enjoyed a share of around 29.6% in December, ITV1's share was down to 25.4% by June 2005. BBC ONE's share by comparison has been more stable in 2005, but it has still shown a drop of 1.6 points in the six months so far, to 24.9% by June 2005.

The combined multichannels have shown a steady increase over the same period up to 22.8% by June 2005, and are steadily closing on BBC ONE and ITV1. Channel 4 and BBC TWO were also gainers during the first six months of 2005. Channel 4 was up by 2.9 percentage points, and BBC TWO by 1.1 points on their December shares of peak time viewing. Five's share has remained stable at 6.5%.

Figure 59: Channel audience share – peak time (all homes)

Share of audience, all individuals 4+ (%)



Source: BARB

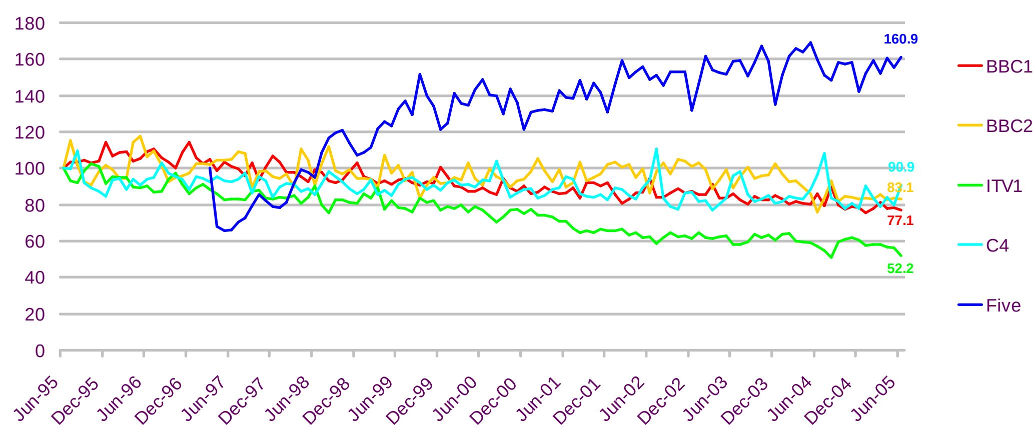
14.2: ITV1's share has almost halved since 1995

Indexing channels' shares against a common point of reference shows how their performance has changed relative to one another. Figure 60 tracks the performance of the main five channels over the last ten years (or in the case of Five, since it launched in March 1997). It shows the way that the encroachment of the multichannels has affected the share of the main five channels, especially ITV1 whose share has halved since 1995. In 1995 ITV1 was the most viewed channel by some distance, usually accounting for well over 35% of all viewing.

Five has been the chief gainer amongst the five main channels, benefiting from increases in audience share as it has been able to invest more in programming, and from the expansion of its coverage due to the emergence of digital TV (Five's analogue terrestrial signal does not have such wide coverage as the other analogue terrestrial channels).

Figure 60: Channel performance since June 1995

Share of audience indexed to June 1995 = 100 (except Five, indexed to March 1997: month of launch)



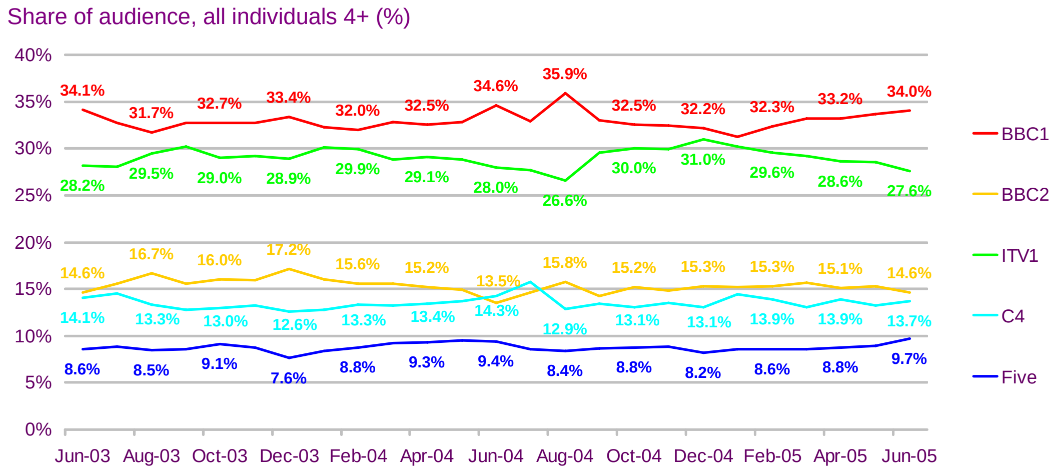
Source: BARB

14.3: BBC ONE's share in analogue and digital terrestrial homes has increased

BBC ONE has maintained and extended its lead of viewing in analogue terrestrial-only homes and reached 34% by June, higher than its share for most of 2004 (Figure 61). ITV1 lost share in the first six months of 2005 after a recovery in late 2004. At 27.6% in June this was down by 3.4 percentage points on December's high share of 31%.

Five gained 1.5 share points in the first six months of 2005 to achieve a 9.7% share of viewing in analogue homes by June, whilst Channel 4 also showed a slight increase to 13.7%. BBC TWO was down slightly at 14.6%.

Figure 61: Audience share by channel – analogue terrestrial-only homes (all day)

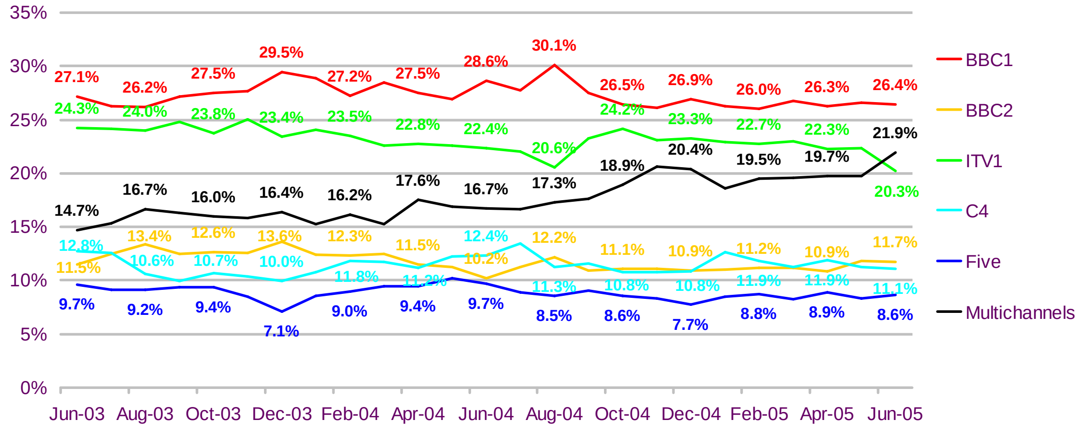


Source: BARB

The multichannels are continuing to gain share in digital terrestrial homes and, for the first time, delivered a greater share of viewing than ITV1 in June 2005. The multichannels' share has increased by 1.5 percentage points since December 2004 to reach 21.9% by June 2005. BBC ONE has maintained a share of around 26% over the last six months with a slight increase in share in recent months. ITV1 has lost three percentage points of share since December and was down to 20.3% by June. BBC TWO, Channel 4 and Five have generally retained a constant share in DTT homes over this period.

Figure 62: Audience share by channel – digital terrestrial-only homes (all day)[5]

Share of audience, all individuals 4+ (%)

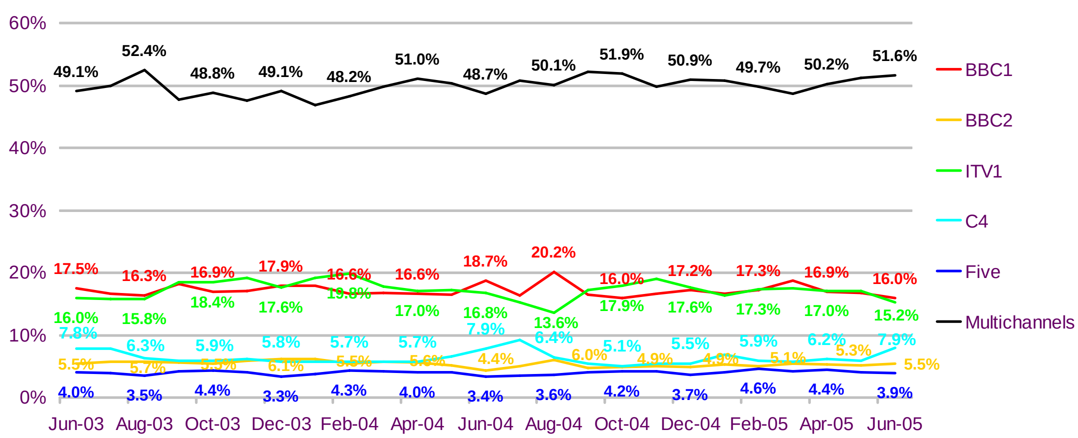


Source: BARB

The combined share of the multichannels continues to dominate in cable/satellite homes with over half of all viewing at 51.6%. BBC ONE and ITV1 have lost some share over the past few months, ITV1 down by over two percentage points between December and June, and BBC ONE by over one point in the same period. Meanwhile Channel 4 and BBC TWO have increased their share in cable and satellite homes, with Channel 4 up by over 2.4 points by June to a share of 7.9% (reflecting the *Big Brother* effect), whilst BBC TWO was up by 0.6 points to 5.5%. Five also made a small gain in the period.

Figure 63: Channel audience share – cable/satellite homes (all day)

Share of audience, all individuals 4+ (%)



Source: BARB

[5] Note that this chart shows trends in viewing in homes with digital terrestrial as the only digital platform, i.e. excluding homes receiving cable or satellite as well as digital terrestrial services. As sales of Freeview boxes for use on second sets increase, it becomes important to focus on viewing in homes that **only** have digital terrestrial TV, as opposed to those who use it in addition to cable or satellite TV on their main sets.

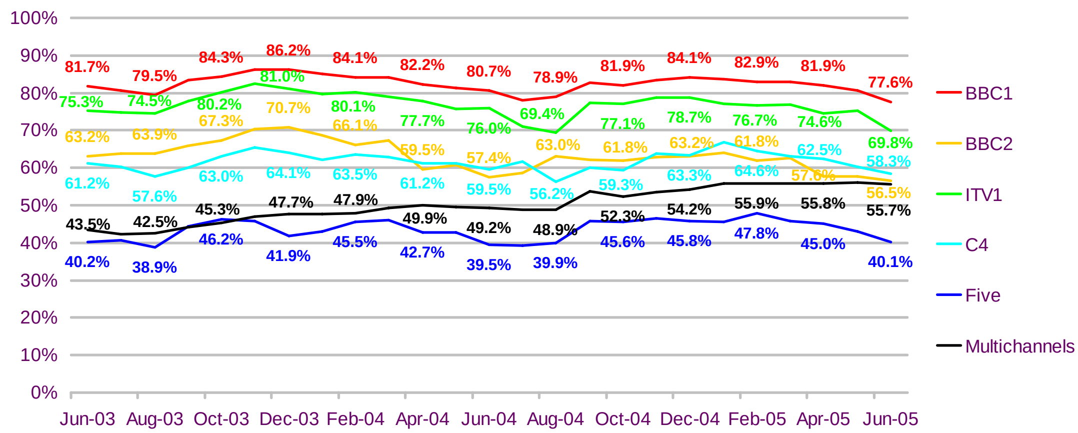
14.4: Reach of five main channels has declined

Audience reach is defined as the proportion of all homes who watch at least 15 minutes of a given channel in a typical week. Audience reach in all homes saw a decrease for all of the terrestrial channels in the first half of 2005. Only the multichannels had a higher audience reach in June than in December 2004 (up from 54.2% to 55.7%).

ITV1 lost almost nine reach points in six months, and was down to 69.8% of homes by June. BBC ONE's reach was down from 84.1% in December to 77.6% by June. BBC TWO, Five, and Channel 4 all showed a drop in the first half of 2005. ITV1 and BBC TWO have lost the most audience reach over the last two years with the multichannels again the only group to gain significantly over this time.

Figure 64: Channel audience reach – all homes (all day)

Channel reach, all individuals 4+ (%)



Source: BARB

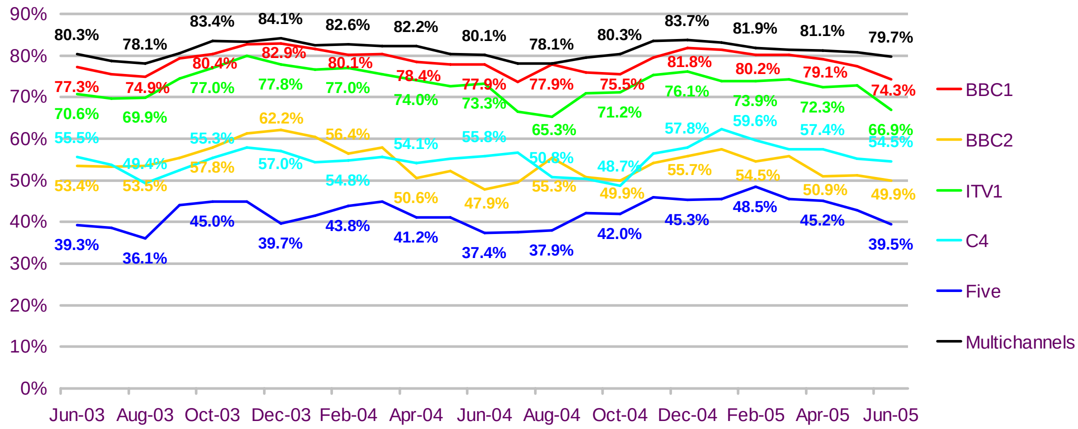
In multichannel homes, all channels showed a drop in reach after reaching a high point over Christmas 2004. The multichannels still had the highest reach at 79.7% but this was down by four percentage points on December 2004.

BBC ONE was down by 7.5 reach points to 74.3% over the same period; ITV1 was down by over nine points at 66.9%; BBC TWO and Five were both down by around six points with Channel 4 down by around five points. This is a trend that has been seen in previous years after Christmas viewing peaks.

Nonetheless, the multichannels, Channel 4 and Five are broadly unchanged on their reach of two years ago. BBC ONE is down slightly (-3 percentage points) on two years ago, whilst BBC TWO (-3.5 percentage points) and ITV1 (-3.7 points) are also both down on their reach of two years ago.

Figure 65: Channel audience reach – multichannel homes (all day)

Share of audience, all individuals 4+ (%)



Source: BARB

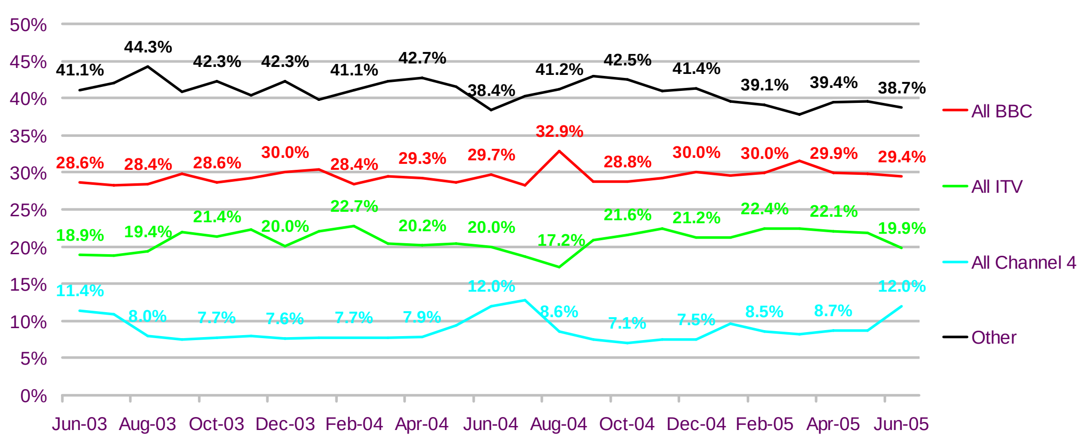
14.5: Major broadcasters' portfolios of channels are winning share

The terrestrial broadcasters are increasingly turning to digital services of their own to shore up their share of viewing. Their hope is that by developing new services they can at least partially offset the increasing encroachment of the multichannels on the audience share of their flagship channels.

Figure 66 suggests that this strategy is bearing fruit. The BBC's channels (BBC 1-4, News 24, CBBC and Cbeebies) have held their combined audience share across all multichannel homes at around 29% for the last two years, delivering 29.4% in June 2005. The combined share of the ITV channels (ITV1, ITV2, ITV3 and ITV News) has fluctuated, but achieved a steady 22% throughout the first five months of 2005. Channel 4 (including E4) has gained share in multichannel homes, particularly during the transmission of *Big Brother* in the summer months. As a result, the share of other channels (including Five and all independent digital channels) has fallen over time, down from 44.3% two years ago to 38.7% in June 2005.

Figure 66: Broadcaster portfolio share in all multichannel homes (all day)

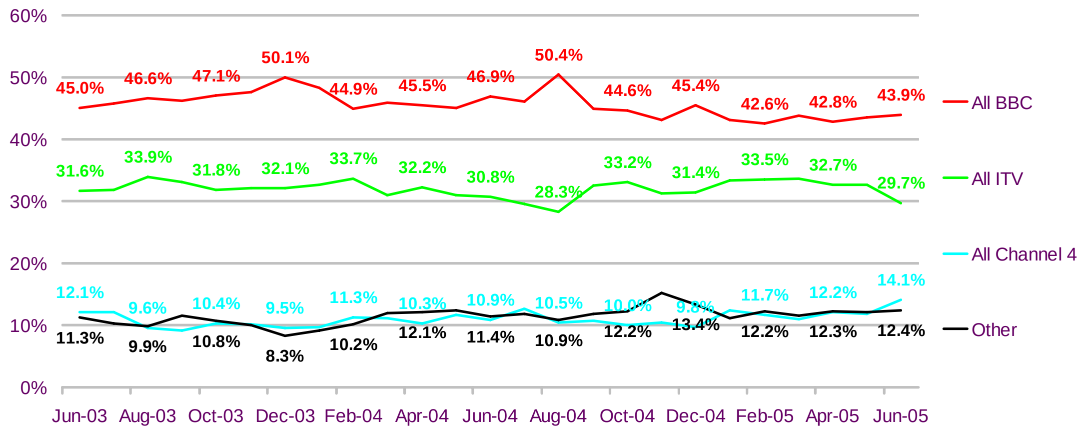
Share of audience, all individuals 4+ (%)



Source: BARB

The increasing share of the terrestrial broadcasters' channels is largely due to the success of Freeview, where the traditional broadcasters are much more dominant. In fact, as Figures 67 and 68 show, the share of viewing of the major broadcasters' portfolios and other channels **within digital terrestrial and cable/satellite homes** has been generally stable over time. ITV1 and the BBC have lost some share in digital terrestrial homes, while Channel 4 has made gains, but the differences are not substantial.

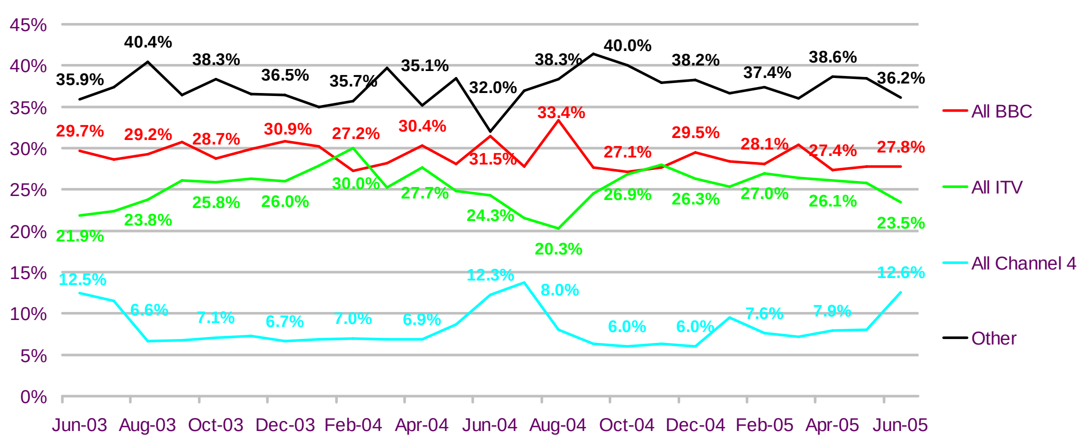
Figure 67: Broadcaster portfolio share in digital terrestrial homes (all day)



Source: BARB

In cable and satellite homes, portfolio shares have fluctuated over the past two years, but overall the trends are similar: the BBC and ITV channels down slightly, Channel 4 up and other channels broadly stable.

Figure 68: Broadcaster portfolio share in cable/satellite homes (all day)



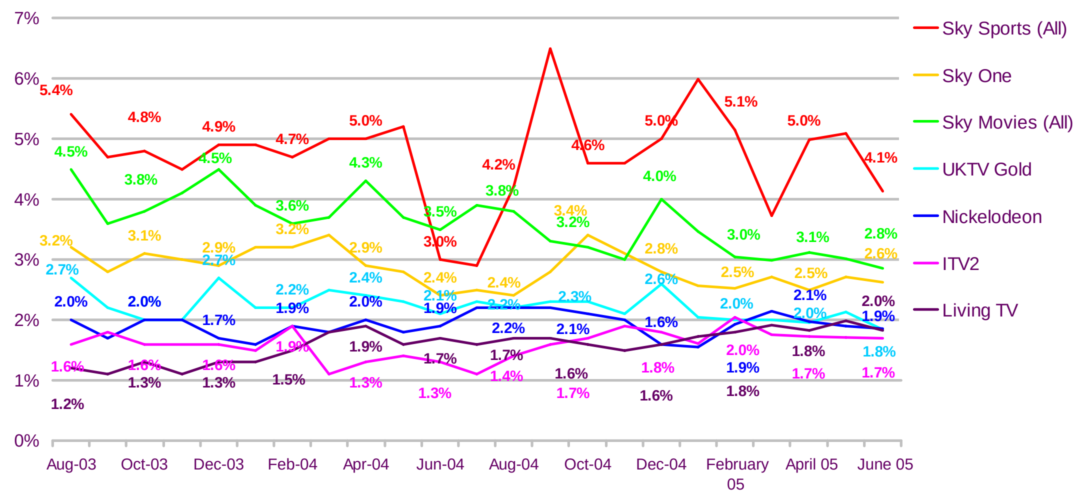
Source: BARB

14.6: Sky services still lead but share is falling

The Sky channels still have the highest viewing share for digital channels in cable/satellite homes, despite a general drop in share over the last two years. The Sky Sports channels' share of viewing can fluctuate depending on sporting events such as the football season. However, Sky Sports still held the highest overall share at 4.1% in June. Similarly, the combined Sky movie channels remained the second most watched of the digital channels, although share dropped to 2.8% in June following the Christmas peak of 4% in December 2004. Sky One also retained its position as the third most watched digital channel with a 2.6% share in June. Living TV, Nickelodeon, UKTV Gold and ITV2 all enjoyed a similar share, with Living TV just edging ahead of the others with a 2% share by June.

Figure 69: Audience share for leading digital channels in cable/satellite homes (all day)

Share of audience, all individuals 4+ (%)



Source: BARB

15: Theme – the multichannel market

15.1: New challenges and opportunities

The multichannel market gets more competitive all the time. In mid-2004, Ofcom estimated that there were 261 unique UK-wide channels broadcasting on the Sky digital platform (i.e. excluding time-shifted services, the regional versions of the terrestrial channels, interactive services and pay-per-view). By May 2005 this number had increased to 352. Ofcom issued more licences to broadcast in 2004 than in any previous year, and the rate of growth increased again in the first quarter of 2005 compared to the same period in 2004.

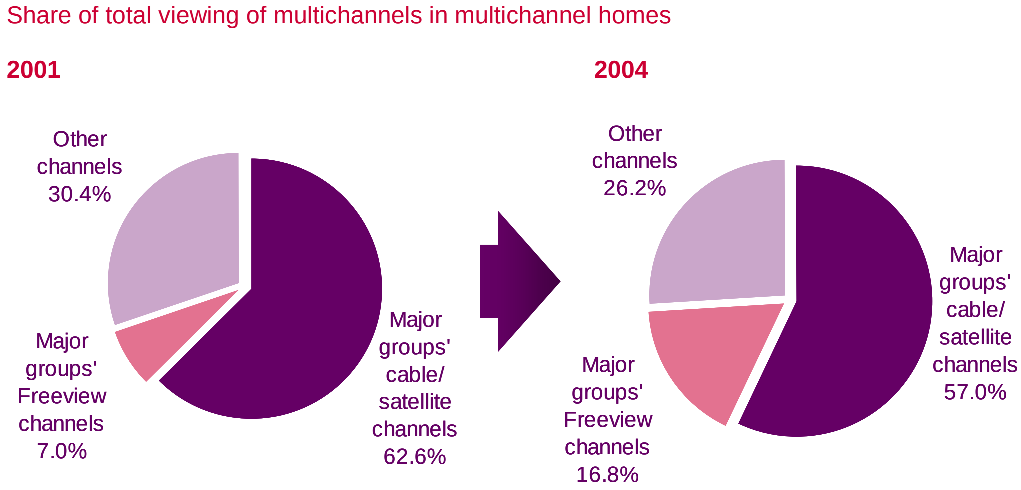
In the January 2005 Quarterly Communications Market report, we focused on how viewers used the digital satellite platform – how much TV they watched and which channels. In this report we investigate the economics of the multichannel market with a particular focus on cable and satellite broadcasters, assessing some of the emerging opportunities in this tightly fought market and the challenges that broadcasters face. Where we discuss revenue data, please note that this generally includes revenues earned by the digital-only channels of the terrestrial broadcasters (ITV2, ITV3, ITV News, E4, FilmFour) but excludes content revenues earned by vertically integrated broadcasters (BSkyB and Flextech), who do not break out their content revenues separately from their retail subscription revenues.

The rapid success of Freeview has significantly changed the dynamics of the multichannel market. As we set out in this year's annual review of the communications sector, *The Communications Market 2005*, the major broadcasters – the BBC, ITV, Channel 4, Five, UKTV, Discovery, Turner and Disney – account for a growing share of multichannel viewing.[6]

This is largely due to these broadcasters' dominance on the digital terrestrial platform, which represents an increasing proportion of all multichannel viewing. As a result, the leading broadcasters' channels that are now available on Freeview accounted for almost 17% of all viewing in multichannel homes in 2004, up from 7% before Freeview launched in 2001 (Figure 70). The only major group to have lost audience share between 2001 and 2004 was BSkyB, which has a relatively limited presence on Freeview. The importance of Freeview was demonstrated earlier in 2004 by E4's move onto the terrestrial platform, in which it sacrificed the subscription fees paid to it by the platform operators in favour of the enhanced advertising revenues available on Freeview.

[6] *The Communications Market 2005*, Ofcom, July 2005, pp. 211-217

Figure 70: Increase in audience share in multichannel homes accounted for by channels available on Freeview



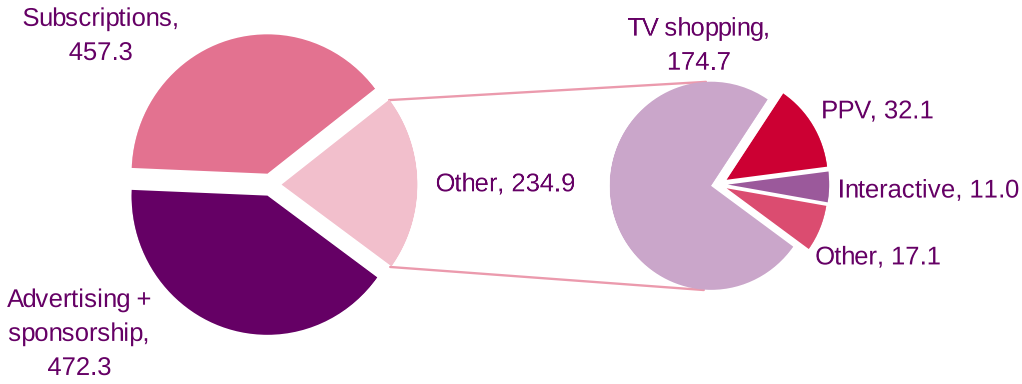
Source: BARB

For those broadcasters operating only on the cable and satellite platforms – that is, the vast majority of channels broadcasting in the UK – the success of Freeview poses two challenges. Firstly, if consumers choose Freeview as an alternative to pay TV when they acquire digital TV – and it is difficult to know the extent to which this takes place – this might be expected to have an impact on the rate of growth of cable and satellite subscriptions. This in turn will have an impact on the rate of growth of subscriptions revenues of cable and satellite broadcasters. Secondly, the growth of Freeview makes advertising on channels that are part of Freeview more attractive to advertisers and diverts advertising spend away from those that are not.

Nonetheless there remain substantial growth opportunities in the multichannel market. In 2004 growth was driven by a significant increase in new and alternative revenues, including teleshopping, interactive services and advertising, and pay-per-view. These services generated almost £235 million in revenues for multichannel broadcasters in 2004, representing almost a fifth of all revenues earned in the sector (Figure 71); note that the TV shopping component **excludes** transfers to providers of goods and services. Although fully comparable figures are not available for 2003, we estimate that this represents growth of around 47% over the previous year.

Figure 71: Revenues earned by multichannel broadcasters

Revenues earned by cable/satellite broadcasters (including ITV and Channel 4 digital-only channels but excluding vertically integrated broadcasters), 2004, £m



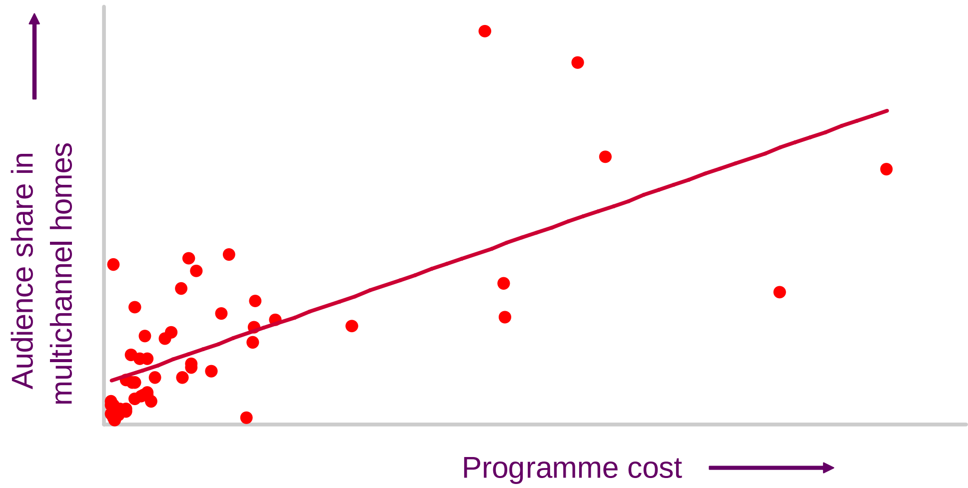
Note: TV shopping revenues exclude transfers to providers of goods and services
Source: Ofcom

The emergence of new revenue streams has enabled different broadcasters to take very different routes to success in the multichannel market. Some channels build their business models on subscription and advertising revenues, seeking to develop sufficiently attractive content offerings to compete for audience share and add substantial value to the platform retailers' subscription packages.

For these broadcasters, the capacity to invest in content is one of the critical determinants of success. In general, the more a broadcaster spends on content – whether acquired or own-produced – the greater their audience share (Figure 72). In turn, larger audiences mean greater interest from advertisers and sponsors and a stronger position in negotiating subscriptions deals with the platform retailers.

Of course this link is not exact – some channels achieve a relatively high audience share with limited programme costs, often by relying on a few breakthrough programmes to establish their brand. But our analysis suggests that it is difficult to achieve real audience impact and awareness without a substantial investment in content.

Figure 72: Relationship between multichannels' programme cost and audience share, 2004[7]



Source: Ofcom

There are other channels, though, for whom the link between audience share and revenue does not apply. Some of those – for example, sports and movie channels – have very high content costs. But others have very low costs, and have built strong businesses by generating relatively high revenues out of a relatively small number of viewers.

Those that have succeeded are those that have developed innovative formats and alternative ways of generating revenues, such as sit-up's "dynamic pricing" shopping channel price-drop tv, and auction channel bid tv. Sit-up makes money both from the sale of goods through its channels, and through calls made to take part in auctions or make purchases. Other emerging areas of growth include 'call TV' formats, in which viewers dial in to take part in real-time quizzes, competitions or votes, and interactive betting and gaming channels.

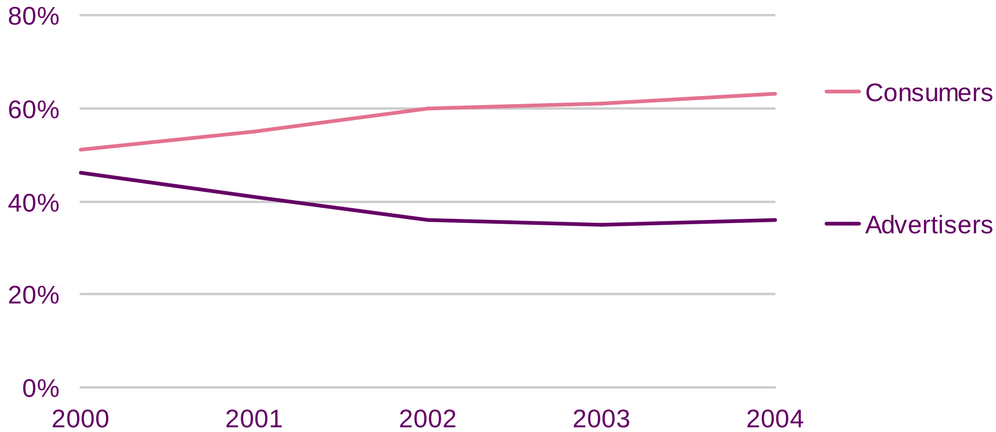
Our analysis suggests that viewers remain willing to spend more on TV and interactive services and that this continues to support the development of new revenue streams. In 2000, on average, every household with a TV in the UK spent around £15.80 per month on TV subscriptions. By 2004 this had risen to £23.30. However these data do not take into account spending on interactive services, premium rate 'phone calls, pay-per-view services and so on. Detailed historical data are not available in these areas, but in 2004 we estimate these services added a further £1.50 per month to an average household's spending on TV.

As a result, consumer spending (including subscriptions, interactive and other services and the TV licence fee) generates an increasing proportion of total TV industry revenues, compared to advertising and sponsorship. In 2000, consumer spending and advertiser spending accounted for roughly similar proportions of industry revenues. But by 2004, consumer spending generated almost two-thirds of TV revenues, with advertisers accounting for a little over one third, even though advertising grew in 2004. Consumers are directly funding a larger proportion of

[7] The data in this chart have been anonymised to preserve the confidentiality of data provided to Ofcom by broadcasters

industry revenues than ever before, and there are continued growth opportunities for those broadcasters able to tap into this audience demand.

Figure 73: Proportion of TV industry revenues derived from advertisers and consumers, 2000-2004



Source: Ofcom