The Consequences of Privatising Channel 4

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Short Summary

This report, commissioned and funded by Channel Four (C4), aims to inform policy by analysing the likely consequences of privatising C4 while still aiming to retain the remit. At this point there is no specific privatisation proposal. The analysis therefore has to make assumptions about what such a proposal might be and to address many other uncertainties. Any change of ownership would require primary legislation. At that point, the proposal would be clear and some of the other uncertainties reduced.

Even at this stage, however, by discussing a range of privatisation options, issues, trade-offs and scenarios, including alternative post-privatisation strategies for the buyer, we think it is possible to reach robust conclusions about the likely consequences if the government were to proceed. Inevitably, these are subject to some uncertainty, which we have tried to indicate, but we think the results are sufficiently clear-cut to show that:

1. **There is no need to privatise C4 to protect its distinctive remit, which is likely to be comfortably sustainable over the next ten years with C4 continuing as a government-owned, commercially funded publisher-broadcaster.** In the unlikely event that, sometime in the next ten years, the remit did appear to be at risk, decisions could be made at that point about priorities within it and/or other ways of ensuring C4's continuing viability by boosting its business model (eg platform retransmission fees, if not already introduced).
2. **Privatising C4 would almost certainly make the remit *less* sustainable**, thereby damaging:
   - *independent producers*, especially smaller ones and those in the nations and regions
   - the wider *broadcasting ecology and creative industries*, especially film
   - *societal aspects of the remit* such as C4's commitment to long-form news, current affairs and other programmes that tackle social and cultural issues – often quite challenging - across a range of genres.
3. **It would also be hard to attract credible bidders for C4 without dropping or weakening the current 100% publisher-broadcaster model** to enable the new owner to switch a proportion of the content budget from commissions from external UK producers to purchases from its own production businesses in the UK and overseas, probably mainly the US.
4. **Privatisation would also be likely to impact adversely:**
   - *consumers*, especially younger and minority viewers (eg BAME and disabled)
   - *advertisers*, especially those targeting hard-to-reach younger viewers and/or seeking to use a more data-enabled approach
   - *the wider economy* (GVA, employment, taxation and the balance of payments).

Executive Summary

C4's remit, culture, role and contribution

C4 plays a unique 'alternative mainstream' role in the UK's broadcasting ecology. Its statutory remit and main channel licence differ from those of the other PSBs: its particular priorities are to be distinctive, innovative, risk taking, diverse and a platform for alternative views and voices, with an emphasis on reaching young and minority audiences.

C4's main channel commissions far more new titles than any other PSB channel – almost twice as many as the main ITV channel and about four times as many as C5. Its organisational culture reflects a strong commitment to the institution and its mission and remit. Staff survey responses are well above the norm for UK companies for questions such as *"I am proud to work at C4"* and *"I know how my role contributes to achieving C4's strategy and goals"*.

Viewers are well aware of how C4 differs from the other PSBs, giving it much higher scores in response to questions such as *"Takes a different approach to subjects compared with other channels"*, *"Home for alternative voices"* and *"The one that, more than others, takes risks with programmes that others wouldn't"*.

C4 is especially important for the UK's independent producers. As a publisher-broadcaster, it commissions about 70% of its programmes by value in the UK, mainly from the indies, and acquires only about 30%. It works with 338 production companies across TV, film and digital; more than half its first-run originated programme hours are commissioned from companies in the devolved nations and the regions outside London. It funds 25% of the independent production sector's first run commissions and enables advertisers to deliver brand messages efficiently, especially to hard-to-reach younger and upmarket audiences.

Beyond this, C4 also contributes to UK public value in many other ways. Its creative output is often reflected in awards, including 16 Oscars since 2009; it is a leader in technological and commercial innovation, especially through its market-leading first-party data strategy; and it delivers a wide range of wider social benefits through its programming, such as changing perceptions of disability, ethnic and other aspects of diversity, and healthy living. Its 'measured' contribution to the UK's gross value added (GVA) has been conservatively estimated at £1.1 billion per annum. It also delivers significant consumer and advertiser surpluses.

Privatisation: The government's priorities

Our understanding, based on statements by ministers, is that the government's top priority if it privatised C4 would be to *ensure the sustainability of the remit* in a fast-changing market and technology environment. However, we assume that, subject to this, the other objective would be to *maximise the proceeds of the sale*.

Clearly, there is some tension between these two aims. But, whatever the exact balance between them, the government would also presumably want a *competitive auction* with as many credible bidders as possible.

The sustainability of the remit

Our analysis suggests that C4's current remit should be comfortably sustainable over the next ten years. In fact our projected 'non-privatisation' base case implies a big *increase* in its ability to deliver the remit, reflected in 58% real (inflation-adjusted) growth in content investment 2014-25.

Whatever the exact numbers, the remit seems to us clearly sustainable, given C4's current commercial success, alertness and agility, and broader market trends. The long-term prospects for TV advertising are excellent – far better than appeared to be the case a few years ago - and even though younger viewers are watching less TV, their viewing is not going to alternatives that advertisers can use to deliver brand messages at scale.

Even if, against our expectations (and those of the current C4 leadership, Ofcom and many other experts) C4's remit did prove unsustainable at some point over the next ten years, there would be many ways of addressing the problem at that point without privatising it, which would actually make the remit *less* sustainable.

Potential proceeds from a sale: the investment case for a prospective buyer

The core of this report is an analysis of what it would take to interest credible media businesses in buying C4, how they might seek to achieve an acceptable return on their investment, and what the consequences would be compared with a non-privatisation scenario.

We see no case for a private equity sale to create a standalone company with no synergies. To us, the most likely credible buyer is an existing media company ('MediaCorp'), probably US-based, seeking to move into, or expand in, the UK, although there are other possibilities such as a UK communications company ('CommsCorp'), which we also discuss.

Most of the credible potential buyers have their own production businesses. To justify the cost of buying C4, they would wish to switch a proportion of its content budget from UK commissions to in-house purchases from these businesses. We therefore think that it would be impossible to achieve a credible competitive auction without dropping, or weakening, C4's 100% publisher-broadcaster model, which currently precludes such in-house purchases.

The investment case at 'MediaCorp'

As (most likely) a US company, MediaCorp would not only have very different financial incentives from a government owned, non-profit-making C4 but also, most likely, a very different mission and culture, with C4's remit seen as a *constraint on maximising shareholder value* rather than, as now, a set of *guidelines for maximising public value*.

The investment case would be based on four potential sources of shareholder value (in addition to squeezing C4's balance sheet): non-programming cost savings; revenue synergies; 'soft' synergies from improved access to C4's talent, systems, brands, expertise and commercial and creative networks; and getting more 'bang for the buck' (revenue per pound) from C4's content investment.

Non-programming cost savings, revenue synergies and 'soft' synergies

There is some potential for *non-programming cost savings*, although they account for only 30% of total costs and C4 is already a 'tight ship' (eg with higher revenue per employee and lower non-programming costs per channel than ITV Broadcast, despite ITV's greater economies of scale). We also see some scope for *revenue synergies* (through cross-promotion, portfolio scheduling and collaborative marketing) and for *'soft' synergies* (depending on MediaCorp's existing UK assets and its attitude to the UK broadcasting ecology).

Taken together, we estimate a 'realistic, perhaps optimistic' range of *£28-36m/year* for the total potential benefit to MediaCorp of these three potential sources of value (non-programming cost savings, revenue synergies and 'soft' synergies). Treating this as equivalent to EBIDTA[1] and assuming a multiple of 11x, this would justify a 'realistic, perhaps optimistic' value of about *£530-620m* including £170-175m from C4's 'spare' cash and £50m from a 20% increase in payables (ie paying suppliers later).

Given the risks and the need for the buyer to make a profit on the deal, a realistic maximum price for C4 based on all these five sources of value in combination (non-programming cost savings, revenue synergies, 'soft' synergies, 'spare' cash, and increased payables) would be £400-500m – around the same as C4's £443m book value. Anything above this could only come from the buyer's ability to get more 'bang for the buck' (revenue per pound) from C4's content budget.

Getting more 'bang for the buck' from C4's content budget

To justify a higher price than the £400-500m estimated above, MediaCorp would need some combination of the following changes in the percentage allocation of C4's content budget:

1. From UK commissions to (mostly US) acquisitions, especially from its own production businesses

2. From loss-making or marginal genres to more profitable ones, especially during peak viewing hours (ie with more aggressive scheduling as well as a more commercial programme mix)

3. From programmes focused on UK issues and attuned to UK sensibilities, to programmes with international appeal to maximise in-house content synergies and external resale potential

[1] Earnings Before Interest, Taxes, Depreciation and Amortisation.

4. From newer, riskier programmes and executions within each genre to safer, more mainstream ones, with longer programme runs and more repeats
5. From finding and nurturing new talent to mostly working with established talent
6. From working with hundreds of independent producers across the UK, including small ones and start-ups, to using fewer, bigger suppliers, mainly in London
7. From paying the full first-run cost of new commissions to deficit financing (as well as paying later, already assumed above in the increase in payables)

All of these ways of getting more 'bang for the buck' from C4's content budget conflict with its current mission, remit, culture and role within the UK broadcasting ecology. There would be significant negative effects on C4's broader social contribution and little way of guaranteeing that the new owner could be held to the spirit of the remit.

What if the buyer were a UK communications company ('CommsCorp')?

If the buyer were a UK communications company such as BT, TalkTalk or one of the mobile operators ('CommsCorp') rather than a US media company like 'MediaCorp', the investment case would be different, based mainly on accelerating the development of CommsCorp's TV activities as part of a broader 'triple play' strategy.

Both BT and TalkTalk are already expanding in TV. The UK mobile operators are not, at this point, but might do so at some point in response to converging market and technology trends and competitive pressures. Vodafone, in particular, could easily afford to buy C4 as a way of expanding into TV and acquiring C4's brands, channels, expertise, first-party data and supplier and advertiser networks.

The most likely CommsCorp candidate, in our view, is BT. Given its cash flow and balance sheet, BT could certainly afford to buy C4, even after the EE acquisition. It is also already expanding in TV, although this development is still at a relatively early stage.

As a commercial company, CommsCorp would of course be under the same pressure as MediaCorp to maximise shareholder value from the purchase, including by getting more 'bang for the buck' from C4's content budget.

Because CommsCorp would be a UK organization regulated by Ofcom, its corporate culture might be more sympathetic to the remit than MediaCorp's; but as a communications company rooted in telecoms, it would be likely to have less understanding of TV audiences and broadcasting more generally - which would a big part of why it might be interested in buying C4.

CommsCorp might be a more attractive buyer politically than MediaCorp because it would keep C4 in UK hands and might be more likely to retain the publisher-broadcaster model. But the government would want and need a competitive auction, rather than having a UK communications company - such as BT, if interested - as the only credible bidder, and would not be able to count on it outbidding all the other potential buyers.

The impact of privatisation

As already noted, we believe that, if the government proceeds with C4 privatisation, it will need a competitive auction (politically, in terms of competition law and to avoid state aid issues, and to maximise the proceeds from the sale). To attract sufficient credible buyers, it would in our view need to amend the 100% publisher-broadcaster model and possibly loosen the remit in other ways to enable the new owner to get more 'bang for the buck' from C4's content budget.

Our analysis therefore assumes that the new owner is allowed reduce the proportion of the content budget allocated to UK commissions from the current 71% (in 2014) to 50%.[2] With this assumption, we model three scenarios, representative of three potential post-privatisation strategies available to the buyer:

- **Option 1**: a 30% cut in total content investment and a 10% cut in sales and marketing spend, leading to a 5% reduction in revenue. These are the assumptions in an investment bank presentation we have seen. They imply a **50% reduction** in C4's UK content investment. This would have equated to £215m less spent on UK originated content in 2014.

- **Option 2**: a 20% cut in total content investment and a 10% cut in all non-programming costs, with revenue broadly unchanged. These assumptions imply a **44% reduction** in C4's UK content investment. This would have equated to £190m less spent on UK originated content in 2014.

- **Option 3** representing, at the other extreme, something close to the most positive plausible case: a 20% *increase* in total content investment and a 10% increase in sales and marketing spend, leading to a 35% increase in revenue but an ***18% reduction*** in C4's UK content investment. This would have equated to £75-80m less spent on UK originated content in 2014.

We think that Option 2, or something close to it, is the most likely one, but even the very optimistic Option 3 would still lead to a significant cut in C4's UK content investment.

A moderately optimistic strategy somewhere between Options 2 and 3 would lead to an intermediate outcome, with a reduction in C4's UK content investment between Option 3's 18% (£75-80m) and Option 2's 44% (£190m). For instance, holding the total content budget constant (while still getting more 'bang for the buck' from it as in the other scenarios) would

[2] Our expectation is that, if the buyer were MediaCorp, all the 21% of content investment released from this change would be allocated to purchases from its own overseas production businesses, but the consequences for the UK are not sensitive to this.

lead to an outcome roughly halfway between that of Options 2 and 3: a 31% (£130-135m) cut in C4's originated UK content investment.

Whatever MediaCorp's exact strategy, the cuts would be even greater for smaller producers and those in the nations and regions, and in remit-related genres and programmes.

The impact would also be overwhelmingly negative for the overall economy, the broadcasting ecology and creative industries, technology adoption and commercial innovation, C4's consumer surplus and advertiser surplus, and wider society.

1. Aims, Issues and Scope

1.1 Aims and Key Issues

The UK government is currently considering the future of Channel Four (C4). One of the options it is exploring is to privatise C4 while still aiming to retain its remit. This report, commissioned and funded by C4, aims to inform policy by analysing the likely consequences if the government were to proceed with this option.

Policy background: the government's aims and priorities

Rational policy is based on evaluating the expected consequences of specific proposals. But, at the time of writing, the government's plans for C4 are unknown: we know that it is 'considering' privatisation but we have seen no concrete proposals.

There is even some uncertainty about the government's aims and priorities. The obvious one is to raise revenue, but Culture Secretary John Whittingdale told the Commons Select Committee in January 2016 that the main reason why he was considering privatisation was not, as widely assumed, to raise money, but to 'ensure [C4] can continue to deliver the remit, *in what is to become a very fast-changing and challenging environment*' [emphasis added].[3] The implication is that he thinks the remit may be unsustainable as things stand but privatisation would somehow make it sustainable.

Privatising C4 would require primary legislation and a full parliamentary process, presumably including green and white papers with clear proposals and expected benefits. It will be easier to evaluate if and when we have these details.

Meanwhile, we have to make assumptions about what the government's aims, priorities and proposals might be. Based on the minister's comments and the background of tight public finances, our assumptions here are that:

1. The government's top priority is to **ensure the sustainability of C4's remit**, which the minister believes may be at risk because of technology and market trends. That is the primary motivation for considering privatisation.
2. Subject to the above (ie without putting the delivery of the remit at risk), the government would aim to **maximise the privatisation proceeds**.
3. In order to achieve both 1 and 2, and in terms of competition law and to avoid any state aid issues, the government would want a **competitive auction** with as many credible bidders as possible.

[3] Kevin Rawlinson, 'Channel 4's public service remit will be protected, vows culture secretary', *The Guardian*, 21 January 2016. http://www.theguardian.com/media/2016/jan/21/channel-4s-public-service-remit-will-be-protected-vows-culture-secretary.

As often in policy, there is some tension between these. Points 2 and 3 are mutually consistent, in line with normal practice when public assets are sold. However, there is an obvious trade-off between Points 1 and 2: the tighter the remit and compliance regime, the less profitable a privatised C4 is likely to be, reducing the expected privatisation proceeds.

For much the same reason (although perhaps less obviously) there is also some tension between Points 1 and 3: the less attractive C4 is as an acquisition target, because of what many will see as unnecessarily complex and burdensome regulation to protect the remit, the fewer potential bidders are likely to be interested.[4]

This policy background has three implications for our analysis here.

Implication 1: The sustainability of the remit

The first implication relates to the sustainability of the remit, that is, C4's continuing ability to deliver it as a government-owned publisher-broadcaster fully funded by commercial revenue.

Our 'base case' uses recent revenue projections from Enders Analysis Ltd (EAL). We agree with these. If EAL and we are correct, the remit is comfortably sustainable over at least the next ten years, even with conservative assumptions about future cost increases. Further, for reasons that will become apparent, we believe that the remit is *less* likely to be sustainable if C4 is privatised.

On this basis, there is in our view no rational basis for privatising C4 in order to protect the remit. On the contrary, the remit is safer under the status quo.

Nevertheless, the previous C4 leadership, the Secretary of State, and some others believe that the remit may be at risk. We therefore, later in the report, give the evidence for our view (and that of EAL, most experts, and the current C4 leadership) that the remit is sustainable for the foreseeable future. We also briefly discuss the implications if, at some point in the next ten years (and against our expectations) it turns out not to be sustainable.

Implication 2: The end of the 100% publisher-broadcaster model?

The second implication relates to the 100% publisher-broadcaster model. Under current legislation, C4 is not allowed to produce programmes for its main channel or to own TV production.[5]

If the government's *only* aim were to protect C4's remit (Point 1 above), this might not be a problem for privatising it. But if the government is also aiming to attract multiple credible bidders and to generate, say, £1bn-plus in privatisation proceeds (Points 2 and 3), we believe

[4] However, the relationship between Points 1 and 3 is not straightforward: other things being equal, having as many credible bidders as possible (Point 3) increases the chance of finding a buyer committed to the remit and willing and able to invest to deliver it (Point 1).

5 Except for advertising and continuity links. C4's Growth Fund involves relatively short-term minority equity investment (up to 25%) in smaller producers to help them grow.

that it will need to weaken the rules. We think this will be essential to ensure that existing media companies are interested in bidding, knowing that, if successful, they will be able to supply a proportion of content from their own production companies, as well as achieving some cost and revenue synergies from combining C4 with their UK distribution business.

The main scenarios we model therefore assume some weakening of the 100% publisher-broadcaster model.

Implication 3: The need to allow for many possible options and outcomes

The final implication of the policy context is that, because there are various ways in which the government might privatise C4, various potential types of buyer, several possible post-acquisition strategies for the new owner, and much uncertainty about the resulting outcome, we need to allow for some alternatives to our main scenario. We aim to cover these in sufficient detail to enable a rational policy decision.

Based on our discussion of alternative options and outcomes, we believe that our results are directionally robust: not only is there no rational case for privatising C4 to protect the remit (as discussed above) but, also, the evidence is that, if the government were nevertheless to proceed with C4 privatisation, the impact would almost certainly be negative for UK producers, consumers, advertisers and several other social and economic aspects of public value, which we discuss in some detail.

With this policy background, we now turn to C4's current model, mission and enterprise value.

C4's current model and mission

C4 is currently publicly owned but 100% funded by its commercial activities, mainly the sales of commercial TV airtime. Its mission is to maximise public value as a publisher-broadcaster through a combination of:

1. The *producer surplus* generated by (a) its commissions and other contributions to the UK broadcasting ecology and (b) its purchases of other UK-supplied products and services. Part of its remit is to support UK independent producers, with specific quotas for the proportions of content hours and investment given to those based in the devolved nations and regions
2. The *consumer surplus* generated by the viewing of its universally available, free-to-air ('FTA') programmes, especially among the younger and minority audiences prioritised in its remit
3. The *advertiser surplus* generated by its commercial airtime, based on its high reach and viewing level and its particular ability to deliver valuable, hard-to-reach younger viewers, increasingly reinforced by its market-leading work on data-enabled advertising
4. *Other public value* generated through its commitment to (a) innovation and risk-taking in both content and other activities (eg online services) and (b) showing a wide range of programmes, including loss-making public service programmes that are more

challenging or of only minority interest, cross-subsidised by more popular and/or high-margin programmes that generate financial surpluses (the 'Robin Hood' model).

In this report, we focus especially on the likely consequences of privatisation on C4's producer surplus (point 1) but also discuss the impacts on its other contributions (points 2-4).

C4's current enterprise value

C4 is deliberately, and very successfully, managed and governed as a non-profit company. Because of its mission, remit and culture, when it generates a financial surplus, it increases its subsequent investment in programmes and innovation to increase its public value in line with 1-4 above. Over the medium term, its aim is to generate only the minimal earnings required to maintain a prudent level of reserves.

Over the last five years (2010-14), as reported in its 2014 Annual Report ('AR14'), C4 has generated an average annual surplus of £7m, less than 1% of its £900m-plus average annual revenue.[6] This raises the question: why would a rational commercial investor pay a significant amount for a heavily regulated broadcaster in a mature, complex, volatile and highly competitive market, and very much in the public eye,[7] currently generating this minimal level of annual earnings?

If we treat C4's £7.0m average annual surplus over the last five years as equivalent to £7m EBITDA[8] and use a typical multiple of 11x[9] (ie assuming an industry-average risk-adjusted expected earnings growth rate), its enterprise value as a standalone investment is of the order of £75-80m plus the value of any realisable assets not needed on a going concern basis.

C4's balance sheet value was £443m as at the end of 2014.[10] This included £222m in cash, money market funds/deposits and investment funds and £103m for property, plant and equipment, including C4's freehold head office in central London, which had a market value of £85m at the end of 2014.[11]

As a commercial going concern with no major staff cuts or other significant changes, a privatised C4 would still need accommodation[12] but could probably operate with much lower liquid reserves, say £50m, potentially releasing £172m (obviously, updated to the figure at the time of the bid).

6 Nominal pounds. AR14, p168
7 C4's 10.9% portfolio viewing share in 2014 (AR14, p167) is equivalent to an average of 24 minutes viewing per day among the whole UK population aged 4+ (Ofcom Communications Market Report 2015, p145 reports average TV viewing of 220 minutes/day in 2014). Like those of the other main broadcasters, C4's most popular and/or controversial programmes have a very high media and public – and, sometimes, political – profile.
8 Earnings Before Interest, Taxes, Depreciation and Amortisation.
9 EV/EBITDA. Source: CitiBank, February 2016, based on 2016 forecast profits This is the average for the following European FTA broadcasters: ITV, M6, Mediaset Espana, Mediaset, ProsiebenSat.1, RTL and TF1.
10 AR14, p132
11 AR14, pp132, 147, 151.
12 A new owner could of course sell the building to release cash, but it would then have to lease it back (or rent other accommodation), increasing its annual operating costs.

On this basis, the enterprise value (EV) of a privatised C4 with no cost savings, synergies or other financial performance improvements would be about £250m: £75-80m for the present value of its expected future profits and £170-175m for its 'spare' cash.[13]

Given C4's balance sheet value of £443m, privatising it for £250m would create an accounting loss for the government of almost £200m, which would be politically hard to explain. In practice, the accounting loss would be higher because a rational bidder would expect to pay less than the full EV in order for the deal to be profitable and to allow for the high risks.

Suppose, however, the government felt that someone would pay a bit more than C4's book value – say, £500m - creating a small accounting profit on the deal. Any change in C4's ownership or business model would require primary legislation, taking about two years to go through Parliament. Given the associated effort, risks and inevitable controversy, and the heavy current political agenda (Europe, refugees, the NHS, etc), it seems unlikely – although not inconceivable - that the government would wish to proceed with C4 privatisation in the hope of raising just £500m from the sale, just above C4's book value.

The main privatisation questions are, therefore:

> Q1. How might a rational investor justify paying a much higher price (eg £1bn-plus) which, in turn, might justify the likely political cost and effort to the government of proceeding?
>
> Q2. What would then be the consequences for the UK public interest?

Q2 is the topic of this report but, to answer it, we first have to answer Q1.

Why would someone pay £1billion-plus for C4?

Obviously, for an investor to pay the £1 billion-plus that has been widely mooted, something would need to change – either (i) the remit would have to be dropped or weakened, or (ii) the buyer would have to believe that it could increase C4's profits substantially despite the remit being retained. From an investor perspective, this implies some combination of:

a. *Non-programming operating cost savings* through synergies and better management
b. *Revenue synergies* through cross-promotions, shared marketing, portfolio commissioning and scheduling, etc
c. *'Soft' synergies* from the buyer's access to C4's talent, systems, brands, supplier relationships, etc

[13] This is, if anything, an overestimate: given that C4 has now built up a prudent level of reserves, its aim over the medium term is, broadly, to reinvest *all* its annual surpluses in additional content. The average level of future profits is therefore likely to be less than the £7m per annum assumed here.

d. *Getting more 'bang for the buck' (revenue per pound) from C4's content investment* by moving to a more commercial mix of programmes and suppliers and more aggressive scheduling, ie getting around the existing remit
e. *Selling or releasing 'spare' assets* such as cash, other working capital or property
f. The government *weakening the remit* to increase C4's profitability as a commercial venture
g. The government making *other changes* to make a privatised C4 more profitable, such as introducing retransmission fees from pay TV operators to PSB channels (albeit such changes would also benefit other PSBs).

Our understanding is that the government has declared itself committed to protecting the remit (f) and has, so far, made no commitment to other potential regulatory changes that might boost C4's profitability (g).

In analysing the privatisation options and their likely consequences, we therefore focus mainly on (a) to (e), while also discussing some potential issues and options under (f) and (g). In particular, as already noted, we believe that, if the government proceeds with C4 privatisation, it will need to weaken one important part of the remit in order to attract enough credible bidders: the 100% publisher-broadcaster model.

1.2 Report Structure

Section 2 sets the context by summarising C4's remit, culture, role and contribution. Given its particular model as a publisher-broadcaster supporting independent UK production as a key part of its remit, we especially focus on C4's contribution to UK content investment and independent production, but also review its broader economic and social contributions. This discussion forms the essential background to our analysis of the likely consequences of privatising it.

Those consequences are then explored in Sections 3-5 in the form of an ex ante impact analysis in three stages:

- *A simple base case scenario projecting a non-privatised C4's revenue and content investment up to 2025 using a recent revenue forecast by EAL and other stated assumptions (Section 3).* This section also discusses the sustainability of the remit and the implications if, at some point in the next ten years, it unexpectedly turns out not to be sustainable
- *A detailed discussion of the investment case for a potential buyer if C4 is privatised (Section 4).* We first look at who might buy it, focusing mainly on 'MediaCorp', an imaginary US media company, although we also discuss 'CommsCorp', a UK communications company, as a potential buyer. We analyse the range of strategic options available to the buyer; potential non-programming cost savings, revenue synergies and 'soft' synergies; and ways in which the buyer might seek to get more 'bang for the buck' (revenue per pound) from C4's content budget by shifting to a more commercial mix of programmes and suppliers and more aggressive scheduling

- *Section 5 then discusses the likely impact of privatising C4 (ie relative to the base case in Section 3).* The initial assumption is that the buyer aims broadly to maintain C4's revenue while cutting programming costs by 20%, shifting to a more commercial mix of programmes and suppliers (including its own production companies) and more competitive scheduling, and also cutting non-programming costs. On this basis, we explore the impact of privatisation on (i) UK content investment and independent production and (ii) the wider UK economy and society. We also discuss the implications if the buyer adopts a different strategy, either cutting costs even more deeply (and accepting some reduction in revenue) or trying to increase C4's revenue.

Sections 3-5 represent the report's core analysis, comparing two scenarios: (i) a base case assuming C4 is not privatised and (ii) a privatisation case, with all the other base case assumptions held constant.

Finally, Section 6 briefly discusses three other privatisation issues and options:

- Other ways in which the government might increase the potential value of a privatised C4 without weakening the remit: retransmission fees, changing the terms of trade with producers, levelling the airtime sales playing field, and extending EPG prominence to the commercial PSBs' portfolio channels
- Strengthening the remit and/or the compliance regime to reduce the scope for the buyer to get around the constraints on its commercial freedom
- The part-privatisation option.

2. C4's Remit, Culture, Role and Contribution

In this section, we first describe C4's remit, culture and role within the wider UK broadcasting ecology. We then discuss its contribution to UK content investment and independent production, and finally its broader economic and social contributions.

2.1 C4's Remit, Culture and Role

C4's central mission is to deliver its public service remit while remaining financially secure. The remit is defined in statute in the 2003 Communications Act and the 2010 Digital Economy Act. In addition, the main channel operates under a licence from Ofcom containing a number of specific obligations (quotas) which stem from – but do not seek to itemise every aspect of – the statutory remit.

C4's overall remit

The 2003 Communications Act defines the remit as *"the provision of a broad range of high quality and diverse programming"* with the following specific features:

- *Innovation, experimentation and creativity* in both form and content
- Appeals to the tastes and interests of a *culturally diverse society*
- Includes *programmes of an educational nature* and other programmes of educative value; and
- Exhibits a *distinctive* character.

The 2010 Digital Economy Act significantly extended the remit, which currently (in summary) covers the following:

High Quality Content: "A broad range of media content of high quality"

Innovation: "Innovation, experiment and creativity in the form and content of programmes

Distinctive: "Exhibit a distinctive character."

Cultural Diversity: "Media content that, taken as a whole, appeals to the tastes and interests of a culturally diverse society."

Talent Development: "Support the development of people with creative talent, in particular people involved in the film industry and at the start of their careers."

Stimulate Debate: "Support and stimulate well-informed debate on a wide range of issues, including by providing access to information and views from around the world and by challenging established views; promote measures intended to secure that people are well informed and motivated to participate in society in a variety of ways."

Alternative Views: “Promote alternative views and new perspectives.”

Inspire Change in People’s Lives: “Provide access to material that inspires people to make changes in their lives.”

Partnership: “Working with cultural organisations”

Multimedia: “The broadcasting or distribution of relevant media content by means of a range of different types of electronic communication networks.”

Education: “Make a significant contribution to meeting the need for the licensed public service channels to include programmes of an educational nature.”

Older Children and Young Adults: “Media content that appeals to the tastes and interests of older children and young adults.”

News and Current Affairs: “The making of relevant media content that consists of both news and current affairs.”

Film: “The making of high quality films intended to be shown to the general public at the cinema in the UK – as well as the broadcasting and distribution of such content and films.”

Schools: “A sufficient proportion of schools programmes” (fulfilled through educational content for teens)

Accountability for delivery of the remit as a whole is conducted through the annual published Statement of Media Content Policy (unique to C4) and regular detailed scrutiny by Ofcom.

The main channel licence

The licence for the main channel includes specific quotas for *peak-time news and current affairs*; *UK-originated* programming and, within that, programming commissioned from *out of London*, from the *devolved nations* and from ‘qualifying’ *independent producers* (not owned by another broadcaster); and for *access services* (subtitling, audio description and signing).

While the C4 remit, broadly defined (ie including the main channel licence) contains numerous specific obligations, the qualitative elements – distinctiveness, innovation, experimentation and so on - are non-genre-specific and apply to its output as a whole and (under the Digital Economy Act) can take account of content beyond the main channel.

The channel’s delivery against its licence quotas is subject to scrutiny by Ofcom through the return of compliance reports (as for other Ofcom licensed broadcasters).

Organisational culture

C4's identity as a non-profit, public service broadcaster with a clear public service remit is well understood and embraced by its employees, as reflected in the following responses to a recent staff survey:[14]

- *"I am proud to work for Channel 4"*: 96% (21% above UK norm)
- *"I would recommend Channel 4 as a place to work"*: 91% (23% above UK norm)
- *"I understand C4's remit"*: 97% (15% above UK norm)
- *"I know how my role contributes to achieving C4's strategy and goals"*: 89% (11% above UK norm)
- *"I personally feel motivated to go the extra mile for my work"*: 87% (16% above UK norm).

These figures reflect an exceptionally high level of employee commitment and engagement. C4's strong organisational culture means that commissioning decisions are always taken with the remit in mind, rather than as a secondary constraint, as would be likely if it were privatised.

C4's distinctive role within the UK broadcasting ecology

When C4 launched in 1982, Jeremy Isaacs, its first CEO, is said to have said that it would be "different, but not *that* different". This is still a fair description.

TV is a high-reach mass medium and C4 is still primarily a TV broadcaster. Different TV channels' audiences do vary but audience segmentation is weaker than for most other media (newspapers, magazines, online media, radio and cinema). Most viewers spread their viewing over several or many favourite channels, typically including most of the main ones and a few others that vary more widely between individuals.

The audiences for different large, mixed-schedule channels like C4's are indeed 'different but not *that* different' - although some of the differences that do exist, such as C4's high share among viewers aged 16-34, are important to advertisers and, therefore, revenue.

C4's main channel's 73% monthly reach among 16-34s is only marginally below ITV's 74% and well above C5's 56%, and with a higher % of ABC1 16-34s (valued highly by advertisers) than either of these main competitor channels.

At a portfolio level, C4's 82% combined monthly reach of 16-34s matches ITV's portfolio reach and is well above the C5 portfolio's 62%.[15] Furthermore, C4's overall portfolio viewing share has broadly remained stable at around 11% for more than the last ten years.[16]

[14] Source: C4.
[15] Source: BARB.

More generally, and in line with its remit, C4's overall positioning within the wider UK broadcasting ecology has always been distinctive:

- ITV, the main advertising-funded PSB, is more mainstream commercial, with generally bigger programme budgets, a growing proportion of programmes and revenue from its own production business and, on average, significantly bigger but somewhat older and slightly more downmarket audiences than C4. The main ITV channel remains the dominant mass-market commercial channel with a viewing share of 15% and weekly reach of 60% in 2014.[17]
- C5, the third commercial PSB, is smaller and more straightforwardly commercial than C4, with no remit and limited licence obligations. Its audiences are broadly similar to ITV's but smaller.
- The BBC, the main publicly-owned PSB, is, of course, mainly funded by the licence fee and and accepts no advertising on its UK PSB services. Its positioning is more 'establishment' than C4's and it is much more burdened by commercial, political and ideological criticism, which discourages innovation and risk-taking.[18] It is sometimes portrayed as if it appealed only to middle aged, middle class adults – the 'John Lewis', Radio 4 and BBC4 market – and young children but, in reality, it appeals to almost everyone. BBC1 is the biggest UK channel with a 22% viewing share and 87% weekly reach.[19]

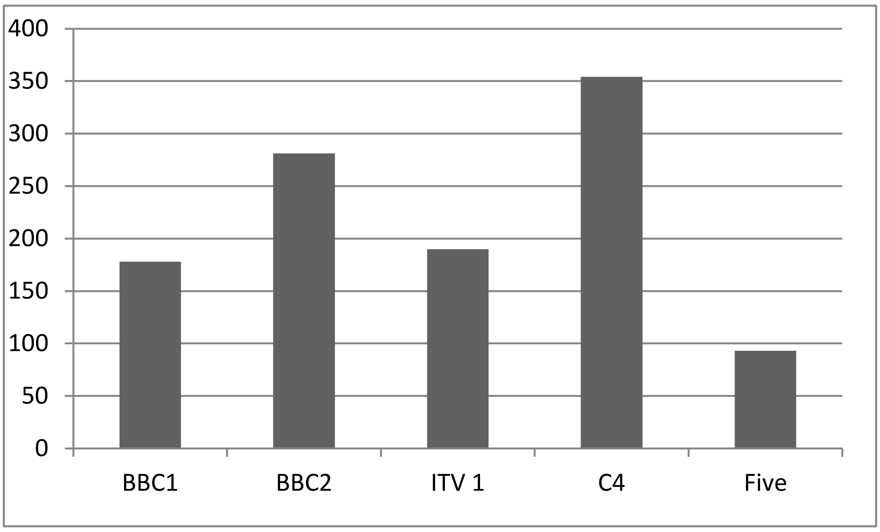
Compared to ITV and the BBC, C4 sits in a slightly less mainstream position. Because of its commercial funding, smaller scale and its explicit remit to take risks, be diverse and innovate, it attracts less criticism than the BBC, despite showing a higher proportion of edgy, risky programmes such as *Things We Won't Say About Race But Are True, The Great British Sex Survey*, *Gogglebox*, *Benefits Street* and *The Inbetweeners*. No one would ever call C4 'Auntie'.

One measure of C4's willingness to take programming risks is the number of new titles commissioned each year for its main channel (Figure 2.1).

A far higher proportion of C4's viewing is to documentaries than for the other PSBs: in 2014, documentaries made up 23% of its portfolio viewing across all individuals, versus only 11% of viewing for all PSBs.[20]

16 The detailed BARB figures are: an increase from 8.6% in 2004 and 9.6% in 2005 to 11.2% in 2006-7, steady around 11.6% 2008-12, then 11.1% in 2013 and 10.9% in 2014. CMR15, Fig 2.56.
17 Ofcom *Communications Market Report 2015* ('CMR15'), Figs 2.48 and 2.49.
18 This may be one reason why the current C4 leadership is not seeking any top-sliced BBC licence fee revenue: the price is too high.
19 CMR15, Figs 2.48 and 2.49.
20 BARB, *Trends in Television Viewing 2014*, March 2015.

Figure 2.1: New programme titles commissioned per annum[21]



C4's audience 'sweet spot' is young adults, but it has also been relatively successful with teenagers. In 2015, 86% of the top 50 factual programmes amongst 16-34s were on C4 - including *Gogglebox, The Undateables, Secret Life of 4 Year Olds* and *One Born Every Minute.*

C4's role has evolved over time to ensure that it remains distinctive in a multichannel world with ever greater competition. It currently formulates its role as being an 'alternative mainstream' broadcaster, bringing impactful and ambitious programming to large audiences. Its output is often more innovative and challenging than that of the other mainstream broadcasters, but its scale and reach still ensure that it can connect with large audiences in ways that fragmented online and most other media cannot, ensuring that its airtime is highly valued by advertisers.[22]

Viewers are very aware of C4's commitment to offering distinctive and innovative content. Its main channel is selected by far more respondents than the other PSB channels on statements such as *"The one that, more than others, takes risks with programmes that others wouldn't"* and *"Taking a different approach to subjects compared with other channels"* (Figure 2.2).

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21 Average 2008-13. BARB, Attentional Limited. Oliver & Ohlbaum Analysis.
[22] Because of its channels' combination of high reach and attractive demographics, commercial airtime on them attracts premium prices not only per minute but also per thousand viewers ('CPM').

Figure 2.2: Viewers' perceptions of C4 and other PSB channels[23]

Reputational Statement	Average for other PSB channels %	C4 %	Difference
"Shows different kinds of cultures and opinion"	10	33	+23
"Challenging prejudice"	7	29	+22
"The one that, more than others, takes risks with programmes that others wouldn't"	7	46	+39
"Showing the viewpoints of minority groups in society"	7	32	+25
"Home for alternative voices"	7	34	+27
"Making audiences think about things in new and different ways	9	22	+13
"Taking a different approach to subjects compared with other channels"	7	44	+37

2.2 Contribution to UK Content Investment and Independent Production

Despite its relatively small size, C4 punches well above its weight as an investor in original UK content and, especially, commissions from the UK indies. Consider the investment in external first-run UK commissions by the top five PSB channels in 2014: the main C4 channel's £377m was 13% more than the £334m invested by BBC1 and BBC2 combined; 68% more than ITV's £224m; and 3.9 times C5's £97m.[24]

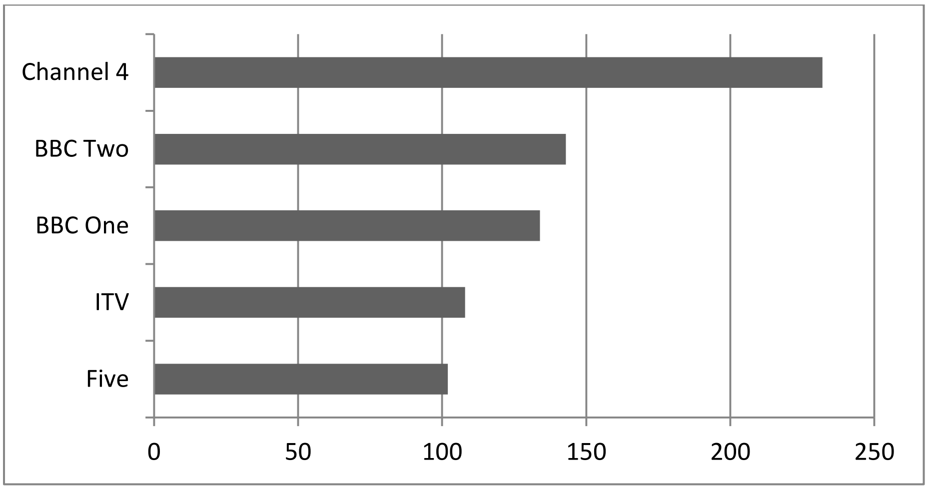
John McVay, chief executive of the independent producers' trade body Pact, looks back to C4's birth in 1982 as a pivotal moment in developing the public appetite for original British shows. "In the early 1980s, it was acquired US programmes such as *Dallas*, *Dynasty*, *Starsky & Hutch* and *Cagney & Lacey* that dominated the primetime schedules," he says. "Channel 4 came in to stimulate origination and creativity and all the other broadcasters had to react."[25]

Many more suppliers

As part of C4's commitment to support a flourishing independent production sector, its main channel also commissions programming from many more suppliers than any of the other top five PSB channels (Figure 2.3).

23 AR14, pp. 24-26.
[24] Source: Ofcom.
25 Ian Burrell. "Why British TV rules the world". *The Independent*. July 7, 2014.

Figure 2.3: Number of production companies worked with, 2013[26]



Commissions in the nations and regions

Finally, C4 is also committed to working with suppliers across the whole UK. It has quotas for both Out of London production (35% of spend and hours) and Nations production (3% of spend and hours).[27] It consistently exceeds both of these, with 52% of hours and 43% of spend from Out of London in 2014 (the latest published figures) and 6.1% of hours and 6.0% of spend from the Nations.[28]

C4's investment in network productions in the Nations has risen every year since 2008.[29] Building on this upward trend, and in recognition of related public policy objectives, C4 has committed under its new licence to a higher Nations quota of 9%, to be achieved from 2020.[30]

Paying full first-run production costs

Finally, as a PSB, C4 normally pays the full first-run production cost in return for only the primary broadcast rights and a share (15-50%) of some secondary rights revenues, eg from international sales and UK secondary transmissions. Other secondary rights (eg VoD) are subject to commercial negotiation and generally involve additional payment.

In contrast, the non-PSBs offer only deficit finance, ie expecting the producer to carry some of the first-run production cost and risk in the expectation of earning a long-term return from secondary rights.

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26 C4 and Enders Analysis "Channel 4 Market Impact". January 5, 2016. p7.
27 C4, *Response to Ofcom's Third PSB Review*, February 2015.
28 AR14, p18.
29 Ibid.
30 Ibid.

2.3 Broader Economic and Social Contributions

Beyond C4's contribution to UK content investment and independent production, especially in the Nations and Regions, it also contributes in many other ways to Britain's wider economy and society. We here briefly review these under the following headings:

- Broader economic contribution
- Contribution to the UK broadcasting ecology and wider creative industries
- Impact on technology adoption and commercial innovation
- Consumer surplus
- Advertiser surplus
- Broader social contributions

Broader economic contribution

The standard measure of an organisation's overall economic contribution is its impact on gross value added (GVA). For C4, this comprises:

- Its *'direct' value added*: the difference between its revenue and its expenditure. The main component of this is its direct employment costs.[31]
- Its *'indirect' contribution to GVA*: purchases from UK suppliers, adjusted for (i) the proportion of those purchases imported by the suppliers, and (ii) purchases from the UK by its overseas suppliers, and
- The additional *'induced' value added* generated by expenditure on UK goods and services by C4's own employees and those of its (UK and overseas) suppliers.

Because programming accounts for 70% of C4's costs and most of this goes to UK independent producers, a significant proportion of its GVA is accounted for by the activity already discussed in Section 2.2. The point here is that its overall economic contribution goes much further than this, not only because of its purchases from other suppliers (transmission capacity, IT, advertising, business services, etc) but also because of the economic activity generated indirectly by all its purchases.

C4 also contributes directly and indirectly to the UK's balance of payments, employment and tax revenue (a combination of VAT, national insurance contributions, income tax, business rates and regulator fees).[32]

Oxford Economics (OE) was commissioned by C4 to assess its 2014 GVA contribution. OE's report, which we have seen, estimated C4's 'measured' annual GVA impact at £1.1bn. This was based on points 1-3 above plus OE's estimates (using an ingenious and, to us, highly convincing methodology) of two additional 'catalytic' contributions:

31 Salaries, bonuses and employer's pension and national insurance contributions. Other items include business rates, regulator fees and profit before tax.
32 GVA measures the value of goods and services at 'basic prices', net of sales taxes such as VAT, which is itself a tax on value added.

a. Producers’ secondary income from C4 commissions and
b. The non-C4 revenue of small producers whose survival depends on their C4 commissions.

We regard OE’s estimates of C4’s ‘direct’, ‘indirect’, and ‘induced’ GVA contributions (points 1-3 above) and of the two components of the ‘catalytic’ contribution it assessed (points a and b) as highly reliable, all being based on measures that can be quantified with a fair degree of confidence.

As OE rightly acknowledges, however, (a) and (b) represent only part – in our view, quite a small part - of C4’s total ‘catalytic’ economic contribution. Indeed, OE discusses two additional catalytic impacts: C4’s promotion of regional diversity and regional business clusters; and its investment in human capital development. However, the economic impact of these activities are inherently less quantifiable than for those included in OE’s £1.1bn estimate of C4’s ‘measured’ GVA. We (and, we believe, OE) therefore see this as a conservative estimate of C4’s total impact on the UK economy because it excludes several ‘soft’ - but, in the long term, extremely important - impacts of C4’s activity on the UK broadcasting ecology, creative industries and technology adoption.

The most important of these, in our view, are C4’s long-term contributions to:

- The wider UK broadcasting ecology and creative industries via the recruitment and development of on-screen, off-screen and support service talent and the growth of informal industry networks, and
- The flow of new ideas driving both content and commercial innovation.

Contribution to the wider UK broadcasting ecology and creative industries

C4 operates within the very successful wider UK broadcasting ecology. Its investment in UK production has a number of multiplier effects on this wider ecosystem. These include the two ‘catalytic’ impacts estimated by OE but also, as just noted, the broadcasting system’s accumulation of ‘human capital’ (on- and off-screen talent) and ‘social capital’ (informal networks and relationships).

The geographical concentration of competitive and complementary businesses and individuals, and the informal networks between them, are the key features of successful innovation clusters. The UK broadcasting ecology as a whole, and the smaller concentrations of production within it, fit this pattern.

UK broadcasters, including C4, also contribute to the UK’s wider creative industries. C4 has especially strong links with the UK film industry. It has invested around £15 million per annum in British film for the last five years and has pledged to increase this to £25 million in 2016. This is more than the BBC.

Film4 has developed and co-financed many recent successful UK films such as Steve McQueen’s *12 Years a Slave*, Danny Boyle’s *Slumdog Millionaire*, Martin McDonagh’s *In*

Bruges and Phyllida Lloyd's *The Iron Lady*. Since 2009, C4-funded films have won 16 Academy Awards (Oscars) and 22 BAFTA Film Awards, in addition to C4's 42 BAFTA TV Awards.

The success of Britain's creative industries, with broadcasting at its heart, has many indirect benefits to the UK:

- Since the early 1960s, coinciding with the development of its broadcasting ecology, the UK has become a major influence on popular culture around the world, second only to the USA.[33]
- The UK is currently ranked global number one on 'soft power', the ability to achieve foreign policy goals through attraction and persuasion rather than force or money.[34] Again, broadcasting – mainly the PSBs – play a major role
- Another indirect impact of UK broadcasting (and the other creative industries) is on tourism. The National Trust was recently quoted as saying that it is getting more visits than at any time in its 120-year history thanks to television series such as *Wolf Hall, Game of Thrones, Poldark* and C4's *The Mill*.[35]

Impact on technology adoption and commercial innovation

C4's commitment to innovation covers technology as well as content. Especially noteworthy is its innovation in online delivery and audience engagement, and related advertising developments. Its first online video on demand (VoD) service, 4oD, launched in 2006, before the BBC iPlayer (2007) and the ITV and C5 services (from 2008).

Since March 2015, all C4's online services have been consolidated as All4, offering viewers a catch up service, an online live streaming service, box sets of some of the best C4 series, and some original short form content. All4 provides this on over 25 devices and in a personalised environment enabled by its data strategy.

C4 was a pioneer in investing in data, the first broadcaster to introduce registration. All4 now has over 13m registered users, including over half of 16-34s.

As delivering an improved experience for consumers, C4's investment in data has enabled it to enhance its commercial offer in multiple ways. Examples include:

- Targeted VoD inventory and some programmatic trading
- The ability to serve video ads dynamically into live streams
- Real-time targeting to viewers watching live
- A 'sequential advertising' product (AdJourney) enabling advertisers to send fresh creative messages to viewers who have already seen the broadcast commercials on All4

33 Dominic Sandbrook, *The Great British Dream Factory: The Strange History of Our National Imagination*, Allen Lane, 2015.
34 Joseph S Nye Jr, *Soft Power: The Means to Success in World Politics*, PublicAffairs, 2004. Jonathan McCrory, *The Soft Power 30*, Portland, July 2015.
35Tom Morgan, 'Star TV roles help National Trust make history', *Daily Telegraph*, 26 December 2015, p10

- Personalised video ads, already successfully trialled with several major clients (Ad4U).

These developments are not main-stream yet, but C4 (with All4's market-leading number of registered users) is well placed to help drive them forward and exploit the new opportunities.

Consumer surplus

GVA, discussed earlier, excludes customer surplus (customer value minus customer cost) - in this case both consumer (viewer) surplus, discussed here, and advertiser surplus, discussed below.

C4's consumer surplus cannot be easily and reliably quantified. Because C4 is largely funded by advertising, both the *gross consumer value* of its programmes and their (indirect) *cost to consumers* are uncertain. Even the assumptions underpinning any estimates of these two numbers are debatable. C4's consumer surplus - the difference between them - is therefore even more uncertain.

Nevertheless, we can at least derive a broad brush estimate based on consumers' 'revealed preference for pay TV (ie its price, penetration and usage) and some assumptions about the indirect cost to consumers of the advertising on C4's channels.

For instance, Sky's basic pay TV homes pay £20/month for the entry-level 'Original' package. This includes a Sky+ PVR, Sky Go (enabling viewing on a smartphone, tablet or laptop) and about 30 incremental channels, ie not available on Freeview.[36] Assuming a value of half of the subscription fee (ie £10/month) for the PVR and Sky Go, these homes value the incremental channels at a minimum of £10/month (£120/year).[37]

These channels account for 6.4% of viewing and the C4 portfolio for 10.7% of viewing in these households.[38] We have no reason to believe that viewers' audience appreciation (and therefore the consumer value per hour) is lower for the C4 channels than for the basic pay TV channels.[39] On this basis, the gross consumer value of the C4 channels is about £200/year in each of these households.[40]

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36 http://www.sky.com/shop/tv/original-bundle/?OSPV=wk29-select. The package also includes Catch Up TV but, as far as we know, this has no capability beyond what is available on Freeview Play, the current version of Freeview (apart, of course, from the ability to download the incremental channels in the Original bundle).
37 This is probably an underestimate, for two reasons. First, we think our attribution of £10/month incremental value to the Sky+ PVR and Sky Go is probably an overestimate. Secondly, the £20/month paid by Sky Original subscribers is in most cases less than they would be willing to pay, although we do not have access to detailed research on how many of them would be willing to pay how much more if they had to. Both of these issues could be addressed through conjoint and other consumer research.
38 Source: BARB.
39 On the contrary, based on a well-established 'double jeopardy' pattern in consumer choice, we would expect the opposite, if anything, ie slightly lower audience appreciation for the basic pay TV channels. In contrast, for the much higher-priced premium sport and movie channels (not included in the basic pay TV package analysed here), we would expect higher average audience appreciation on average and, therefore, consumer value per hour.
40 £120 x (10.7/6.4).

If we assume that TV advertising has an indirect cost, or opportunity cost, to consumers equal to commercial broadcasters' net advertising revenue (NAR),[41] C4's £870m or so annual NAR costs each of the UK's 26.7m households about £33/year.[42] This implies a consumer surplus of about £167/year per Sky Original household.[43]

A full analysis of C4's consumer surplus is beyond the scope of this report. But even a conservative assumption of £100 per average household across *all* households would be equivalent to a consumer surplus of £2.67bn per annum - more than double OE's £1.1bn per annum estimate of C4's 'measured' GVA contribution.

Advertiser surplus

Advertisers should, on average, generate a surplus on all their advertising investment, but the surplus should be especially high for a channel or medium that enables them to increase advertising efficiency.

C4 does this, not because it enables advertisers to reach viewers that they would be unable to reach using other TV channels (it does not) but because its high reach and attractive audience characteristics enable them to achieve their reach objectives more efficiently than if it did not exist or – crucially – if its programming and audience delivery were less distinctive from those of other commercial broadcasters such as ITV and C5.

For a given share of commercial impacts (SOCI), a less distinctive C4 would be less valuable to advertisers, especially those seeking to reach upmarket younger viewers (a light viewing, and therefore hard-to-reach, segment highly valued by most advertisers) with low wastage.

In addition, advertisers are starting to benefit from C4's digital innovations, as already discussed.

Broader social contribution

C4's broader social or 'citizenship' (as opposed to consumer) contributions reflect its remit, especially the emphasis on minorities, mainly through its programming and scheduling.

Trevor Phillips, former chair of the Equality and Human Rights Commission, singled out C4's role as a leader in catering to BAME audiences in his recent speech to the 2016 Oxford

41 Barwise and Picard (2014), pp33-4. NAR here includes sponsorship and digital video advertising revenue, as in Section 3.1.
42 £871m advertising and sponsorship revenue in 2014 (see Section 3.1). Population estimate from ONS. £871m/26.7m = £33. This, correctly, includes all UK homes, since even those that do not watch C4, or commercial TV, still pay indirectly for the advertising (see Barwise and Picard 2014, pp 33-4). Note: on the same basis, the Sky Original basic pay TV channels also have a small additional indirect cost to consumers, which we here ignore.
43 £200 minus £33.

Media Convention.[44] He presented data showing that the main C4 channel was unique among PSB channels in being almost as popular among BAME viewers as among all viewers.

Similarly, C4's commitment to, and coverage of, the 2012 Paralympics significantly shifted the general public's perceptions – and the self-perceptions - of those with disabilities. 83% of people said they thought its Paralympics coverage would improve society's perceptions of disabled people; and 64% said they felt more positive about disabled people as a result of watching.[45] Further factual programming has also sought to address disability issues, including *Born to be Different, The Undateables* and *The Autistic Gardener.*

From *Jamie's School Dinners* in 2005 to last year's *Jamie's Sugar Rush,* Jamie Oliver has fronted numerous programmes focused on promoting healthier eating, alongside others such as *What Not to Eat* and *Food Unwrapped*.

Much of C4's drama output also tackles important social issues, such as *Humans,* which examined the implications of artificial intelligence and *Cyberbully* which looked at online security and young people.

Finally, one of C4's most important social contributions is its commitment to long-form news and current affairs, including on challenging topics.

Multi-award-winning *Channel Four News,* its flagship early evening news programme, has a one-hour slot, seven days a week. This enables it to explore topics in greater depth than any other daily news programme. *Dispatches* tackles a wide range of topics, including analysis and investigations including politics, social and health care and consumer issues, extensive coverage of the current conflict in Syria and its investigations into the Sri Lankan civil war, which shaped the international agenda leading to an investigation by the UN.

Since 2011, *Unreported World* has been made available online globally for free, enabling viewers in countries featured in the series – including many where accessing impartial journalism is difficult - to watch it.

[44] Robert Cookson, 'Equality fears over Channel 4 privatisation', *Financial Times,* 2 March 2016. http://www.ft.com/cms/s/0/d91c39ec-e07b-11e5-9217-6ae3733a2cd1.html#axzz44HoUQAqs
[45] C4 Annual Report 2012.

3. Base Case: No Privatisation

3.1 Base Case Assumptions

The base case assumes a continuation of the status quo, ie that C4 remains government owned with its current remit and licence obligations in place. The current C4 leadership, Enders Analysis Ltd (EAL), Ofcom, and Ernst & Young all expect C4 to be sustainable over the long term under these conditions.[46] We agree, for the reasons discussed later in this section. [47]

The other base case assumptions are that:

1. The government continues to give C4 and the other commercial PSBs privileges (DTT spectrum at below market rates and EPG prominence) in return for their PSB commitments[48] but introduces no new legislation or regulation to increase its or their revenue or profit
2. C4's revenue over the next ten years is in line with EAL's latest projections, see below
3. C4's non-programming costs increase by 1% per annum in real terms.

EAL's revenue projections

EAL's 10-year revenue projections (point 2 above) are based on the following more detailed assumptions:[49]

- Roughly constant total TV and video viewing of around 250 minutes (4 hours 10 minutes) per person aged 4+ per day[50] across all homes, including non-TV homes, over the next ten years
- In 2025, 74% of this will still be live or up to 7-day time-shift/catch-up viewing of broadcast channels on a TV set; 12% will be other viewing on a TV set (DVDs, 8+-day time-shift/catch-up, pure-play online TV services, short-form videos); and 14% will be viewing on other devices (smartphones, tablets, laptops and PCs)
- 83% of viewing in 2025 will still be of broadcast channels (live or time-shifted/catch-up, on TVs or other devices) for all individuals aged 4+, ranging from 48% for those aged 16-24 to 98% for those aged 65+
- Continuing real (CPI-adjusted) growth in total TV net advertising revenue (NAR), with the real annual growth rate steadily declining from 4.7% in 2016 to 1.5% for

[46] Toby Syfret and Claire Enders, *Channel 4: Sustainability and Privatisation*, Enders Analysis, 18 December 2015 [2015-118] pp12-15; this draws on Toby Syfret and Julian Aquilina, *Watching TV and Video in 2025*, Enders Analysis, 4 November 2015 [2015-096]. Ofcom, *Review of Channel Four*, July 2015, p4. Ernst & Young, *The Future of Channel 4 in a Changing Market Environment*, March 2016.
[47] Section 3.3, which also discusses the implications in the unlikely event that the remit turns out not to be sustainable at some point in the next ten years.
[48] Strictly speaking, these commitments currently apply only to the three commercial PSBs' main channels – Channels 3, 4 and 5. Ofcom has suggested a simplified regulatory framework for C4 with a single remit and a single set of obligations and privileges applied across all its services: Ofcom, *Review of Channel 4*, pp1-2.
[49] Syfret and Enders, 2015.
[50] Excluding video games, video material on static web pages, and viewing in pubs and cinemas.

2023-25. This leads to cumulative real growth of 27.6% over the ten years 2016-25, on top of 6.4% real growth in 2015

- Stabilisation of C4's main channel viewing share and total portfolio viewing share, based on the new programmes introduced after the loss of *Big Brother* in 2010 (especially through C4's heavy investment in creative renewal in 2012-14) and boosted by the closure of BBC3 as a broadcast channel from February 2016[51]
- Maintenance of the main and portfolio channels' premium airtime prices relative to the rest of the market, based on their high reach, valuable demographics and C4's increasingly sophisticated use of first-party data to support programme commissioning, digital marketing, and airtime sales
- C4's online video revenues roughly doubling in real terms between 2014 and 2025.

The combined effect of these assumptions is an increase in C4's total real advertising and sponsorship revenue from £871m in 2014 (£739m NAR plus £132m other advertising sales revenue) to £1,287m in 2025 (£1,018m NAR plus £269m other revenue), all in constant 2014 pounds, an increase of 48% over 11 years.

3.2 Revenue and Content Projections 2014-25

To project C4's revenues and costs, including content investment, to 2025, we start with the most recent published figures. These are shown in the left-hand two columns in Figure 3.1, based on C4's 2014 Annual Report ('AR14'). The main cost heading is content, equivalent to 70% of revenue. The other main cost headings are transmission and regulation, sales, and marketing.

The right-hand two columns in the table show our base case revenue and cost projections for 2025 in 2014 pounds, assuming the following:

- Real advertising and sponsorship revenue increased by 48%, in line with EAL's forecast
- Other revenue (mostly secondary rights) conservatively assumed to remain flat in real terms
- Transmission and regulation, sales, marketing and other costs all growing 1% per annum in real terms[52]
- Content costs as a 'balancing item', increasing by 58% in real terms to maximise delivery of the remit, while maintaining a small constant real surplus of £4m.

51 There is a view that C4 may be more vulnerable than other broadcasters to shifts in audience behaviour because of its relatively high reliance on younger viewers, whose behaviour is changing faster than that of older viewers. We address this concern in Section 3.3.
52 This is a simple, broad brush assumption. In practice, we would expect some costs to go up by less than this (eg possibly sales) and others by more (eg distribution costs, as online viewing puts increasing strain on broadband networks).

Figure 3.1: C4 Revenues and costs, 2014 and 2025

(Constant 2014 £s)

	2014		2025	
	£m	***% revenue***	**£**	***% revenue***
Revenue	938	*100*	1355	*100*
Content	661	*70*	1045	*77*
Transmission & Regulation	112	*12*	125	*9*
Sales	91	*10*	102	*8*
Marketing	39	*4*	44	*3*
Other costs	31	*3*	35	*3*

3.3 The Sustainability of the Remit

Obviously, if the projections in Figure 3.1 are correct, C4's current remit is easily sustainable over the next ten years. In fact, they imply a big *increase* in its ability to deliver the remit, reflected in the 58% projected increase in the real (inflation-adjusted) level of content investment between 2014 and 2025.

C4's continuing ability to maintain its revenue and content investment while still delivering the remit has defied many people's expectations, including those of its previous leadership. It has not merely survived the advertising recession; the loss of *Big Brother*; increased competition from online advertising, multichannel, pay, and now online TV services; and other technology and market threats, but thrived, as discussed in Section 2. A key question is whether this model will continue to be viable.

Some commentators do appear to believe that the remit may not be sustainable. In particular, as noted in Section 1.1, Culture Secretary John Whittingdale has said that the main reason why the government is considering privatising C4 is to "ensure it can continue to deliver the remit, *in what is to become a very fast-changing and challenging environment"* [emphasis added].[53]

Of course, we agree that C4 faces a fast-changing and challenging environment, but we believe that the resulting impact (already incorporated into EAL's and the other experts' projections) is unlikely to be sufficient to put its remit at risk. We here explain the reasons for this view.

Two distinct internet-based threats[54]

In broad terms, the big technology threat is the internet. More specifically, there are two, largely separate, internet-based threats to C4's business model:

- Well-funded **online-only TV players** such as Netflix, Amazon and YouTube (owned by Google/Alphabet) threaten to weaken all commercial broadcasters, including C4, both directly (by capturing a growing proportion of viewing and revenue) and indirectly (by bidding up the price of premium content and talent)[55]
- The continuing growth of **digital marketing channels** threatens to capture revenue from all existing advertising media, including TV.

To be clear, the continuing growth of online TV and digital marketing is not in dispute. What is contested is *how much* they will grow over the next ten years, and their *likely impact* on (live and time-shifted) TV viewing and advertising.

To address this, we now explore the threat of online TV, the threat of digital marketing, and the related question of whether C4 is at particular risk because of its younger audience.

The threat of online TV

Those who have argued over the last 20-25 years that TV viewing is about to undergo rapid, revolutionary change because of the internet[56] have so far been consistently wrong.

There are of course many changes in viewing behaviour underway, especially among younger viewers (as reflected in Ofcom's figures and EAL's analyses) and the pace of change may accelerate over the next few years. But the underlying reasons why the changes have

53 Quoted in Kevin Rawlinson, 'Channel 4's public service remit will be protected, vows culture secretary', *The Guardian*, 21 January 2016. http://www.theguardian.com/media/2016/jan/21/channel-4s-public-service-remit-will-be-protected-vows-culture-secretary.
54 Patrick Barwise, the first author of this report, has published widely on this topic. See Patrick Barwise and Kathy Hammond, *Predictions: Media*, Phoenix, 1998, pp 23-30; Patrick Barwise and Alan Styler, *Marketing Expenditure Trends*, Havas and London Business School , 2002 (second edition 2003); Sarah Pearson and Patrick Barwise, 'PVRs and Advertising Exposure: A Video Ethnographic Study', *Qualitative Market Research*, 11, 4, (2008), 386-399; Patrick Barwise and Robert G Picard, *The Economics of Television in a Digital World*, Reuters Institute for the Study of Journalism, Oxford University, October 2012, pp 38-42.
55 This would C4's increase programming costs and/or further impact its revenue by reducing the viewing share achievable with a given programme budget
56 Eg George Gilder, *Life After Television*, Norton, 1990; Nicholas Negroponte, *Being Digital*, Knopf, 1995; Bill Gates, *The Road Ahead*, Viking Penguin, 1995.

been so much slower than many predicted appear to reflect fundamental consumer needs that *TV programmes* meet particularly well at a deep psychological, and perhaps neurophysiological, level. These have nothing to do with the *distribution technology* used to enable viewers to see the programmes – increasingly, where and when they want.[57]

Given this 25-year history and our interpretation of it, it would be very surprising if viewing patterns suddenly started changing much faster over the next ten years.

Even if this happened, the impact on *TV advertising revenue* would be proportionately much less because of the 'price elasticity' effect:[58] if pure-play online viewing grew by a factor of five over the next ten years, from about 7 minutes per person per day (2.8% of total viewing) today[59] to, say, 35 minutes per person per day (14% of viewing) in 2025 – which seems unlikely – and the effect were to reduce TV commercial exposures by, say, 15%,[60] the cost per thousand viewers (CPM) would be likely to increase almost proportionately, especially for the increasingly scarce high-reach channels. The net impact on total TV advertising revenue would be minimal – and certainly nothing like enough to make the C4 remit unsustainable.

Finally, despite the huge media coverage of, and general excitement about, the growing investment by Netflix and other online players in original content such as the US remake of the BBC's *House of Cards*, the amount invested to-date is still small compared with the investment in original programming by established Pay TV and FTA commercial broadcasters. The amount invested in UK content and talent is close to zero.

The threat of digital marketing

If online TV poses only a minimal threat to the sustainability of C4's remit over the next ten years, what about the threat of digital marketing, given that most of C4's revenue comes from traditional TV advertising?

The biggest trend in marketing over the last 20 years has indeed been the relentless growth of digital (online, data-based, social and mobile) channels and methods. Digital marketing is especially well suited to:

- *Response activities* (search and online classified advertising, largely as a replacement for print classifieds, directories, inbound telesales, etc)
- *Customer relationship management*
- Various types of both qualitative and quantitative *market research* and

57 Patrick Barwise, 'Waiting for Vodot', *Market Leader,* Spring 2011, 30-33.
58 Barwise and Picard (2014), Appendix A.
59 Adults 16+: Toby Syfret and Gill Hind, *BBC TV Airwaves Beyond 2026?,* Enders Analysis, 16 September 2015 [2015-082], p11.
60 Also probably an overestimate, since a relatively high proportion of the growth in online viewing would be at the expense of recorded TV (40 mins/day), physical format TV and films (13 mins/day) and on-demand/catch-up TV and films (12 mins/day) rather than live TV (178 mins/day). Syfret and Hind, 2015.

- Some *specific, highly targeted 'push' communications* (online and mobile display advertising and permission-based email, often replacing print display advertising and traditional direct marketing).

Digital media are less well suited to the kind of high-reach, mass-market, awareness- and brand-building at which TV advertising excels.[61]

There is also a degree of 'push-back' by advertisers concerned about unreliable measurement of digital advertising exposures, relatively low audience engagement, the amount of traffic generated by bots, and the growing impact and threat of ad-blocking software.

Moreover, TV advertising is itself starting to converge and combine with online, allowing more efficient buying and targeting than in the past. These developments are still at an early stage but are gathering pace, supported by improved measurement of audiences' exposure to commercials in an increasingly time-shifted, multiscreen world.

This is not to say that digital marketing poses no threat to TV advertising. Over the long term, marketing budgets are unlikely to increase significantly, if at all, as a % of sales (although they are currently growing rather fast). The growth of digital marketing therefore puts pressure on the budgets for all other marketing expenditures.

But the impact on *TV* advertising seems likely to continue to be limited for the foreseeable future – and certainly much less than the impact on print media – because there is no close online substitute for it, especially on big, high-reach channels such as C4's.

This view appears to be increasingly accepted within the financial markets. Leading analyst Ian Whittaker recently published a compelling summary of the reasons why the future of FTA television looks much more positive than may have appeared to be the case a few years ago.[62] Similarly, ITV's booming share price clearly reflects the market's positive medium- to long-term view of the prospects for TV advertising (as well as its positive view of ITV's ability to perform within that market and as a content producer).

Is C4 more at risk because of its younger audience?

C4 focuses especially on younger viewers, whose behaviour is changing much faster than for the population as a whole. It might therefore be seen as particularly exposed to these threats. However, there are two reasons why we do not see this as a major threat to the revenue projections in our analysis.

First, even for younger viewers, the rate of change is less than suggested by the hype.

61 Online video advertising is more akin to TV, however, especially in high-engagement, long-form content, which also generates relatively low levels of fraud. Its reach and viewing levels are still much lower than for broadcast TV. It is steadily reducing that gap but is extremely unlikely to impact traditional TV advertising revenue significantly in the next ten years – and if it does, C4 will be well-placed to exploit it via All4.
62 Ian Whittaker and Annick Maas, 12 Excellent Reasons to Love TV Stocks, Liberum, 11 December 2015

Secondly, and more important, C4 has shown itself better than the other PSBs at understanding younger viewers' needs and interests and at technological innovation to enable it to stay on top of market shifts and exploit new opportunities:

- It is the only PSB with a higher portfolio viewing share among 16-34s than among the general population: 17.0% in 2014, believed to be its highest ever level.[63]
- All4, its umbrella brand for digital content and services, now has 13 million registered users, including half of all UK 16-34s.[64]

All this reflects C4's commitment to its remit, which emphasises innovation and a focus on younger and other hard-to-reach viewers.

Combining these factors with C4's relatively small size and young leadership and workforce, it is better-placed than most media organisations to adapt to unpredictable market and technology changes.

Conclusion: the remit is almost certainly sustainable but we need to allow for the possibility that it is not

In conclusion, digital marketing and online TV do offer a number of threats to EAL's 10-year revenue forecasts for C4 but the impact seems likely to be limited:

- *The viewing of pure-play online TV* is growing relatively fast from a very small base, but is still much less than widely supposed (as it always has been, since the 1990s)
- *The impact of this online viewing on TV advertising revenue* is in any case likely to remain small because of the 'price elasticity' effect
- *The online TV players' investment in original content* is still a very small proportion of the total and their investment in original *UK* content is minimal. The resulting impact on C4's content costs over the next ten years seems likely to be very small
- *The continuing growth of digital marketing expenditure* puts pressure on all other marketing budgets, but less on TV because there is no good online substitute for it
- There are also some signs that *the rate of growth of digital marketing* may be decreasing because of concerns among marketers about its effectiveness (measurement, ad blocking, etc)
- *C4's focus on younger viewers* – whose viewing behaviour is indeed changing much faster than for the population as a whole – makes it potentially more vulnerable than other commercial broadcasters. However, C4 has shown itself more adept than the other PSBs at adapting to the threats and exploiting the opportunities presented by the technology and market shifts discussed here, especially in the context of younger viewers.

Overall, these threats, even in combination, seem to us insufficient to put C4's remit at serious risk over the next ten years. EAL has, of course, already factored them into its

63 AR14, p32
64 Source: C4.

analysis. Even with *no* real revenue growth (a huge shortfall below EAL's forecast) the model would still be viable with no reduction in the delivery of the remit.

What if we and the other experts are wrong?

Nevertheless, we have to allow for the possibility that EAL, Ofcom, Ernst & Young, Liberum, the financial markets, the C4 leadership and we ourselves may be overoptimistic about the long-term prospects for TV advertising; and/or that C4 may prove less adept at maintaining its market position than we have assumed.

How would C4 respond if it turned out that its revenues were much lower, and/or its costs – especially the cost of original UK content – were much higher, than we expect?

In this case, tough choices would need to be made about priorities within the remit. Almost all the ways available to MediaCorp to increase C4's profitability (Sections 4.3-4.5) would still be available, including partnerships to achieve synergies while continuing as an independent publicly owned but commercially funded PSB. As with a privatised C4, the main opportunity for a non-profit, government-owned C4 would be to get more 'bang for the buck' from its content investment, which accounts for 70% of its costs.

The policy issue at that point would be which aspects of the remit and/or licence to dilute or drop. For now, however, the key implication is that these options provide a second 'safety margin' (in addition to the wide margin implied by EAL's and our financial projections) to ensure that a non-profit C4 under public ownership remains viable – without resorting to top-sliced BBC licence fee revenue or any other new subsidies.[65]

Why would the remit be more sustainable if C4 were privatised?

A more fundamental question is, even if the remit were not sustainable for C4 under government ownership, why might it be more sustainable under private ownership?

If, despite the evidence, the remit (even with some dilution) at some point proves unsustainable for C4 under public ownership, there might be an argument for dropping it and simply privatising C4 as a purely commercial broadcaster. What seems to us implausible, however, is the idea that the government might privatise C4 *in order to preserve the remit*. As we have shown:

- Because of the economics, the only way a rational investor could justify paying a significant price for C4 (of the order £1 billion-plus) would be by getting much more 'bang for the buck' (revenue per pound) from its programming investment - and the only way it could achieve this would be by getting round the remit in the ways discussed in Section 4.5

[65] The only subsidies under the current model are C4's privileges as a PSB: spectrum at a below-market price and EPG prominence. These are probably more than offset by (i) the current absence of retransmission fees, (ii) the non-level playing field on commercial airtime sales (the COSTA rules, see Section 6.2), the effect of which is a subsidy of the (mostly US-owned) non-PSBs by the (still mostly UK-owned) PSBs, and, of course, (iii) the PSBs' content and supplier commitments.

- Assuming the new owner is one of the big US media companies discussed in Section 3.1 ('MediaCorp'), it would also most likely be culturally hostile to the remit, especially at a senior, group head office level; even if the buyer were CommsCorp, there would be a big shift in culture in addition to the change in underlying aims and financial incentives (Section 4.8)
- In any case, we believe that the government would be unable to attract enough credible bidders without dropping or significantly weakening the 100% publisher-broadcaster model, a key part of the remit, to allow the new owner to broadcast at least some of its own programmes.

Whatever the underlying sustainability of the remit – and we believe it is highly sustainable for the reasons we have given – we believe that privatisation would make it *less* likely to be sustained.

Having spelt out our 'no privatisation' base case, we now turn to the privatisation alternative. We first explore the investment case at a company thinking of acquiring a privatised C4 (Section 4). We then turn to the likely impact on UK content investment and more broadly if this were to happen (Section 5).

4. The Investment Case for a Potential Buyer

4.1 Who Might Buy C4?

If C4 is privatised, it will most likely be bought by an existing media company (or a joint venture between two or more such companies): it is hard to see a credible case for an IPO or private equity sale to create a standalone business with no potential synergies.

The most likely buyer is an existing media business seeking to move into – or, more likely, expand its existing operations in – the UK. The main candidates are large US media companies although there are other possibilities including CommsCorp, discussed in Section 4.8.[66]

Examples, with their UK media operations in brackets, include the following:

- 21st Century Fox (Fox channels and 39% of Sky)
- Comcast/NBC Universal (channels and production companies)
- Disney (strong children's channels and many other assets in the UK and continental Europe)
- Discovery (channels - including Eurosport, which recently paid £920m for European Olympics rights - and production assets)
- Liberty Global (Virgin Media)
- Scripps (lifestyle channels and 50% of UKTV)
- Sony Pictures Television (channels and production companies)
- Time Warner (channels and film and TV production)
- Viacom (channels, including C5, and TV production).

We have no evidence of how interested each of the above companies may be in acquiring C4. Their level of interest is likely to vary widely. Many may have other strategic priorities. Some (eg 21st Century Fox) may be precluded by competition constraints. Others may be put off by regulatory uncertainty and the – to them – alien nature of the UK's mixed economy in broadcasting.

As a group, these companies have little if any experience of public service broadcasting except, to a limited extent, as a competitor.[67] Their US head offices are likely, in most cases, to lack empathy with PSB and to see the UK as overregulated – perhaps admiring its very

[66] Additional possible buyers include a wide range of other UK and non-UK technology, media and telecommunications ('TMT') companies such as RTL, Vodafone, Apple or YouTube (Google/Alphabet); and potential 'wild cards' such as a Russian oligarch who thinks owning C4 would be more fun or prestigious, and more sensible financially, than owning a football club. We do not analyse these other possibilities.

67 The only exceptions we are aware of are marginal: Viacom now owns C5, the smallest and most commercial of the UK PSBs; Liberty has a stake in ITV and owns TV3 in Ireland; and Scripps owns 50% of UKTV in which the other partner is BBC Worldwide, the commercial arm of the BBC.

successful broadcasting ecology but with little intuitive sense of the PSBs' central role in driving this success.

In other words, if any of these companies buys C4, the result will be a complete change not only in the owner's *economic incentives* but also, most likely, in its underlying *mission, governance, culture and values*, especially at a group leadership level.

However, all of these companies base their main European or EMEA media operations in or near London and – apart, perhaps, from a degree of bafflement about PSB and UK media regulation – are likely to regard Britain as a generally benign and congenial overseas market in which to do business, as well as being the other dominant player in international broadcasting and popular culture, with many links to the US system.

We now explore C4 privatisation from the perspective of 'MediaCorp', a potential buyer broadly representative of the US media companies listed above. We think this represents the most likely scenario, but much of the analysis would be equally relevant to many other buyers. As already noted, we also specifically discuss CommsCorp as a potential buyer (in our view, the most likely alternative to a US media company) in Section 4.6.

4.2 Three Potential Strategies

The buyer would in principle have three possible generic post-acquisition strategies:

- **Deep cuts in C4's content investment and other costs, accepting some reduction in its viewing share, share of commercial impacts (SOCI) and revenue**. This is the scenario explored in a recent presentation we have seen by an investment bank. It is likely to be the starting-point for most bankers, hedge funds and potential private equity investors.
- **Cutting costs as much as possible to increase margins while still broadly maintaining C4's viewing share, SOCI and revenue.** This, or something close to it, is the most likely scenario in our view and the main one we explore here, although we also discuss how the outcome might differ under the other two options.
- **Seeking to increase C4's viewing, SOCI and revenue.** This would be similar to Options 1 and 2 in adopting a more commercial approach to commissioning, but with a total content budget that in this case might be slightly lower, about the same, or – in principle - even higher post-privatisation. MediaCorp would aim to capture market share from other commercial broadcasters, while still increasing its profit margin from near zero to, say, 15-20%.

Option 1 seems to us unlikely because we think it would be hard to cut costs deeply enough to get the required margin without losing more revenue – and therefore shareholder value – than projected in the presentation we have seen.

Option 3 also seems to us unlikely because generating a big enough revenue increase to provide a margin of 15-20% without a significant cut in programming costs would be challenging and risky, especially given the scope for retaliation by other commercial broadcasters. There is also a time lag of at least a year between increases in SOCI and increases in SONAR, increasing both the investment risks and the pressure on cash flow and funding.

Potential buyers may well have discussed Option 3 privately with ministers, doubtless expressing their enthusiasm for significantly increasing C4's content investment, especially with the UK indies. We would regard any such non-binding expressions of intent with extreme scepticism.

If, as we expect, MediaCorp were the buyer, part of its motivation would almost certainly be to tap into the UK's on- and off-screen talent through C4's human and social capital. But the suggestion that this would lead to a net increase in UK content investment, especially for the small, out of London indies that are especially dependent on C4, seems to us implausible. Talk is cheap, as Kraft showed when making similar statements about investment and jobs before it acquired Cadbury in 2010.

We now turn to the potential sources of shareholder value for MediaCorp, in particular, if it acquires a privatised C4. We categorise these under the following three headings:

- Non-programming operating cost savings (Section 4.3)
- Revenue synergies (Section 4.4)
- 'Soft' synergies (Section 4.5)
- Getting more 'bang for the buck' from C4's content budget (Section 4.6)

All of these are potentially relevant to all three of the above strategic options.

4.3 Non-Programming Cost Savings

We do not have access to detailed data on C4's operating costs and how they compare with those of other FTA commercial broadcasters, but we note that 89% of its 2014 non-programming costs comprised transmission and regulation, sales and marketing (Figure 3.1). What is the scope for synergies and other cost savings in these three areas if C4 is acquired by MediaCorp?

- **Transmission and regulation** (£112m, 12% of revenue). The cost of regulation is non-negotiable but we assume that most of this heading is for transmission. We can see no reason why private ownership per se, or shared ownership with Media Corp's other UK channels, would enable C4 to negotiate lower transmission costs. It is, in any case, likely to be committed to long-term contracts, so any reduction would take several years to come through. Savings equivalent to a 5% reduction in this heading - probably optimistic – would be worth £5.6m per annum.[68]
- **Sales** (£91m, 10% of revenue). C4 Sales now represents several other commercial broadcasters (UKTV, Box TV and BT TV) as well as the C4 portfolio, making it a

68 Note that this also assumes that, as part of the agreement to retain the remit, C4 keeps its existing spectrum (and EPG prominence) without having to pay a market rate.

strong number three behind ITV and Sky. It is a leader in the use of technology, including programmatic buying of online video inventory. We see no reason why these costs might be lower if C4 were privatised. If anything, the pressure on remuneration in the private sector would be upwards. Nor do we see any scope for material cost synergies with MediaCorp's existing UK channels, which will already be represented by one of the few remaining sales houses. Nevertheless, *very* optimistically, we again assume a potential annual saving equivalent to 5% of C4's costs under this heading (£4.6m).

- **Marketing** (£39m, 4% of revenue). MediaCorp could of course cut C4's marketing budget, as can every company, but only at the expense of losing some revenue (if the cuts were focused on publicity for its popular programmes) and/or reduced delivery of the remit (if they were focused on remit-related programmes). Again very optimistically, the marketing budget could be cut by up to 10% (£3.9m/year) with no impact on revenue or remit delivery.

Excluding these three items, we estimated C4's other non-programming costs at just £31m in 2014, 3.3% of revenue (Figure 3.1). Assuming, again optimistically, that these other non-programming costs could be cut by 20% with no reduction in performance, the resulting annual savings from this source would be £6.2m.

Combining these four optimistic estimates of potential cuts in C4's non-programming costs, we have a total annual saving of £20.3m (Figure 4.1):

Figure 4.1. Potential non-programming operating cost savings 2014 (£m)

Transmission and regulation (5% of £112m)	**5.6**
Sales (5% of £91m)	**4.6**
Marketing (10% of £39m)	**3.9**
Other (20% 0f £31m)	**6.2**
Total	**20.3**

Already a 'tight ship'

These figures show that, even with optimistic assumptions about the potential for reducing C4's non-programming operating costs, the annual savings would be very limited. In reality, they would mainly have to come from cost synergies with MediaCorp as they would not be achievable from 'pure' efficiency savings at C4 without impacting its commercial performance and/or remit delivery, because it is already a 'tight ship':

- As a publisher-broadcaster with only 800 full-time equivalent employees,[69] C4 is a relatively small, simple and agile organisation. None of those proposing or analysing its possible privatisation has, to our knowledge, pointed to any current areas of significant inefficiency, unnecessary bureaucracy or excessive overheads.
- As some have noted, executive remuneration at C4 is generally higher than at the BBC, especially at the most senior levels. But it is much lower than for other commercial broadcasters. Total 2014 CEO remuneration was £855,000 for David Abraham (C4), £4.4m for Adam Crozier (ITV) and £4.9m for Jeremy Darroch (Sky). The previous year, 2013, Crozier's and Darroch's total remuneration was £8.4m and £17.0m, respectively.[70] We don't even know the equivalent figure for C5, nor would we, probably, for a privatised C5. But the idea that C4 executive remuneration would be *lower* if it were privatised is implausible.
- Another example is pensions. C4 responded quickly to the pressure on its defined benefits scheme, closing it for new joiners in 2007 and for future accruals by existing members on 1 January 2015.[71]

C4's overall efficiency is reflected in its financial figures in 2014 relative to those of ITV Broadcast, despite ITV's greater economies of scale:

- C4's *total non-programming cost per channel* (£18.2m) was 21% lower than the equivalent figure for ITV Broadcast (£23.0m)[72]
- C4's *revenue per employee* (£1.16m) was 17% higher than the equivalent figure of £0.99m for ITV Broadcast.[73]

We do think there would be some cost synergies from combining C4's and MediaCorp's UK back office functions – finance, marketing, IT, HR, communications, etc. But, with *total* employment costs of only £72m (7.7% of revenue),[74] the potential savings are small in absolute terms even under the most optimistic assumptions.

As with all organisations, there is and always will be scope for further efficiency gains at C4. But we believe that the scope for *incremental* efficiency gains at a privatised C4 under shared ownership with MediaCorp's other UK businesses (ie *extra* cost-cutting without weakening the business, relative to a C4 owned and managed as now) are very limited. We see the £20m/year in Figure 4.1 as realistic, perhaps optimistic.

Given the limited scope for incremental non-programming cost savings, the claim that C4 can be privatised for a significant sum while maintaining the remit rests largely on the value of other synergies with the new owner's existing businesses. Interestingly, the investment bank's analysis assumes none of these. Nevertheless, we believe that, depending on the

69 808 on average in 2014: AR14, p142, which also breaks this down by area.
70 Abraham: AR14, p125; Crozier: ITV 2014 Annual Report, p85; Darroch: Sky 2014 Annual Report, p71. There are no equivalent published figures for C5.
71 AR14, p5 and C4 internal documents.
72 C4: £273m/15; ITV: £437m/19. Source: Mediateque, *A Comparison of ITV and Channel 4 Non-Schedule Costs*, analysis prepared for C4, 17 March 2016.
73 C4: £938m/808: AR14 pp100, 142; ITV Broadcast (ie excluding ITV Studios, which is much more labour-intensive) £2023m/2042: ITV 2014 Annual Report, pp6, 120.
74 AR14, p141.

buyer, there should be *some* scope for them as we now discuss under two headings: revenue synergies (Section 4.4) and 'soft' synergies (Section 4.5).

4.4 Revenue Synergies

Post-privatisation, MediaCorp could use a combination of cross-promotion, portfolio scheduling and collaborative marketing to increase the viewing of both C4's and its other UK channels. This would have an opportunity cost (airtime that might have been sold or used to promote other programmes/services - eg, for Disney, its movies, theme parks and merchandise) but could still provide some net benefit across the combined portfolio, depending on MediaCorp's existing UK assets. However, we note that some of this benefit is already incorporated in the reduction in marketing spend (equivalent to 10% of C4's marketing spend) assumed in Figure 4.1.

There may be scope for some further revenue synergies from a buyer moving its advertising sales to C4 Sales; although this could have an adverse knock on effect on its syndication revenue from Sky. Whether there was a net benefit would depend on the details.

For simplicity, we assume that the incremental value of revenue synergies would twice that of the cut in marketing spend already incorporated in Figure 4.1, ie about £8m/year. This brings the total benefit of marketing cost savings and revenue synergies to about £12m/year, roughly 30% of C4's current £39m/year marketing spend.

4.5 'Soft' Synergies

Finally, acquiring C4 would potentially offer 'soft' benefits through access to C4's talent, expertise, and commercial and informal networks.

The value of these 'soft' benefits is not easily quantifiable and would depend even more on the nature and scale of the buyer's UK business and also its attitude to the UK broadcasting ecology. As a broad-brush estimate, MediaCorp's view of the incremental value of these synergies could be anything from zero to, say, 80% of the value of the cost savings in Figure 4.1, ie £16m/year. [75]

Importantly, in contrast to the cost and revenue synergies, the value of these 'soft' benefits would be *higher* if MediaCorp has few or no TV assets in the UK. That is, if MediaCorp has no or few UK assets, the potential cost savings and revenue synergies would be less but the potential value of 'soft' benefits would be more.

[75] One potential problem here is that if MediaCorp shifted C4's priorities too aggressively in a commercial direction it might start haemorrhaging talent to other players within the highly competitive UK broadcasting ecology. MediaCorp should be aware of this execution risk, encouraging it to be somewhat cautious in pursuing nakedly commercial goals and reducing the amount it would be willing to pay to acquire C4.

4.6 The Total Value of Non-programming Cost Savings and Synergies

Taken together, we see the value of potential savings and synergies as fairly limited. Our 'realistic, perhaps optimistic' estimate is:

1. £20m/year from incremental non-programming cost savings
2. £8m/year from revenue synergies
3. Zero to £16m/year from whatever additional value MediaCorp attributes to the 'soft' benefits of improved access to C4's talent, expertise and informal networks: more if MediaCorp has limited UK activities (so that 1 and 2 are low), less if it already has significant UK activities (so 1 and 2 are higher).

Because 3 would be higher if 1 and 2 were lower, and vice versa, a 'realistic, perhaps optimistic' range for their combined profit contribution is roughly **£28-36m/year**. Valuing this again at a multiple of 11x (as in Section 1.1 for the current C4) gives a present value of around **£310-£395m** for potential non-programming cost savings, revenue synergies and 'soft' synergies.

MediaCorp would also allow, say, £170-175m for C4's 'spare' cash, as in Section 1.1, and probably seek to release some more cash by paying its suppliers more slowly. C4's payables and accruals at the end of 2014 were £263m.[76] Increasing this by 20% would release about £50m.

On this basis, C4's total potential value to MediaCorp would be around £530-620m: £310-395m from future incremental profits, £170-175m from 'spare' cash and £50m from increased payables (ie squeezing C4's suppliers).

Given the high risks and the need for MediaCorp to make a profit on the deal, a realistic maximum price for C4 based only on these sources of value in combination (non-programming cost savings, revenue synergies, 'soft' synergies, cash, and increased payables) would be £400-500m. [77]

Any price above this approximate range can only come from MediaCorp's ability to get more 'bang for the buck' – revenue per pound – from C4's content budget. This is the big issue for privatisation because of the tension between delivering the remit and maximising shareholder value and, therefore, the privatisation proceeds.

4.7 Getting More 'Bang for the Buck' from C4's Content Budget

C4's content spend is equivalent to 70% of revenue. In the words of the investment bank presentation, *"A [programming cost] cut of 30% alone would increase EBITDA margin by*

[76] £15m trade payables, £48m 'other creditors' and £200m accruals: AR14, p153.
[77] Assuming MediaCorp does not overpay due to overestimating the potential savings and synergies (the 'winner's curse' in auctions where the post-purchase value of assets is highly uncertain). From a Treasury perspective, having MediaCorp overpay might be just fine, but from the perspective of UK viewers and producers, it would create problems, as has happened in the past, eg when the original LWT failed in the 1980s.

20% assuming no associated losses in revenue". The presentation itself assumes that a 30% cut in programming spend, with a 10% cut in sales and marketing costs, would lead to a 5% reduction in revenue. A crucial question is whether and, if so, how such a small revenue loss could be achieved with such a big reduction in content investment.

More generally, the key question for MediaCorp (or any other buyer) under all three strategic options is the extent to which it thinks it can get more 'bang for the buck' (revenue per pound) from C4's content budget. The only way to achieve this will be by significantly changing the % allocation of its content investment towards a more commercial mix of programmes and suppliers and more aggressive scheduling.

Specifically, regardless of which of the three strategic options it chooses, to justify a price higher than the maximum £400-500m or so based on potential non-programming cost savings, revenue synergies, 'soft' synergies, 'spare' cash and increased payables, MediaCorp would need to use some combination of the following directional changes in the percentage allocation of its content budget:

1. From UK commissions to (mostly US) acquisitions, especially from its own production businesses
2. From loss-making or marginal genres to more profitable ones, especially during peak viewing hours (ie with more aggressive scheduling as well as a more commercial programme mix)
3. From programmes focused on UK issues and attuned to UK sensibilities, to programmes with international appeal to maximise in-house content synergies and external resale potential
4. From newer, riskier programmes and executions within each genre to safer, more mainstream ones, with longer programme runs and more repeats
5. From finding and nurturing new talent to mostly working with established talent
6. From working with hundreds of UK independent producers across the UK, including small ones and start-ups, to using fewer, bigger suppliers, mainly in London
7. From paying the full first-run cost of new commissions to deficit financing (as well as paying later, already assumed above in the increase in payables)

Accepting a lower price premium

One potential concern for MediaCorp might be that making the content mix safer and less distinctive, with fewer programmes aimed at hard-to-reach viewers, might reduce the price premium of C4's airtime.[78] However, assuming it did not cut content investment so much that its reach and its share of commercial impacts (SOCI) were drastically reduced - which would not make commercial sense - a privatised C4 should be able to maintain a significant (although somewhat reduced) price premium, mainly as a result of its high reach.

78 Above-average cost per thousand viewers (CPM), reflected in C4's high share of net advertising revenue (SONAR) relative to its share of commercial impacts (SOCI).

Further, although some of the hard-to-reach viewers C4 delivers are of high value to advertisers (younger adults, ABC1s), many are not (BAME and disabled viewers). MediaCorp would have a particularly strong financial incentive to reduce investment in content aimed at these groups which would, for a given total content spend, increase its SOCI without reducing its price premium.

As far as we know, no privately owned FTA commercial channel in the world has a programme mix even roughly similar to C4's. This suggests that, although MediaCorp would doubtless aim to maintain a premium positioning for C4 in the airtime market - eg by focusing the cuts especially on programmes aimed at less commercially valuable viewers - its main priority would be to maximise its overall viewing level and SOCI relative to its reduced content budget via a combination of points 1-6 above.

Why privatisation would put the remit in jeopardy

All of the ways of generating more 'bang for the buck' from C4's programme budget (points 1-6 above) conflict with its current remit, mission, culture and role within the UK broadcasting ecology. MediaCorp would have such a powerful incentive to get more 'bang for the buck' from C4's programme budget, and so many ways of doing so, that it seems to us inevitable that privatisation would put the remit in jeopardy. However, we can distinguish between two possible scenarios:

1. The remit remains unchanged but MediaCorp finds ways of getting around it
2. The requirement for C4 to continue as a publisher-broadcaster is dropped or weakened, allowing it to buy some programmes from MediaCorp, with all other aspects of the remit unchanged. (In practice, we see this as the most likely scenario because it would be almost impossible to attract credible bidders without making this change)

We now discuss the first scenario, starting with the potential for MediaCorp to get round the qualitative elements of the remit and, then, the main channel licence quotas. We then discuss the second scenario, dropping or weakening the 100% publisher-broadcaster model.

Getting round the qualitative elements of the remit

As discussed in Section 2.1, the purposes listed in C4's remit - which apply across all its output and services - are purely qualitative (ie a commitment to innovation and risk-taking, talent development, programmes for minorities and the smaller UK nations, news, etc). These are all things that, to varying degrees, purely commercial, profit-maximising broadcasters do - but not to the same extent as C4 and not with such consistency. They are in the remit precisely because they are important features but – at least beyond a certain point - they diverge from the priorities of a profit-maximising commercial broadcaster.

There is abundant evidence that the qualitative remit has worked well in the context of a publicly-owned C4 governed, managed and culturally committed to maximise the delivery of the listed items, but with a fair amount of flexibility in how to do so.

The situation would be very different for a privatised C4 governed, managed, and – increasingly - culturally attuned to maximising MediaCorp's shareholder value. The overall aim would be to deliver as little as possible of the profit-reducing aspects of the remit, the main strategic question being how far to go, including a judgement about compliance, ie what Ofcom and the UK government could and would and do if MediaCorp were seen as having gone too far.

MediaCorp's discussion about this would be likely to involve corporate (and, probably, City) lawyers as well as commercial people. To counter this, Ofcom and the UK government would need comparable legal and commercial support and advice.

The C4-wide qualitative remit would be a very weak defence against the pressure to make a privatised C4's reduced content spend more commercial. What about the quantitative quotas in the main Channel 4 licence?

Getting round the main channel licence quotas

C4's licence obligations and terms of trade currently apply only to its main channel. One option MediaCorp might explore would be to allow the current main channel, with these restrictions, to decline and to shift content and marketing resources into C4's other channels, which have no quotas and for which the terms of trade are whatever C4 negotiates with the producer.

For instance, E4, which specialises in comedy, drama and entertainment, especially for younger adults, already achieves a 2.0% viewing share, using a combination of original commissions and US acquisitions.[79] Further, under the current COSTA airtime sales rules, C4 can sell significantly more airtime on E4 and its other portfolio channels than on the main channel. [80]

In the short term, it would be more profitable for MediaCorp to continue C4's policy of prioritising investment in in the main channel, with its 5.6% viewing share,[81] to maintain its high reach and the price premium of its commercial airtime.

Longer term, however, a privatised C4 might create more shareholder value by shifting the balance of its investment towards E4 and the other portfolio channels – provided these continue to be defined and regulated as non-PSB multi-channels, ie not subject to the same content quotas, terms of trade and COSTA airtime restrictions as the main channel.

How far to go for this strategy of shifting content and marketing investment into the more loosely regulated portfolio channels would be another judgement call for MediaCorp, partly dependent on its view of the risk that the government and Ofcom might:

79 AR14, p103. The closure of BBC3 as a broadcast channel – forced by the government's BBC funding cuts – should enable E4, at least marginally, to increase its share even without more resources.
80 In particular, 50% more minutes during peak hours 6PM-11PM. We discuss COSTA in more detail in Section 6.2.
81 Including C4+1.

- Broaden the definition of PSB channels to include C4's (and the other commercial PSBs') portfolio channels and
- Level the airtime sales playing field between the commercial PSB channels and the non-PSBs' channels.

As discussed in Section 6.2, we would recommend both of these changes[82] and that, if the government proceeds with C4 privatisation, it should signal them and implement them as soon as possible.

Meanwhile, we note that, in line with C4's remit, mission and culture, the main channel significantly exceeds all of its licence quota commitments:

MediaCorp would presumably still aim to meet the quantitative targets, although probably by a smaller margin than now. But with little if any commitment to the spirit of the remit and licence, it would look for ways to dilute their impact in terms of both the nature of the programmes in each genre (making them safer and more commercial) and their scheduling (moving the public service content as close to the margins of the schedule as possible).

A similar process was identified 20 years ago by Sir George Russell, Chairman of the ITC (the then regulator for commercial TV), who specifically contrasted the behaviour of ITV ('Channel 3') and C4:

> *"Quantification in all licences…is only of limited value. The requirement to produce minimum amounts of particular programme types does nothing to guarantee either quality or diversity within those programme types, or within specific parts of the schedule such as peak time…*
>
> *The Channel 3 licences contain more quantification than for Channel 4. Moreover, the Channel 3 licensees generally exceed their minimum quantitative requirements… The problems that have arisen…have not therefore been in satisfying requirements set in terms of hours and minutes or even in the overall size of programme budgets. It is rather in the scheduling policies… and the narrowing of range and breadth within programme types that there have been causes for concern".*[83]

MediaCorp's willingness and ability to get around the aims and spirit of the licence quotas would depend on:

- How much 'wriggle room' it believed there was in the quota definitions
- Its beliefs about the probability and expected cost of any penalty if Ofcom decided it had gone too far and
- Its risk appetite.

82 On COSTA, we recommend a policy closer to 'levelling down' than 'levelling up', see Section 6.2.
83 George Russell, letter to Rt Hon Virginia Bottomley, MP, Secretary of State, 16 September 1996.

Dropping or weakening the 100% publisher-broadcaster model

As already noted, we see no case for selling C4 through an IPO or private equity sale where there would be no synergies with an existing media business. However, the great majority of potential buyers for whom there would be significant potential synergies (including all the US media companies listed in Section 4.1) already have their own production. So in order to have a viable competitive auction with credible bidders, the government would need to allow C4 to be bought by a company with its own production capacity.

Even this, however, would be insufficient in our view. To enable MediaCorp or any other credible bidder[84] to generate a big enough increase in the 'bang for the buck' (revenue per pound) it gets from C4's content budget to justify the acquisition, we think it will be essential to move away from the 100% publisher-broadcaster model, enabling MediaCorp to spend a proportion of its content budget on programmes from its own production companies.

The main financial benefit would be to switch a proportion of the budget from UK commissions to US acquisitions (point 1 in the list of ways of getting more 'bang for the buck' in Section 4.6) – regardless of whether the extra acquired programmes were bought internally or externally.

In addition, there might be some vertical integration benefits if a significant proportion of acquired programmes came from MediaCorp's own production companies, although the benefits of vertical integration are somewhat contested.[85]

4.8 CommsCorp as the Buyer

As noted in Section 4.1, we believe that the most likely buyer if C4 is privatised is a large US media company (or a consortium of two or more such companies) seeking to expand its presence in the UK market, exploit C4's brands and tap into UK talent and other aspects of our flourishing broadcasting ecology. However, there are other possible buyers.

One particular type of company that might be interested is a UK communications company ('CommsCorp') such as BT, TalkTalk or one of the mobile operators. Media and

[84] Most likely a UK communications company (see Section 4.8).

[85] In an efficient market, a firm's upstream business would prefer to have the freedom to sell to all downstream businesses (ie including competitors) and vice versa for its downstream businesses' choice of suppliers. A situation in which the upstream business is forced to supply content to the downstream business which it might have sold more profitably to another distributor, and/or the downstream business is forced to take content that the upstream business is unable to sell to anyone else, is likely to be both highly political and value-destroying. Insofar as vertical integration creates genuine value (as, for instance, seems to have happened with ITV's acquisition of production companies) this comes from a combination of (i) soft benefits from reduced transaction costs and more efficient transmission of market signals and ideas, (ii) some reduction in the volatility of revenue and earnings due to both category and geographical diversification and (iii) the ability to use transfer pricing to shift profits to lower-tax regimes if, as in the case of MediaCorp acquiring C4, the up- and downstream businesses are in different countries.

communications markets are converging – although perhaps less dramatically than much of the hype might suggest.[86] From the media end, satellite and cable TV platform companies (in the UK, Sky and Virgin Media) now routinely offer broadband and fixed-line telephony as well as pay TV. In some cases, including Virgin Media, they also offer mobile communications ('quad play').

However, these are still primarily media companies. In the case of Sky and Virgin Media, crucially, both are controlled by large US-based media conglomerates (21st Century Fox and Liberty Global, respectively) as discussed in Section 4.1. Each is unique, but the investment case for both, and the likely consequences if they acquired C4, is that already discussed under the above analysis of MediaCorp as the buyer, with some company-specific issues such as potential competition concerns in the case of Sky.

Meanwhile, the convergence of media and telecoms is also happening from the telecoms end, with a growing number of telcos expanding into TV. In the UK, both BT and TalkTalk are already TV players, albeit still at a relatively small scale. In contrast, the mobile operators have not yet entered this market, although they might do so at any stage in the future.

In particular, Vodafone now has a large cash pile from selling its stake in its US business. Buying C4 would be enable it to acquire TV talent and expertise, channels, informal networks, data and brands, while barely making a dent in its cash reserves. As far as we know, Vodafone has no plans to acquire C4 if it is privatised, but such plans may exist and, even if they do not, Vodafone's strategy might change at any point in response to shifts in the market, including what its competitors are offering.

In contrast to Vodafone, TalkTalk is already a converged 'quad play' operator but much smaller, with annual turnover of about £2bn. Acquiring C4 would be a stretch financially but would, at a stroke, make it a serious player in UK television. Again, we have seen no indication that TalkTalk would, in practice, be a potential bidder for C4.

As things stand, the most likely CommsCorp candidate is, in our view, BT, given TalkTalk's relatively small scale and the mobile operators' current lack of expressed interest in expanding into television (although this might change at any point). BT's current TV strategy focuses on sport and its main aim appears to be to protect or drive broadband, but it is still at a fairly early stage of development.

BT's evolving strategy and organisational development following the £12.5bn acquisition of EE will take up a lot of management time, but also opens up further potential for exploiting C4's expertise in content commissioning and first-party data management (All4). C4 would certainly be affordable to BT even after the EE acquisition, which was funded by shares as well as cash.

[86] For instance, compare George Gilder, *Life After Television: The Coming Transformation of Media and American Life*, Norton, 1990 and Nicholas Negroponte, *Being Digital*, Knopf, 1995 with Patrick Barwise and Robert G Picard, *The Economics of Television in a Digital World*, Reuters Institute for the Study of Journalism, Oxford University, 2012, https://reutersinstitute.politics.ox.ac.uk/publication/economics-television-digital-world and **[add a recent Enders or Ofcom analysis].**

The cultural fit between CommsCorp and C4

Culturally, CommsCorp would be both closer to and further from C4, compared with MediaCorp:

1. Its British base and legacy would mean that it should have a better understanding of PSB and UK regulation – UK communications companies are already regulated by Ofcom.
2. On the other hand, CommsCorp is likely to have less understanding than MediaCorp of TV production and content, TV audiences and TV advertising, key factors in making a C4 acquisition a success. Indeed, acquiring the relevant expertise, informal networks and other intangibles would be part of the motive for the acquisition. However, the gaps in CommsCorp's current knowledge base would increase the risk of buying C4.

The government's perspective on CommsCorp as a buyer

From the government's perspective, CommsCorp would in some ways be a more attractive buyer than MediaCorp if the price were right, not only because it would be British (a political benefit) but also because there are two rational-economic reasons why it might be less aggressive than MediaCorp in seeking to get round C4's remit:

- **First, its main reason for acquiring C4 would be to boost CommsCorp's commissioning, selling, and other TV skills as part of its wider 'convergence' strategy**. Unlike MediaCorp, CommsCorp would not have a large upstream production business from which it would want to buy content, instead of from UK independent producers.

  In terms of the analysis in Sections 4.3-4.5, the main benefit would be from what we called 'soft' synergies. On top of these, there would, at least in BT's case be potential content synergies in rights acquisition. BT is building its position in premium sport to support its pay TV business: owning a FTA broadcaster could enable it to bid for both free and pay rights, and cross promote programmes from free to pay and vice versa. Other cost savings and revenue synergies would be small, however, at least in the short term: BT and the other CommsCorp candidates have few or no existing media activities and no exclusive US content to distribute.[87]

  Also, because all C4's SD channels are FTA and therefore available on Freeview as well as on the other pay TV platforms, owning them would add nothing to the BT or TalkTalk TV proposition unless one or more of them were converted to pay TV,

[87] Except AMC, in BT's case.

which would be expensive as it would greatly reduce their reach and advertising revenue.[88]

In the longer term, if CommsCorp's TV strategy involved investing in large-scale production and distribution, there might be more synergies. Nevertheless, to justify the acquisition in its own right (except at a relatively low price, close to C4's book value), CommsCorp would, like any other commercial buyer, still need to find ways of getting more 'bang for the buck' from C4's content budget.

- **Secondly, CommsCorp would have a lot of other UK activities**. It would be cautious about jeopardising its relationships with Ofcom, the government and the public for what would most likely be only a small part of its UK operations. [89]

In summary, if CommsCorp bought C4, the investment case would be similar in many ways to the case at MediaCorp discussed earlier, but with the main emphasis on the 'soft' benefits of boosting the capabilities (human and social capital and systems) and other intangible assets required to execute (or, in the case of BT or TalkTalk, accelerate) a TV strategy – if that is what it wants to do. In the short term, other synergies would be limited but if TV became a substantial part of CommsCorp's long-term 'converged' offering to UK consumers, they would increase over time.

Although CommsCorp would, overall, be an attractive buyer politically, the government would not be able to count on it outbidding all the other potential buyers of C4.

[88] This would also be very much against the public interest as it would greatly reduce C4's consumer surplus., advertiser surplus, ability to deliver the remit, and probably its content investment.
[89] The competition considerations if BT acquired C4 – on top of those already raised its ownership of Openreach and now EE – are complex, contested, and beyond the scope of this report.

5. The Impact of Privatisation

Having discussed the no-privatisation 'base case' (Section 3) and the investment case for a potential buyer (Section 4), we now explore the likely impact of privatisation (ie the likely outcome relative to the no-privatisation base case).

We focus on what we see as the most likely scenario, where the buyer is a US media company like MediaCorp, although we also briefly discuss how the outcome might differ if it were CommsCorp. We also focus mainly on the impact on UK content investment and independent production, but go on to discuss the likely consequences for several aspects of the UK's wider economy and society (Section 5.3).

5.1 Impact on UK Content Investment and Independent Production

Of MediaCorp's three potential post-acquisition strategies (see Section 4.2), the most likely one in our view is Option 2, or something close to it, ie to reduce C4's content and other costs as much as possible while broadly maintaining its revenue. This is the main scenario modelled here. In Section 5.2, we discuss how a different MediaCorp strategy – Option 1, Option 3, or something between Options 2 and 3 – might affect the outcome.

We assume a partial relaxation of the publisher-broadcaster model enabling a privatised C4 to reduce the proportion of UK commissions and acquisitions from the current 71%[90] to 50% of content spend.

Specifically, we assume a 10% cut in C4's non-programming costs[91] and a 20% cut in its total content spend, combined with two changes in the supplier mix (in addition to the shifts towards a more commercial programme mix discussed in Section 4.7):

- From 71% UK/29% overseas acquisitions to 50% UK/21% MediaCorp content/29% other overseas acquisitions
- The size composition of UK programme suppliers is moved into line with the industry average, ie with fewer, larger suppliers.

90 £430m/£602m = 71% (AR14, p100).
91 Note that this is more than our optimistic 7.4% estimate for the total cuts in C4's non-programming costs (mainly transmitters and regulation, sales and marketing) that might be achieved without impacting its commercial performance or delivery of the remit (Figure 4.1). A 10% cut in non-programming costs implies a very significant increase in the 'bang for the buck' from C4's programming investment in order to maintain revenue while cutting programming costs by 20% – even greater than if C4's non-programming costs were kept constant.

We assume that these changes in the programme and supplier mix enable C4 to maintain its revenue post-privatisation despite cutting non-programming costs by 10% and programming costs by 20%. We see this as a realistic scenario, although there is clearly considerable uncertainty around it in terms of both MediaCorp's strategy and how successfully it would be executed. We certainly do not see it as pessimistic.

Percentage reduction in UK content investment

Based on these numbers, quantifying the percentage impact on C4's UK content investment is straightforward. For every £100 *total* (ie UK and non-UK) content spend pre-privatisation, the *UK* content spend would be:

- £100 x 71% = £71 pre-privatisation (because we assume 71% is invested in the UK)
- £80 x 50% = £40 post-privatisation (because we assume a 20% cut in the total content budget and that the proportion of this smaller budget invested in the UK falls from 71% to 50%).

On this basis, C4's total UK content investment would be reduced by 44%.[92]

Absolute reductions: 2014 and 2025

C4's direct originated UK content investment in 2014 was £430m, 71% of its total direct content spend.[93] On this basis, **privatisation under Option 2 would have led to a reduction of about £190m in C4's direct original UK content investment in 2014** (44% of £430m) from around £430m to around £240m.[94]

In 2014, C4's £430m direct UK content investment was 27% of the indies' total £1,586m primary UK commissions.[95] A 44% reduction in C4 commissions resulting from privatisation (under MediaCorp's strategic Option 2) would therefore lead to a reduction in total primary UK commissions of about 12%.[96]

Projecting forward to 2025 using the numbers in Figure 3.1 and assuming constant percentage allocations,[97] a 44% reduction in C4's£740m[98] total UK content spend would equate to **a loss of about £330m in 2025** (in 2014 pounds). In practice, the loss would be likely to be even greater if the revenue and non-programming cost projections in Figure 3.1 are correct: the resulting increase in content investment from 70% of revenue in 2014 to 77% of a much higher revenue figure in 2025 would enable C4 to increase the UK proportion of its content spend above 71% to maximise remit delivery while still breaking even.

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[92] £71 minus £40 = £31; £31/£71 = 44%.
[93] AR14, p100: 'originated content spend' £430m, 71% of £602m direct content costs. (This excludes 'indirect programme costs' – AR14, p140).
[94] This excludes the impact on indirect programme costs (£49m in 2014: AR14, p140).
[95] AR14, p100; Mediateque, 'TV production sector evolution and impact on PSBs', presentation to Ofcom, December 2015, p16.
[96] 44% of 27%.
[97] Base case: 71% of content spend is on UK content; privatisation, Option 2: total content spend cut by 20% and the proportion allocated to UK content falls to 50%.
[98] 71% of £1045m. Note, this *includes* indirect programme costs.

For this reason, and because of the continuing cuts in BBC funding, the percentage impact on total primary commissions is likely to be significantly higher than the 12% in 2014.

Disproportionate cuts in remit-related programmes, audiences and producers

Our assumption of a 20% cut in content spend with no reduction in revenue would be achievable only through *disproportionate* cuts in remit-related content, in line with the discussion of ‘more bang for the buck’ in Section 4.6. One of these is the reduction in the proportion of UK content (from 71% to 50%) already built into the projected 44% reduction in C4’s total UK content investment. However, there would also be a shift in the programme and supplier mix, leading to disproportionate cuts in:

- Public service genres
- New, risky, innovative programmes
- Content aimed at minorities(especially BAME, disabled, etc)
- Commissions from small producers
- Commissions in the nations and regions.

These programmes and suppliers would all be cut by well over 50%.

5.2 How Would a Different Buyer Strategy Affect This?

Section 5.1 assumes that MediaCorp opts for the second strategic option: cutting content and other costs as much as possible without losing revenue. How would the outcome be affected if, instead, it opted for either Option 1 (even deeper cuts in the content budget, accepting some reduction in revenue) or Option 3 (investing to increase C4’s revenue while controlling costs enough to increase margins to, say, 15%)?

Option 1: Deep cuts, some revenue loss

Qualitatively, this scenario is again straightforward: deeper cuts than in Option 2 would lead to even greater reductions in UK content investment and independent production and an even bigger impact on UK producers and, especially, remit-related programmes and audiences.

Quantitatively, we can roughly model this scenario using the assumptions in the investment bank presentation mentioned in Section 4.2:

1. A30% cut in content investment
2. A 10% cut in sales and marketing
3. A 5% reduction in revenue (implicitly driven by a combination of 1 and 2 mitigated by changes in the programme and supplier mix, and in scheduling, along the lines discussed in Section 4.5).

If we combine (i) the bank’s assumption of a 30% cut in total content spend with (ii) our assumption of a reduction from 71% to 50% in the proportion of that spend going to UK suppliers, the first-order impact would be that, for every £100 total content spend pre-privatisation, the UK content spend would be:

- £100 x 71% = £71 pre-privatisation (as with Option 2)
- £70 x 50% = £35 post-privatisation.

This is equivalent to a 51%[99] reduction in C4's total UK content investment versus 44% under Option 2.

The net impact would in practice probably be very slightly less than this first-order impact because the reduction in C4 revenue (5% in the investment bank's analysis) would lead to a marginal increase in the other advertising-funded commercial broadcasters' revenue, some of which might then flow through to an increase in these other broadcasters' UK content investment.[100]

We have not formally modelled this second-order effect – the likely increase in other commercial broadcasters' UK content investment if a privatised C4 lost 5% of its revenue – but we would expect it to be very small, partly because:

- A 30% cut in C4's programme investment would reduce the pressure on other commercial broadcasters to invest to 'compete on quality' for viewers
- These other commercial broadcasters (ITV, C5 and – especially - the non-PSBs) in any case invest a significantly lower proportion of revenue than C4 in original UK content.

Even allowing for a marginal increase in other commercial broadcasters' UK content investment, we believe that **Option 1, based on the assumptions listed above, would lead to a net reduction equivalent to about 50% (£215m) in C4's direct originated UK content investment.**

Again, the reduction would be even more for the smaller producers, public service genres, and suppliers in the nations and regions, given the need for a privatised C4 in this scenario to make aggressive changes in its programme and supplier mix in order to limit the revenue loss to only 5% with a 30% cut in total programme spend (in addition to a 10% cut in sales and marketing spend). As with Option 2, the impact would also increase over time.

99 £71 minus £35 = £36; £36/£71 = 51%.
100 For an analysis along these lines for BBC-TV's 'crowding out' of UK content investment by advertising-funded commercial broadcasters, see Patrick Barwise and Robert G Picard, *What If There Were No BBC Television?: The Net Impact on UK Viewers*, Reuters Institute for the Study of Journalism, Oxford University, February 2014, pp 28-30. https://reutersinstitute.politics.ox.ac.uk/publication/what-if-there-were-no-bbc-television

Option 3: Investing to increase C4's revenue

The best outcome for UK producers, viewers, advertisers and the wider public interest (although not for the other commercial broadcasters) would be if MediaCorp invested heavily in C4 to increase its revenue while also increasing its profit margin from near-zero now (in line with its non-profit mission) to, say, 15%-plus, to generate enough profit to justify the cost of the acquisition.

We think this outcome is unlikely but not impossible. To illustrate it, we consider a scenario where MediaCorp:

1. Makes similar changes in the programme and supplier mix to those in Option 2, to generate more revenue per pound of content investment but, in this case,
2. *Increases* C4's content budget by 20% and its sales and marketing spend by 10%, while maintaining other expenditure at its current level; and, through these changes,
3. Achieves a 35% increase in revenue

Points 2 and 3 imply that the changes in 1 lead to C4 getting 12.5% more 'bang for the buck' (revenue per pound invested) from its content investment in Option 3 compared with today.[101]

This is only half the 25% increase assumed in Option 2, with a 20% cut in investment leading to no change in revenue,[102] because of diminishing returns on content investment and also because we assume that the cuts in Option 2 would be focused on programmes *known* to be less profitable (on top of the changes in the mix of genres and suppliers) whereas the 20% increase in investment under Option 3 would include more programmes that would turn out to be less popular than expected.

Assume, for simplicity, that C4 is running at breakeven pre-privatisation. Points 1-3 imply that a 15.5% increase in total costs[103] lead to a 35% increase in revenue, giving a margin of 14.5%[104] - just about enough to make commercial sense.

We see this as optimistic, especially given the likelihood of competitive retaliation by the other commercial broadcasters in response to C4's attempt to increase its share of viewing and revenue by over one-third. What would it imply for the impact on total UK content investment?

Using similar methodology to the one we used for Option 1, the first-order impact would be that, for every £100 total C4 content spend pre-privatisation, its UK content spend would be:

- £100 x 71% = £71 pre-privatisation (as with Options 1 and 2)

101 1.35/1.20 = 1.125.
102 100/80 = 1.25.
103 Based on the 2014 cost breakdown in Figure 3.1: (£661m x 1.2) + (£130m x 1.1) + £143m = £1079m, a 15.5% increase on the £934m total costs in Figure 3.1.
104 1.35/1.155 = 1.17. 1.00/1.17 = 0.855, implying a margin of 14.5%.

- £120 x 50% = £60 post-privatisation.

In other words, even with our optimistic assumption that, under this option, C4 increases its total content spend by 20%, the first order impact would be a 15% *reduction* in its UK content investment[105] – and, again, significantly more for the programmes and suppliers specified in the remit.

In practice, the negative impact on UK production would be higher than this first-order effect, because of some 'crowding out' of investment by other commercial broadcasters – the reverse of the situation for Option 1.

Given the price elasticity of TV advertising,[106] all or virtually all of the 35% increase in C4's revenue would come from other commercial broadcasters' revenue, leading to significant crowding out of their content investment. The magnitude of this *negative* second-order effect – driven by a *35% increase* in C4's revenue - would be roughly seven times the *positive* second-order effect in Option 1, driven by a *5% reduction* in C4 revenue.

Conservatively assuming that every £1 of revenue switched from another commercial broadcaster to C4 leads to a 20p reduction in direct originated UK content investment,[107] the effect would be to increase the impact by 20% – that is, from the 15% first-order impact to about 18% (15% x 1.20) after allowing for this second-order crowding-out effect, ie £75-80m.[108]

Even under Option 3, and with optimistic assumptions, privatising C4 would have led to a £75-80m reduction in UK content investment in 2014 (again increasing significantly over the next ten years).

A moderately optimistic strategy somewhere between Options 2 and 3 would lead to an intermediate outcome, with a reduction in C4's UK content investment between Option 3's 18% (£75-80m) and Option 2's 44% (£190m). For instance, **holding the total content budget constant[109] would lead to an outcome roughly halfway between that of Options 2 and 3: a cut of about 31% (£130-135m) in C4's direct originated UK content investment.**

105 60/71 = 0.85.
106 Barwise and Picard (2014), op cit, Appendix A.
107 This conservatively assumes a 20 percentage point weighted average difference between the % of revenue invested in UK content by C4 versus the commercial broadcasters from which it captures revenue, a mixture of the other commercial PSBs and the non-PSB channels wholly or partly funded by advertising.
108 18% of £430m = £77m. Even this is an oversimplification of the competitive dynamics. The increase in C4's SOCI and revenue would mean that the other commercial broadcasters would have less revenue (because of the price elasticity effect) but would quite likely increase the *proportion* of that (lower) revenue invested in content (although not necessarily UK content) in response to C4's increasing its content investment.
109 While still getting more 'bang for the buck' from it as in the other scenarios.

Summary: the impact under MediaCorp's three strategic options:

In summary, we have the following results for the percentage reduction in C4's investment in UK content:

- Option 1 (30% cut in total content spend): -50%
- Option 2 (20% cut in total content spend): -44%
- Option 3 (20% *increase* in total content spend): -18%

In other words, even under the optimistic Option 3 assumption of a 20% increase in content spend, C4's investment in *UK* content would be cut by 18%. The impact would again be significantly bigger for the remit-related genres and the smaller UK producers and would increase over time.

This, of course, reflects our assumptions about the changes in the supplier mix MediaCorp would need to get more 'bang for the buck' from C4's content investment. Others may make different assumptions, but there are two reasons why we think it will be hard for MediaCorp justify acquiring C4 without a shift in the supplier mix something like what we have assumed:

- Programming costs account for 70% of C4's total costs
- The scope for cutting non-programming costs (the other 30%) is limited, as discussed in Section 4.3.

Further, even with our optimistic assumptions about C4's costs and revenues under Option 3, its 14.5% profit margin would be barely acceptable for such a risky investment.

Beyond Option 3: How much would C4 need to increase its total content spend in order to maintain its UK content spend?

What drives the above cuts is the need for MediaCorp to get more 'bang for the buck' from its content investment and our assumption – across all three strategies – that an important part of this would be to reduce the proportion of content spend going to UK producers from 71% to 50%, the other 21% going to MediaCorp's own content. (The impact on UK production would be the same if some or all of it went to other non-UK producers, but that would make it harder for MediaCorp to achieve an acceptable profit margin).

This is equivalent to a reduction of almost 30% in the proportion of spend going to UK producers.[110] On this basis, MediaCorp would need to increase C4's total content investment by 42%[111] in order just to maintain its investment in UK content even before allowing for the 'crowding out effect'.

110 50/71=0.704.
111 71/50=1.42.

Assuming a 15% increase in sales and marketing costs, C4 would need to increase its revenue by 54% in order to get a 15% profit margin, likely to be the minimum acceptable to MediaCorp.[112] Such a large increase in C4's revenue would undoubtedly provoke retaliation by the other commercial broadcasters, increasing their marketing spend and bidding up the cost of content, especially popular content. C4 would need to increase its content, sales and marketing investment even more, again reducing its margin.

Even under this extremely optimistic scenario, C4's investment in *remit-related* UK production would most likely be reduced.

CommsCorp as the buyer

If CommsCorp were the buyer, the impact of C4 privatisation on UK content production would be directionally similar to the impact we have discussed for MediaCorp: CommsCorp, too, would have an economic incentive to get 'more bang for the buck' from C4's content investment. Quantitatively, however, the negative impact might be less because:

- On balance, CommsCorp might have more cultural affinity with the C4 remit (see Section 4.8)
- At least in the short term, its main emphasis would be on the 'soft' benefits of acquiring C4's talent, informal networks, brands, data and systems, rather than synergies with other UK channels or vertical integration with content production.

However, as noted in Section 4.8, it may be hard for the government to sell C4 to a UK communications player such as BT in the context of a credible competitive auction.

5.3 Impact on the Wider UK Economy and Society

In Section 2.3, we listed C4's broader economic and social contributions under a range of headings. Selling C4 to MediaCorp would impact all of these. All, or almost all, of the impacts would be negative, although this would partly depend on which generic strategy MediaCorp adopted: we think that Option 2, or something close, would be the most likely; Option 1 would be even worse, Option 3 less bad, for the UK public interest. We here briefly discuss these impacts under the same headings as in Section 2.3. Again, we focus on MediaCorp as the most likely buyer.

Overall economic contribution

The reduction in UK content investment and MediaCorp's repatriation of profits would reduce C4's contribution to GVA, employment, tax revenue and the balance of payments. The Oxford Economics report mentioned in Section 2.3, using a scenario very similar to our

112 Revenue of £1448m, with costs of £1231m, based on Figure 3.1.

Option 2,[113] estimated a 20-35% reduction in C4's 'measured' contribution to GVA,[114] a 38% reduction in its contribution to employment and a 26% reduction in its contribution to tax revenues.

Given the baked-in conservatism of the OE estimates, our view is that the economic impacts would almost certainly be even bigger than OE's estimates. This is because (as discussed by OE and in Section 2.3) OE's numbers do not quantify the 'soft' elements of C4's 'catalytic' economic contributions. We further note that within OE's analysis, the negative impact of C4 privatisation on the two 'catalytic' contributions OE did estimate, was proportionately much higher than its estimates of the impact on C4's 'direct', 'indirect' and 'induced' contributions.

Specifically, OE's privatisation scenario included (on the optimistic assumption that all C4's after-tax profits remained in the UK):

- A *14%* reduction in C4's total 'direct', 'indirect' and 'induced' GVA contribution versus a *49%* reduction in its estimated 'catalytic' GVA contribution,[115] leading to a *20%* reduction in total 'measured' GVA contribution)
- The equivalent estimates for employment were: *36%*, *57%* and *38%*, respectively
- And for taxation: *22%*, *52%* and *26%*.

In other words, the percentage negative impact of privatisation on the two 'catalytic' economic contributions estimated by OE (indies' secondary rights revenue and sustainability) was much higher on all three measures (GVA, employment and taxation) than the percentage impact on C4's total 'direct', 'indirect', and 'induced' contributions - a huge difference of between 21 (employment) and 35 (GVA) percentage points.[116]

Since OE's estimate of the 'catalytic' impacts are conservative, focussing only on two quantifiable impacts, it is important to remember that OE's estimate of the overall 'measurable' impact of privatisation is only part of the picture. The 'soft' and unquantified impacts are likely to be high. That is to say, OE's quantification of the likely impact of privatising C4 should be seen as a lower bound, and in reality, the impact is likely to be significantly worse once we take into account the significant unquantified impacts, which we discuss in more detail below.

Impact on the UK broadcasting ecology and creative industries

113 OE assumed: a 20% cut in non-programming spend, other than taxes and regulator fees; programme spend (i) cut by 19%, to push gross profits to 20% of revenue and (ii) switched from 75% UK/25% overseas acquisitions to 50% UK/25% overseas acquisitions/25% parent company content; the size composition of UK programme suppliers moved into line with the industry average; and no net change in revenue. OE used the same definitions and methodology for this privatisation counterfactual as it used to estimate C4's actual economic contributions in 2014, see Section 2.3.

114 Depending on how much of C4's after-tax profit the new owner repatriated.

115 Secondary rights income 44%, sustained income 56%, see Section 2.3.

[116] Eg for employment: 36% ('direct', 'indirect' and 'induced') versus 57% ('catalytic'); 57% minus £6% = 21%.

As discussed in Section 2.3, UK broadcasting is a complex social ecosystem which has not been systematically studied or even documented. We are therefore not in a position to analyse the impact on it of the reduction in UK content investment that would almost certainly result from MediaCorp's acquisition of C4. The knock-on effects of a reduction in UK content investment would clearly be negative, but not quantifiable without extensive research.

Similar comments apply to the likely impact on C4's contribution to the UK creative industries except to note that it would most likely be disproportionately negative because of the shift to a more commercial programme mix.

In particular, we would expect a significant negative impact on UK film production. As far as we know, no other commercial broadcaster invests in the kind of films Film4 supports as part of C4's remit. As already noted, Film4 has been remarkably successful in term of supporting prize-winning, critically acclaimed films. It has also contributed significantly to the wider development of UK film production and talent. It is possible that the new owner of a privatised C4 would maintain its commitment to these activities, but unlikely, since their aims are remit-related rather than commercial: we do not have figures on Film4's full incremental revenues and costs, but it is clear that it has not been set up as a profit-maximising venture.

More generally, C4 runs a range of talent and skills initiatives through 4Talent, reaching out to young people, as well as running strands such as *Comedy Blaps* and *First Cut* that feature new talent. These are inevitably risky and unlikely to be supported – especially on air - by a new, profit-maximising owner.

Impact on technology adoption and commercial innovation

This is the one area where the new owner might increase investment in order to build on C4's strengths in first party data strategy, using C4 as a centre of expertise for its wider UK and international business. On the other hand, it might take the view that investing in this area ahead of its bigger commercial competitors was too risky to be justified. The outcome would depend on who the buyer might be and how C4 fitted into its wider strategy.

Consumer surplus

Under Options 1 and 2, there would be a clear reduction in C4's UK consumer surplus due to a combination of (i) lower total content investment and (ii) a significantly lower proportion of that investment going into UK programmes (which, other things being equal, UK audiences prefer).[117]

Under Option 3 as modelled, with a 20% *increase* in total content investment but an 18% *reduction* in UK content investment, the impact on consumer surplus would depend on consumers' relative preference for the lost UK programmes versus the US ones (mainly from MediaCorp's own production companies) used to replace them.

117 Barwise and Picard (2014) op cit, p27.

As noted, we see Option 2, or something similar, as MediaCorp's most likely strategy, leading to a clear reduction in consumer surplus. But if MediaCorp chose a sufficiently growth-oriented version of Option 3, with content investment increased by 20%-plus and focused on high-quality US programmes, the net impact on C4's UK consumer surplus would most likely be positive even after allowing for the other commercial broadcasters' response (reduced UK content investment, increased marketing investment, some bidding up of the cost of premium content).

A further concern if CommsCorp were the buyer would be that it might turn some of C4's portfolio channels (currently all FTA) into – probably exclusive – pay TV channels, with a clear reduction in consumer surplus. The impact would be negative for all households who currently watch the channels, both those who would opt to pay for them and for those choosing instead to forgo them.

Advertiser surplus

A MediaCorp acquisition of C4 would almost certainly be bad for UK advertisers. Even under Option 3, which would lead to a net increase in commercial exposures, the shift to a more commercial programme mix would reduce the diversity of commercial audiences and advertisers' ability to reach valuable viewers, especially upscale younger viewers, efficiently.

As discussed in Section 4.6, a privatised C4 would seek to protect the price premium (higher cost per thousand viewers or 'CPM') of its airtime by focusing its content cuts on programmes aimed at viewers of less value to advertisers (eg BAME and disabled viewers). But to get more 'bang for the buck' from its content investment, the overall strategy would still be to become more mainstream commercial, reducing the range of TV options available to advertisers.

In addition, UK advertisers and agencies are themselves part of the UK creative, and increasingly digital, economy. If, as we believe, privatising C4 would also threaten its innovation and creativity (including Film4 and All4), the indirect cost, or opportunity cost, to advertisers would be likely to increase over time.

The ISBA View

The idea that privatising C4 would be bad for UK advertisers is not just our view. We also asked ISBA, their representative body, to comment. This is their response: [118]

"We do not position ourselves as 'cheerleaders' for the incumbent ownership model, nor its management, but we do have some clear and strong views about the possible consequences of a sale of Channel 4.

[118] On the record email from Mario Yiannacou, Media and Advertising Manager, ISBA, to Patrick Barwise, 18 March 2016.

Its output and audience are complementary to most other commercial channels, especially those of scale, which makes it attractive to certain advertisers like those targeting upmarket or younger audiences.

Moreover, its programming is also complementary within itself, which is why it delivers very high aggregate reach from relatively low audience programmes, another unique attribute amongst commercial broadcasters which makes it attractive to many more advertisers.

The UK's advertisers are by no means ungrateful for Government's much earlier decision to licence a fifth 'terrestrial/PSB' channel. However, Five does not share the same attributes referred to above, typically instead delivering similar but smaller audiences to, say, ITV, effectively meaning that it delivers 'a bit more of the same'.

Advertisers would therefore not welcome any change of ownership which led to Channel 4's operation and output more closely resembling, say, Five's.

Having established our preoccupation with protecting the nature and quality of Channel 4's output, we find it extremely difficult to imagine how a commercial operator could guarantee to maintain current levels of investment in content while extracting returns for shareholders. The sums simply don't add up.

So in summary Channel 4's audience and aggregate delivery of it are uniquely attractive to its advertisers, and any change in ownership would most likely to threaten this uniqueness."

ISBA also sent comments from Nestle and MediaCom (part of WPP and one of the top media agencies):

"Nestlé is concerned by recent speculation of any potential government sell-off of Channel 4. As a long-term advertiser and partner of the station, Channel 4 is particularly valuable to Nestlé in its current form owing to it being able to deliver unique and incremental coverage against many hard-to-reach Nestlé consumers. The diverse programming and its aim to 'foster the new and experimental in television' differentiates the station from its commercial rivals and makes it highly valuable to the advertiser community. Any acquisition that leads to a more 'commercial' ratings driven programme strategy would most likely compromise the channel's ability to deliver such reach and would be a serious concern to Nestlé."

"We [MediaCom] were asked whether a change in C4 ownership or a significant shift in remit will have implications for brands and their agencies. The short answer is yes. If C4 become private, the shift in their remit will be driven by making profit for shareholders… taking C4's uniqueness in a highly consolidated market away overnight.

Any profit C4 makes goes straight into programming and C4 uses independent productions to create its content. Privatisation means profit goes to the shareholders, creativity could be lost, and content creation could go to the cheapest bidder.

Our clients engage with Channel 4's [innovative activities and programmes such as] All4, *Gogglebox* and *Humans*, but would we see restrictions placed on this? *Gogglebox* was a slow burner in regards to ratings and is now a jewel in the crown. If C4 was private, *Gogglebox* would have been axed after its first series, or shifted to a digital channel to fill some daytime minutes. Programming such as F1 and the Paralympics would have been harder to deliver under a privatised C4."

The Omnicom view

Omnicom Media Group, another top media agency, recently published a note on the potential impact of C4 privatisation on media buying.[119] This argues that, as well as offering "young and light viewers at scale", C4 provides "a guaranteed quality environment for advertisers [and] risky, talked about programming".

The OMG note gives estimates of the three main sales houses' 2016 shares of net advertising revenue: ITV Sales 44.7%, C4 Sales 27.0%, Sky Sales 26.2%. The three sales houses' combined share is 97.9%, illustrating that there is minimal scope for further sales house consolidation and resulting efficiency gains. The only possible material changes post-privatisation (beyond those arising from C4's content becoming less distinctive) might be some switching of third-party sales contracts between C4 and Sky. This would have little net cost or benefit to advertisers.[120]

OMG also argues that," If ITV and Sky were to be acquired by foreign investors," (which it sees as quite likely given ITV's profitability and the attractiveness of a formal 21st Century Fox takeover of Sky, post Sky's acquisition of Sky Italia and Sky Deutschland), "the Government may feel pressured to retain a UK owned commercial broadcaster".

Broader social contributions

There is no ambiguity here and little needs to be said: although C4's programmes are sometimes controversial, its remit-related content and activities make a significant contribution to UK society in multiple ways, which is why Parliament has put so many aims and quotas into the remit and licence. A sale to MediaCorp would lead to a significant reduction in this content and these activities, and therefore in C4's broader social contributions.

[119] "Channel 4 Privatisation", *Viewpoint*, Omnicom Media Group, UK, March 2016.

[120] The impact on C4 might be positive or negative. For instance, according to OMG, if C4 were acquired by, say, Discovery, which then switched its airtime sales contract to it from Sky, the net impact would be to increase its market share to 29.4% (while reducing Sky's to 23.8%) if it retained its key third party contract selling UKTV's much sought after airtime. But if C4 lost the UKTV contract, its share would drop to only 21.1% (with Sky's increasing to 28.6%).

One particular area where C4 punches well above its weight is diversity. In his recent Oxford speech, mentioned in Section 2.3,[121] Trevor Phillips said C4 was "the most important agent of integration in our national media. Privatisation would destroy that at a stroke…[as it] would have little incentive to appeal to minority audiences, or to bring them together with majority audiences".

He added that, "*Big Brother* was probably the first popular format routinely to put people of different races together on screen…. Many people got their first glimpse of how the other 14 per cent live and behave when we think no one white is looking through tuning into *Big Brother*.

Since *Big Brother* moved to Channel 5, the commercial broadcaster owned by Viacom, the proportion of non-white housemates on the show has halved. I think we can expect something similar to happen to Channel 4's output if it were privatised".

More generally, TV programmes are a prominent and very widely shared part of popular culture. Although their effects are inherently complex and contested, they clearly have many societal impacts beyond their value as pure entertainment (captured in consumer surplus). Reducing the amount of original UK content available to viewers, and replacing it with US content, is likely to dilute UK national culture and Britain's soft power internationally.

Even if UK content were to remain a dominant feature of a privatised C4, there are limited ways in which the new owner could be forced to continue delivering these broader societal impacts through its approach to commissioning. As we have discussed elsewhere, the programme mix would be likely to change; it would be likely to look to a more commercially optimised schedule and work with a smaller range of suppliers, thus reducing the range of different creative ideas coming to the table. In short, it is far from clear how it could be made to live to the spirit of the remit even if it could be forced to tick all the required boxes.

Summary and conclusion

The value of C4's remit appears not to be in dispute. In this section, we have shown that the impact of privatisation would almost certainly be negative for UK content investment and independent production, the economy (GVA, employment, taxation and the balance of payments) the wider UK broadcasting ecology and creative industries, consumers, advertisers, and society.

The analysis underpinning this conclusion compares the likely outcome of privatisation, based on the investment case for the buyer (Section 4), and the likely outcome if C4 continues as a government-owned but commercially funded publisher-broadcaster (the non-privatisation base case in Section 3).

The revenue and non-programming cost assumptions in the base case imply that the remit is comfortably sustainable under the current model. In the first part of the report's final Section

[121] Cookson (2016), op cit.

6, we return to the important question of why we and other experts, and the current C4 leadership, believe that the remit is indeed sustainable under the current model. We then briefly discuss a number of other privatisation issues and options.

6. Other Privatisation Issues and Options

6.1 Legislative and Regulatory Changes to Increase C4's Revenue

There are a number of changes the government or Ofcom might introduce, without weakening the remit, to increase C4's revenue and the proceeds from privatisation. We here discuss four such possible changes: retransmission fees, changing the terms of trade with suppliers, levelling the airtime sales playing field (COSTA) and extending EPG prominence to the commercial PSBs' portfolio channels.

There are, to varying degrees, good arguments for all these possible changes, but we here note that, for two reasons, they are not costless:

- *They are all 'zero-sum'*: all involve redistributing revenue from the platforms (retransmission fees), suppliers (terms of trade) or the non-PSB commercial channels (COSTA and EPG), relative to the status quo
- Insofar as they would increase C4's revenue, *they would also increase its ability to deliver the remit if it is not privatised*. Because C4 re-invests its surpluses in programmes and innovation, the higher its revenue, the greater the opportunity cost to the UK broadcasting ecology, wider creative industries and society, if it is privatised.

In other words, none of these options is a free lunch – and, insofar as they may be justified if C4 is privatised, they are also likely to be justified if it is not – and offer even more assurance that the remit is sustainable.

Retransmission fees

Retransmission fees (potential payments from pay TV platforms to PSBs to include the PSBs' channels in their offer) involve complex and contested issues around Must Offer/Must Carry rules, EPG prominence, and other aspects of PSB regulation and legislation. They are also subject to a recent DCMS consultation on which the results are expected soon.[122]

Estimating the likely impact of potential changes in the rules on retransmission and EPG prominence falls beyond the scope of this report. The relevant points here are:

- Directionally, the overall net effect of any change is likely to be positive for the PSBs, ie to involve some payment by the platforms, either agreed by negotiation or, failing agreement, imposed by compulsory arbitration

122 *The Balance of Payments between Television Platforms and Public Service Broadcasters: Options for Deregulation*, DCMS consultation paper, 26 March 2015; Toby Syfret, *Retransmission Fees: A Pandora's Box*, Enders Analysis, 20 November 2015 [2015-104]; Mediateque, *Carriage of TV channels in the UK: Policy options and implications*, report for DCMS, July 2012, http://webarchive.nationalarchives.gov.uk/20120913095731/http://dcmscommsreview.readandcomment.com/wp-content/uploads/2012/07/120709-DCMS-Carriage-Consent-Report-FINAL.pdf; .

- As already noted, if the net effect of the new regulations were to increase the PSBs' revenue – and therefore the potential value of a privatised C4 – it would equally increase the remit-related opportunity cost and the assurance that the remit is sustainable.

Terms of trade

The current regulation of the terms of trade between PSBs and independent producers precludes PSB channels (including C4's main channel but not its portfolio channels) from owning secondary rights. Those secondary rights Channel 4 does control are secured through negotiation with Pact. As already noted, however, because of C4's remit and culture, it normally pays the full first-run production cost despite most secondary rights going to the supplier (Section 2.2).

C4 is currently able to negotiate variations to its Terms of Trade with Pact. For example, when C4 launched its VoD service, it negotiated to obtain VoD rights for its commissioned programming. However, the Terms of Trade are always the common reference point; and negotiations tend to be protracted and result in value being traded for additional rights – in reference to the example above, C4 currently pays an incremental amount for catch up VoD viewing.

If the legal requirement to agree terms of trade were removed, C4 could negotiate for more flexibility in the use of the rights for the programmes it commissions across both existing and any new services. This would give it more freedom to innovate by, for example, significantly reducing transaction costs and reducing time to market. Such changes could have a material financial benefit to both C4 and the wider industry.

In terms of any associated financial value transfer between C4 and the indies, the benefit to C4 is likely to be relatively low. Most of the programmes it commissions are intentionally designed to UK audiences, and tend to display limited resale value abroad. Their secondary value – apart from repeats, largely on C4's portfolio channels - is limited.

That said, given C4's operating model, any financial gains accruing to it from de-regulation in this area would then be reinvested in the creation of new content, mainly with the indies.

In conclusion, it is arguable that deregulating the terms of trade would make some contribution to ensuring C4's sustainability by facilitating its service innovation - particularly important in the context of changing media consumption habits.

Levelling the airtime sales playing field (COSTA)

The amount of advertising airtime commercial broadcasters are allowed to sell is regulated by Ofcom via its Code on the Scheduling of Television Advertising (COSTA).[123] In this context,

123 House of Lords Select Committee on Communications, *Regulation of Television Advertising*, 17 February 2011, pp 41-49.

only the three commercial PSBs' main channels (ie the main ITV, C4 and C5 channels) are currently defined as 'PSB channels'; all others, including the commercial PSBs' portfolio channels, are defined as 'non-PSB' channels. The rules are complex but, in summary, the 'non-PSB channels' are allowed to sell:

- 28.5% more airtime per hour (an average of 9 vs 7 minutes) than the three 'PSB channels' over the broadcast day and, even more importantly,
- 50% more airtime per hour (an average of 12 vs 8 minutes) during the peak-time hours 6pm-11pm that account for the majority of advertising and sponsorship revenue.[124]

Most commentators, including Ofcom, believe that the 1991 predecessor of these differential rules was first introduced (i) because the then regulator, the ITC, felt that it had an obligation to regulate the quality of the viewing experience (in terms of the frequency of commercial interruptions) on the 'PSB channels' but no such remit for the 'non-PSB channels' and (ii) in order to help the nascent multi-channel platforms get established.

Neither of these arguments is relevant today and it is hard to see any rational justification for the continuation of COSTA post-digital switchover, which was in November 2012. We believe that the playing field should have been levelled then, allowing all commercial channels to sell the same amount of airtime ('harmonisation').

We would recommend 'levelling the playing field' at a level that kept the overall number of commercial exposures, and the resulting total revenue, roughly constant, in order to avoid either (i) significantly *increasing* the overall frequency of commercials (which would be unpopular with viewers and might reduce the viewing of commercial channels and the effectiveness of TV advertising[125]) or (ii) significantly *reducing* the number of advertising exposures (which might reduce total TV advertising revenue, although the evidence on that is unclear). [126]

The effect would be the long overdue removal of a subsidy of the pay TV platforms and non-PSB broadcasters by the three commercial PSBs, including C4.[127] Naturally, the platforms

124 Peak-time hours are several times more valuable than off-peak hours because they attract much higher revenue per thousand viewers (CPMs) as well as much higher ratings. The underlying reasons for their higher CPMs are that they are much more efficient than off-peak slots at delivering (i) reach and (ii) valuable viewers.

125 By increasing 'wear-out' and encouraging ad avoidance.

126 An average of 8 minutes per hour through the broadcast day rising to, say, 9 minutes 15 seconds per hour during peak time would roughly achieve this at minimal risk to advertisers and total TV advertising revenue. The calculations are complicated by the fact that the 'PSB channels' achieve much higher CPMs than the 'non-PSB channels', but it should be possible to develop a policy that levels the playing field at minimal risk to both advertisers and TV industry revenue, while significantly benefiting UK producers and, therefore, viewers through the resulting net increase in total investment in UK programmes, because the commercial PSBs invest a much higher proportion of revenue in original UK programmes than the non-PSBs.

127 Moving to a level playing field as described (without increasing or decreasing total TV advertising revenue) would increase the revenue of the commercial PSBs' main channels more than it would reduce that of their portfolio channels. The *net* effect would be to increase their total revenue.

and non-PSBs oppose the removal of this continuing subsidy, which we see as well past its 'best before date' (analogue switch off in November 2012).

Because the commercial PSBs invest a *much* higher percentage of revenue in original UK content (of order 40-50% versus less than 10% for the non-PSBs), levelling the airtime sales playing field would materially boost UK production.

Levelling the airtime sales playing field would benefit the commercial PSBs as a group (ITV, C4 and C5) but the benefit to C4 would be proportionately less than for ITV and C5, because C4's portfolio channels account for a relatively high proportion of its viewing and commercial revenue. Nevertheless, we believe there would be a significant net benefit because airtime on the main channel attracts a much higher cost per thousand viewers (CPM) than the portfolio channels, and still attracts more than 50% of C4's total viewing.

Extending EPG prominence to the commercial PSBs' portfolio channels

The impact of extending EPG prominence to the commercial PSBs' portfolio channels, such as ITV2 and E4, would be to promote them above some of the other channels currently above them, leading to a small redistribution of viewing shares (and, therefore, advertising revenue). Directionally, the impact on revenue would be similar to that of levelling the airtime sales playing field (COSTA): a net shift from the non-PSBs to the commercial PSBs leading to an increase in UK content production

In both these cases (COSTA and EPG), the effect would again be to increase both the proceeds and the opportunity cost of privatisation.

6.2 Stronger Remit and/or Compliance

In principle, Ofcom or the government might look for ways to strengthen C4's remit, or other regulation, or the compliance regime, to reduce the new owner's ability to get round the remit in order to get more 'bang for the buck' from C4's content budget (Section 4.5).

As a general principle, we would neither recommend nor expect Ofcom or the government to strengthen the regulation of C4 pre-privatisation unless this involves eliminating a specific loophole without adding undue complexity. The underlying problem is that, unlike the current C4, MediaCorp would have both a financial incentive and a cultural bias towards minimising the impact of regulation on its revenue and profit. Adding more complexity would not address this fundamental issue but would increase costs and might even lead to unintended consequences.

There may, however, be a case for strengthening the compliance regime to encourage the new owner to be less aggressive in trying to get round the remit and licence. On the downside, this would reduce the privatisation proceeds and might also increase administrative and legal costs post-privatisation by raising the stakes and encouraging MediaCorp to seek judicial reviews and make other legal challenges.

6.3 Part Privatisation

Finally, an alternative to full privatisation would be to part-privatise C4. Within this strategy, the three options would be to sell a majority, 50%, or minority shareholding.[128]

Selling a majority shareholding, with the new owner acquiring a controlling interest, would lead to the same negative consequences as full privatisation, while reducing the privatisation proceeds. It is hard to see any benefit from this option.

Selling a 50% stake would be even worse. It would almost guarantee conflict with the new owner, create uncertainty for both parties and reduce the privatisation proceeds even more – not only because the buyer would be acquiring only a 50% profit share, but also because it would not be gaining control and would be facing substantial uncertainty.

In our view, the only plausible option would be to sell a minority stake, while retaining control. The benefits are that this would generate some money towards the public finances and, potentially, facilitate collaboration with, and the ability to draw on the expertise of, the minority shareholder, while maintaining the overall remit and the level of total and UK content investment.

The disadvantages are that:

- The amount of money it would raise would be minimal because it would preclude most of the potential ways of creating shareholder value for the outside investor (Sections 4.3-4.7) while giving it no control over strategy, investment, etc
- As discussed in Section 3.3, the remit is comfortably sustainable for the foreseeable future with C4 remaining 100% owned by the government
- Conflict would be inevitable because of the two shareholders' inherently different objectives.

The scope for incremental operating cost savings is small (see Section 4.3) and, insofar as there are potential synergies while still protecting the remit, it should be possible to find them through arms-length collaboration without bringing in a particular player as a minority shareholder. In fact, selling a stake to any one commercial player might preclude, or at least complicate, other potential partnerships.

[128] Strictly speaking, the government could separate the financial shares from the voting shares, eg by retaining a controlling 'golden share'. This would not materially affect change the analysis here: from an investor perspective, acquiring a majority financial stake but with the government retaining voting control would be broadly equivalent to acquiring a minority stake with just one class of shares.

Part-privatisation would therefore bring very little benefit while increasing complexity, conflict, and additional governance and regulation challenges. It might be attractive as a marker for the future, but the opposite is also true, ie that having a minority shareholder in place would reduce the range of potential future options.