



**AANA Submission on DCITA Issues Paper**

**Provision of Commercial Television  
Broadcasting Services  
After 31 December 2006**

**“BEYOND THE THREE PILLARS”**

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Prepared on commission by the Australian Association of National Advertisers

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The AANA commissioned **Peter J Cox BEc MBA, Principal of Cox Media** to research and develop the position presented in this submission, which is endorsed by its Board.

An independent expert with many years of experience, Peter Cox specialises in providing corporate advisory services to Australian and overseas suppliers, operators, bankers and investors in the Australian communications and media sectors.

His background includes being commissioned by The Department of Transport and Communications in 1990 to develop an independent model on the effect the introduction of Pay TV in Australia would have on the commercial television industry, invited to address the Caucus Transport & Communications Committee on Pay TV, and being appointed consultant to the Senate Select Committee on Subscription Television Broadcasting Services.

A leading advocate of new broadcasting technology since his involvement in the introduction of commercial FM in the late 1970s, his experience been maintained through involvements with high technology overseas and Australian companies.

As a recognised authority in Australia on the convergence of the computing, telephony and broadcasting industries he has been invited to lead and speak at more than 60 conferences in Australia, New Zealand and Asia.

In analysing the media industry in Australia and internationally for this submission, Mr Cox was provided with an open brief “to consider the issues from the perspective of the funding of commercial television by advertisers and the carry through consequences for the viewing public.”

The political and commercial views of the AANA are clearly identified in the document.

While there are many complex issues raised in this submission on which various members of the AANA could offer a range of views, the aim of the author and contributing AANA directors and staff has been to present a well-researched and reasoned argument representing the best interests of the broader community of which its members are a part.

## INDEX

1.	GOVERNMENT AND THE MEDIA	4
1.1	Government To Take Control	
1.2	Cross and Foreign Ownership	
1.3	Digital reviews	
1.4	Submission	
2.	SUMMARY	7
3.	BACKGROUND ON AANA	12
4.	AANA POLICY POSITION	13
5.	COMPETITION	14
6.	THE THREE PILLARS	17
6.1	AUSTRALIAN CONTENT AND PROGRAMMING QUALITY	
	Quantity of Services	
	Programming Expenditure	
	Overseas and Repeat Programming on FTA	
	Programming Quality	
	Programming Awards	
	Australian programming Requirements	
6.2	DIGITAL CONVERSION	24
	The Objectives	
	The Economics	
6.3	FINANCIAL VIABILITY	28
	Population	
	Revenue and Expenditures	
	Profits	
7.	ADVERTISING EFFECT	31
8.	RADIO INDUSTRY COMPARISON	33
9.	THE FOURTH NETWORK	34
10.	DEMAND FOR MORE CHANNELS	36

## 1. GOVERNMENT AND THE MEDIA – A DANGEROUS LIAISON?

*“The restrictions on media ownership serve no good purpose and, to the extent they invest politicians with some discretion over who should own what, are dangerous. They are neither necessary to nor consistent with a free society.”<sup>1</sup>*

David Flint, former Chairman of the Australia Press Council  
and the Australian Broadcasting Authority.

### 1.1 Government to Take Control

Gaining control of the Senate in 2004 affords the Federal Coalition Government the opportunity to fulfil its long-term commitment to “*reforming Australia’s outdated media ownership laws in the interests of development, flexibility and diversity,*”<sup>1</sup> alongside its stated intention of amending current legislation to ensure that the power to allocate new television licences is vested in itself as the government of the day.

While, in previous terms, the Government has chosen to largely ignore the considerations and recommendations of the Productivity Commission and Australian Competition and Consumer Commission in relation to commercial television policy, it is now committed to considering and responding to Department of Communications, Information Technology & the Arts’ reviews of the digital television regime in the declared interests of “*the continuing development of a vibrant digital television regime for the benefit of Australian viewers.*”<sup>2</sup>

In this context, the reviews by DCITA of both multichannelling and a fourth commercial television channel are of paramount importance to the future of Australian broadcasting, and potentially represents the most significant contribution to public policy development in this area since the introduction of commercial television in 1956.

This submission is made recognising that:

- **There is a risk** that changes to the cross and foreign media ownership laws will deliver further concentration of media ownership alongside an immense increase in the value of the commercial television network holdings of existing media proprietors; but that
- **There is an opportunity** that, with a new focus on public interest in modernising broadcasting policy to meet the circumstances of the 21<sup>st</sup> century, the outcome of the latest considerations could achieve:
  - An increase in the number and diversity of “free to air” commercial television services; and
  - An increase in the efficiency of existing as well as new “free to air” commercial television services incorporating a lowering of the unit cost of advertising and a reduction the costs of goods and services to the broader community.

<sup>1</sup> David Flint, Prejudice against proprietors ought to perish, *The Australian*, October 21, 2004

<sup>2</sup> 21<sup>st</sup> Century Broadcasting, *The Howard Government Election 2004 Policy*

This submission draws particular attention to this “win/win” opportunity on the basis that it clearly meets the Government’s stated dual objectives of *“the need for reform in the area of media ownership while protecting the public interest in a diverse and vibrant media sector.”*<sup>3</sup>

It is not the intention of the AANA in this submission to presume to recommend specific legislative arrangements, but rather to suggest a framework of policy objectives from which both DCITA and the Government can formulate detailed regulatory changes.

It is the intention of the AANA in this submission, as in its submission on multichannelling which it requests to be considered as a supporting part of this submission, to demonstrate the compelling case for the introduction of new commercial television channels in competition to those currently existing under the mislabelled area of “free to air” services.

Within this submission, the AANA sets out to demonstrate:

- The benefits of competition and competition policy;
- The shortcomings of the so-called “Three Pillars” defence of the three “free to air” networks; and
- The demand for and public and political advantages attached to the introduction of new channels.

In making this submission, the AANA is openly of the view that governments should be protected from positions where, in the absence of any ancillary administrative or judicial process following transparent, clear and objective criteria, their decisions in areas of sensitive public policy are likely to be widely seen as based on political interest rather than public interest considerations.

In making this submission, the AANA has canvassed a broad range of opinion and experience, both domestically and internationally, some of which is referenced in this document, including that of Dawn Airey, Managing Director of Sky Networks in the UK, whose presentation to the annual ABA Conference in Canberra in June 2004 effectively summarised a view the AANA now commends to DCITA and the Government:

*“As we have seen again and again over the years, where broadcasters rely not on competition but favours from the regulator they tend to develop a false sense of security. And it’s the great tragedy of British broadcasting that for 40 years ITV and BBC settled into a cosy duopoly that had the effect of acting as a brake on innovation. With no real competition to speak of they missed opportunity after opportunity to promote new technology and build up an international business that could have truly rivalled the US production sector.*

*“Competition is not easy, but it is essential.*

*For competition to flourish, government and policy makers must create fair opportunities for all participants, and let the market do its work. There will be winners and there may even be some losers. But the ultimate beneficiary is always the same: the consumer.”*<sup>4</sup>

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<sup>3</sup> Ibid

<sup>4</sup> Dawn Airey, What I saw at the Digital Revolution, ABA Conference, 24 June 2004

## 1.2 Cross and Foreign Ownership

The Federal Government is committed to changing the cross and foreign media ownership laws.

While this has a potential to deliver both (i) further concentration of media ownership and (ii) immense additional value to the owners of Australia's television networks, it also affords an opportunity for the Government to ensure the public interest is fairly and properly served through:

- an increase in the number and diversity of “free to air” commercial television services; and
- an increase in the efficiency of the “free to air” commercial television services, bringing about a lowering of the unit cost of advertising and consequent reduction in the costs of consumer goods and services.

## 1.3 Digital Reviews

While well-reasoned economic reviews undertaken by the Productivity Commission and the ACCC have already established the economic consequences and public interest detriments flowing from existing anti-competitive market structures, the Australian Government is now committed to considering and responding to reviews of the digital television regime undertaken by DCITA to ensure “*the continuing development of a vibrant digital television regime for the benefit of Australian viewers.*”<sup>5</sup>

Consequently,, the reviews by DCITA of both multichannelling and a fourth commercial channel are of paramount importance for the future of Australian broadcasting policy and to the future of the Australian broadcasting industry.

## 1.4 Submission

It is not the intention of this submission to recommend specific legislative arrangements, but rather to suggest a framework of policy objectives from which both DCITA and the Government can form detailed regulatory changes necessary to Government policy.

It is the intention of the AANA in this submission, and in its separate submission on multichannelling, to draw attention to the compelling case for introducing new “free to air” commercial television services.

This AANA submission will demonstrate:

- The benefits of competition policy;
- The illusory nature of the “Three Pillars” defence of the protected oligopoly of the three commercial networks; and
- A compelling case for the early introduction of additional commercial television channels.

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<sup>5</sup> Ibid

## 2. SUMMARY

1. National Competition Policy and coincidental removal of regulatory restrictions to competition have been major components in increasing the economic performance of Australia and raising its rate of GDP per capita to one of the highest in the world.
2. Competition policy is based on the concept that there should be no regulatory restrictions on competition unless such restrictions are demonstrably in the public interest.
3. The burden of proof is not for increased competition but for the parties seeking ACCC authorisation to prove how public benefits flowing from anti-competitive arrangements outweigh the costs to the economy and its consumers.
4. Existing Government policy protects the three existing commercial television networks against a fourth commercial network, multichannel “free to air” services, datacasting services and competition from sporting events migrating to Pay TV.
5. By contrast with all other industries, the commercial networks enjoy a shared monopoly protected by Government regulation.
6. The Australian “free to air” television market has remained at only three commercial networks for 40 years whilst other comparable economies have multichannel television markets.
7. In the last 24 years alone, revenue has increased over 8 times and profitability sevenfold with the public having to pay a premium price by way of the flow-through from advertising costs to goods and services.
8. Both of the major regulatory bodies for ensuring competition in Australia, the ACCC and the Productivity Commission, have determined that television networks enjoy a level of protection from competition policy not available to other businesses and that this is in contradiction with the intent of the Competition Principles Agreement and the Trade Practices Act.
9. The adverse economic by-products of this protection have been shown to include price gouging, barriers to new entrants, constraint on the financial performance of suppliers and denial of basic services to consumers.
10. Sometimes referred to as “The Three Pillars,” the attempted defence by the networks of such anti-competitive restrictions is based on three arguments:
  - Affording high quality programming and in particular Australian programs:
  - Compensation for the cost of digital conversion: and
  - A requirement to maximise their shareholder’s value.
11. This submission establishes that “The Three pillars” defence is unsustainable and illusory.

## PROGRAMMING QUALITY

12. While the networks argue the relationship between programming expenditure and programming quality, over the last 14 years:
- Networks' expenditure on Australian programming has increased at only 2.1% per annum compared to revenue at 5.9%;
  - Australian program share of total expenses has fallen from 35% to 25%;
  - Expenditure on Australian programs has declined in real terms;
  - Savings on Australian program costs appear to have gone into executive salaries, intra group management fees and shareholder profits; and
  - The combined PBIT (profits before interest and tax) of the networks has increased from \$80 million in 1989 to \$760 million in 2003.
13. The "free to air" networks argue against multichannelling on the grounds that it would be more like Pay TV—"dominated by overseas materials and repeats"—yet in two very recent major ratings weeks, between 7.00pm and 10.30pm:
- US programs were about 60% of "free to air" programming time against 40% Australian;
  - Between 26% and 38% of programming constituted repeats;
  - The Nine and Ten networks both ran repeats each week night at 7.00pm alone.
14. Currently, the most successful Australian programs besides sport and news are relatively low cost reality programs such as *Australian Idol*, *The Block*, *Big Brother* and *My Restaurant Rules*, which cannot be argued as high quality but deliver high profitability to the networks
15. The major US television awards, the *Emmys*, are dominated by the high quality and innovative programs on HBO on Pay TV, with 32 awards followed by the fourth commercial network, Fox, with 10. By contrast, the most popular traditional US "free to air" network, CBS, won only two awards.
16. Dawn Airey<sup>6</sup> argues that in the UK "*audience fragmentation hasn't led to a decline in the quality of programming on the major networks—quite the reverse*"
17. The primary reason for the Australian networks providing more Australian programming than required by regulation is its popularity with viewers and the consequent revenues and profits generated.

## DIGITAL CONVERSION

18. The depreciation cost of new equipment for digital conversion has been absolutely minimal for the metropolitan networks at only about .03% of total expenses.
19. The cost for regional networks may be even less after the direct reimbursement from the Government of \$260 million.
20. Improved inventory controls, sales and traffic management and reduced staff from digital conversion have brought efficiencies acknowledged by both the Nine and Ten networks.

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<sup>6</sup> Ibid

21. It can be argued that the metropolitan networks did not need any special protection for digital conversion, with any marginal increases in their costs of operation being no different to those of any other industry needing to upgrade technology and operating systems as a normal business expense.

## FINANCIAL VIABILITY

22. Revenue has grown at 9.4% per annum over the last 24 years, from \$400 million to \$3.5 billion.
23. Profits have grown by 8.5% per annum over the same period, from \$71 million to over \$500 million in 2003.
24. PBIT has increased over the last 14 years from 1989 by 17.4% per annum, from \$80 million to \$760 million in 2003.
25. There have only been four years of losses over the 24 years (with three of these attributable to the excesses of new owners), and only one in the last 14 years.
26. The profits of the industry again escalated in 2003/04, and PBIT could be approaching \$1 billion in 2004/05.

## ADVERTISING EFFECT

27. Advertisers provide the predominant income of Australia's commercial television industry, at nearly 85% of current total revenues of around \$3 billion.
28. With only three competitors and a limit on the amount of advertising per hour, the supply of advertising time is fixed.
29. The controlled market means advertising demand consistently exceeds supply, driving effective price increases of 9.4% per annum for the last 24 years.
30. The burden to advertisers is over three times the inflation rate and gets passed through to consumers in the form of higher prices for goods and services.
31. The level of "free to air" commercial television viewing has declined about 10% over the last eight years with the advent of Pay TV, DVDs and the Internet.
32. The television networks are asking for further advertising rate price increases of between 10% and 20% for 2005.
33. Television advertisers are having to continually pay higher costs per thousand for consumers reached, with the Australian public consequently paying higher costs for goods and services. **Advertisers, and the public, are paying more for less.**

## **RADIO INDUSTRY COMPARISON**

34. In the period since the introduction of commercial FM, the number of radio stations has increased by nearly a third .
35. New radio services have increased competition, attracted new advertisers, reduced prices, increased volumes, increased revenue and increased profits.
36. The radio industry has a history of nearly a third of stations making a loss and yet Governments have increased the number of competitors and allowed foreign ownership.
37. Television, with a fifth of the number of stations, four times the revenue and six times the profit, is protected against competition, both foreign and local, with no new networks in 40 years.

## **THE FOURTH CHANNEL**

38. Television revenue has grown at an average rate of 9.4% over the last 24 years, from \$403 million to \$3.5 billion—more than three times the rate of inflation. Advertising price increases of \$2.1 billion accounted for 85% of this growth.
39. The \$2.6 billion revenue growth above CPI increases over this period could have funded a number of new channels.
40. If the revenue growth had been over four networks rather than three, the average network today could have been about the same size as the Ten Network.
41. The increased competition would have helped to reduce the drift away to Pay TV of the higher socio economic groups, reduced prices, attracted new television advertisers and maintained the growth of the industry.

## **CONCLUSIONS**

42. The AANA supports the view shared by the competition regulatory bodies, the ACCC and the Productivity Commission, that the protection provided by the Government to the commercial “free to air” networks is against the intent of The Competition Principles and the Trade Practices Act.
43. The existing protection provided by the Government to the commercial networks (including the anti-siphoning regime) is anti-competitive, not in the public interest and unreasonably wasteful of society's resources.
44. The “Three Pillars” argument of programming quality, digital conversion and viability is not sustainable as a defence of the status quo.
45. The networks have effectively siphoned off expenditure from Australian programming to executive salaries and corporate profits.
46. Digital conversion costs have been, at most, minimal to the networks and deserve to be treated as normal business expenses with no grounds for protection.
47. The networks have enjoyed revenue and profitability growth way beyond the level of inflation, and of the remainder of the economy in general, driving unnecessary and unwarranted cost increases on advertisers and consumers.

48. The profitability of the industry could easily support a fourth commercial work or a number of smaller “free to air” channels as in multichannelling.
49. The experience of multichannelling based on the huge success of *Freeview* in the UK, with cable TV in over 90% of homes in the US, and over 50% of Australian homes having sampled Pay TV, demonstrates the demand for multichannel services.
50. Market research by the Seven Network demonstrates unequivocally the demand by up to 91% of Australians for increased “free to air” channels.
51. If the Government proceeds with its intended legislation on cross and foreign media ownership it risks not only greatly enhancing the value of existing media shareholdings but also opening the way to further ownership concentration.
52. The public interest deserves and demands a freeing up of competition in this sector through the removal of regulatory restrictions and protection, thus creating the opportunity for consumers to benefit from the future effects of competition.
53. The networks have first mover advantage to own future channels by agreeing to multichannelling or face a new fourth commercial competitor.

*“Rather than deciding the future of the Australian broadcasting landscape on the basis of who has the deepest pockets & the burliest director of public affairs, let’s examine the merits of the arguments. I hope .... I have been able to convince you that some of the opinions that pass for holy writ in relation to competition in the broadcasting sector are at best naïve or at worst, plain disingenuous.”<sup>7</sup>*

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<sup>7</sup> Dawn Airey

### 3. BACKGROUND ON AANA

The Australian Association of National Advertisers appreciates this opportunity to offer its views to the Department of Communications, Information Technology & the Arts [DCITA] relating to the July 2004 Issues Paper.

Having stood for open and fair competition in the Australian marketplace for 75 years,, the AANA is the peak industry body for the advertising community and represents marketing and advertising interests of a diverse range of manufacturing and service industries, advertising agencies and other service providers.

The combined advertising expenditure of AANA member organizations totals more than 80% of national main media advertising revenues, currently amounting to around \$10 billion.

The AANA has played a significant role in:

- deregulation of the advertising industry in Australia, with particular reference to the disbanding of the media accreditation system which embodied a range of anti-competitive practices including uniformity in the commission-based remuneration of advertising agencies;
- establishment of Australia's advertising industry self-regulation system set up with government encouragement by way of the formation of the *Advertising Standards Board* and *Advertising Claims Board*—a system of self-regulation now viewed as one of the best in the world.

As the peak advertising industry body, the AANA has been a long term advocate of the interests of the advertising business sector and has a history of providing government with submissions on public policy including:

- Productivity Commission inquiry into the Broadcasting Services Act 1999;
- Inquiry into the Broadcasting Services Amendment (Media Ownership) Bill 2002;
- AANA Policy Position on Anti-Siphoning;
- AANA Policy Position on Advertising to Children and Obesity Issue;
- Joint industry submission on alcohol advertising;
- Joint industry submission on Trans Tasman Harmonisation of Therapeutic Goods Advertising as part of CER;
- ACCC Report on Competition in the pay TV Market;
- AANA Submission to DCITA on Multichannelling.

Many members of the AANA operate in a highly competitive market but are locked between two major oligopolies exerting naked market power—two supermarket chains and three commercial television networks.

#### 4. AANA POLICY

The AANA has consistently publicly expounded policy and commercial positions that are particularly applicable to television broadcasting services, with concerns including:

- The longstanding need for more vigorous competition and program and service innovation in the media;
- An unwarranted and unnecessary level of protection of the incorrectly labelled ‘free-to-air’ networks against fair and reasonable competition from additional commercial television enterprises, while protected against competition from subscription television through ‘anti-siphoning’ regulations;
- Television advertising rates are well above inflation rates, caused by an imbalance of supply and demand in the television advertising media market directly attributable to the moratorium on new competitors;
- The structure of the television industry does not meet the first two objects of the Broadcasting Services Act 1992:
  - § *To promote the availability to audiences throughout Australia of a diverse range of radio and television (and datacasting) services offering entertainment, education and information; and*
  - § *To provide a regulatory environment that will facilitate the development of a broadcasting industry in Australia that is efficient, competitive and responsive to audience needs.*

This paper should be read in conjunction with the AANA’s July 2004 submission to DCITA on multichannelling;

That submission examined the economic relationship between television and advertising, considered international trends and the market power of the television networks, developed economic models for the viability of multichannelling services and analysed the arguments for sustaining the moratorium against competition;

In this submission the AANA seeks to enlarge on the concept of competition and the contradiction of legislated media protection with the intent of the Competition Principles Agreement and the Trade Practices Act

This submission then examines the case as presented by the networks to continue their uniquely protected position of legislated market power in the Australian economy. This has been called “The Three Pillars,” and is based on:

- Australian Content and Programming Quality;
- Digital Conversion; and
- Financial Viability.

The aim is to determine whether the anticompetitive restrictions caused by the Three Pillars are demonstrably in the public interest.

## 5. COMPETITION

Thirty years ago, when the Trade Practices Act was established by the 1974 Whitlam Government, Australia was internationally recognised as an inefficient economy with numerous monopolies, cartels and anti-competitive practices.

The Attorney General in introducing the Bill stated:

*‘The purpose of the Bill is to control restrictive trade practices and monopolisation and to protect consumers from unfair commercial practices...These practices cause prices to be maintained at artificially high levels...they interfere with the interplay of market forces which are the foundation of any market economy; (and) they allow discriminatory action against small businesses, exploitation of consumers and feather-bedding of industries.’<sup>8</sup>*

In the 1980s, Paul Keating as Treasurer deregulated the banking system, allowing the issue of 16 additional banking licences, floated the Australian dollar and reduced trade barriers. However, Australia was still not internationally competitive and ranked 16<sup>th</sup> in GDP per capita in the OECD in 1990.<sup>9</sup>

In 1992, following an agreement by Australian governments on the need for a national competition policy, the Prime Minister established the Independent Committee of Inquiry into National Competition Policy chaired by Professor Fred Hilmer.

The “Hilmer Report” recommended the implementation of a national competition policy for Australia to improve productivity, increase international competitiveness and to maintain and improve living conditions.

A key recommendation of the report was that as part of a national competition policy, there should be no regulatory restrictions on competition unless such restrictions were demonstrably in the public interest.

The National Competition Policy was introduced by all governments and the ACCC and the National Competition Council were formed. A major objective was to remove regulatory restrictions to competition including legislated monopolies for public utilities, statutory marketing arrangements and licensing arrangements for the professions.

Structural reform and access regulation were brought into major monopolies such as electricity, gas, telecommunications and transport.

These have brought about increases in services, reductions in prices and increases to GDP worth billions of dollars to the Australian economy.

Over the last 30 years the Australian economy has become an outstanding international performer, providing Australians with one of the highest rates of GDP per capita in the world.

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<sup>8</sup> Extract from a speech by Ross Jones, ACCC commissioner, to the Australian Broadcasting Summit, 20 February, 2003

<sup>9</sup> Joe Dimasi, ACCC, The Role of competition in structural adjustment, Tokyo, 9 September, 2004

The only remaining major industry sector that has Government legislated concentration of market power is the commercial television industry.

In addressing this situation an ACCC commissioner recently stated:

*“As a competition regulator, I find it peculiar that many firms in the broadcasting industry are given a level of protection from failure that is not given to firms in other industries. The overwhelming majority of Australian firms are subject to the rigours of the marketplace. Governments have reduced regulatory barriers and protection that was once endemic in Australian industry and the results have been beneficial to economic growth. Broadcasting has been a major exception in market liberalisation. Any legislation that restricts competition should be retained only if the benefits to the community as a whole outweigh the cost, and if the policy objectives can only be met through restricting competition.”<sup>10</sup>*

The Productivity Commission Report concluded:

*“Broadcasting policy .... reflects a history of political, technical, industrial, economic and social compromises. This legacy of quid pro quos has created a policy framework that is inward looking, anti-competitive and restrictive.”<sup>11</sup>*

The AANA has made numerous representations on proposed legislation and inquiries including:

*“The AANA subscribes to the ACCC’s stated opinion that television operators enjoy protection from competition not available to other business sectors and believes this to be in contradiction with the intent of the Competition Principles Agreement and the Trade Practices Act.”<sup>12</sup>*

The Minister for Communications has stated that:

*“The Government has long maintained the view that the regulatory framework for ownership and control of media assets in Australia unnecessarily constrains the sector within outdated structures. Existing restrictions impede commercial flexibility and access to capital for infrastructure and content investment. And they hinder the ability of Australian media organisations to succeed and grow in the international market.”<sup>13</sup>*

The networks are protected by Government legislation including:

- Commercial television licences may not be issued before 2007;
- Multichannel free to air commercial television services prohibited;
- Datacasting not allowed on existing or potential services by existing television licensees or new competitors; and
- Anti-siphoning legislation protects existing sporting events on FTA from migrating to Pay TV

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<sup>10</sup> Ross Jones, *ibid*

<sup>11</sup> Productivity Commission

<sup>12</sup> ACCC submission to the Minister on the ACCC Report on Competition in the Pay TV Market, July 2003

<sup>13</sup> The Hon Darryl Williams AM QC MP, Australian Broadcasting Conference, Canberra, 24 June 2004.

The adverse economic effects include:

- Oligopoly pricing;
- Barriers to entry;
- Prohibited competition;
- Limits on advertising inventory and increases in advertising costs;
- Constraint on program suppliers; and
- Denial of services to consumers.

Television networks have managed to defend regulatory barriers to entry of new competitors on the basis of the “Three Pillars”:

- To meet the cost of Australian content obligations;
- Compensation for the costs of digital conversion; and
- The need to optimise financial performance and maximise value.

It is the object of this submission to briefly assess the validity of each of these claims and to determine whether there is a need for such regulatory protection.

The television networks have strongly protected their commercial interests through powerful lobbying and by utilising significant coordinated and common resources.

The networks have exploited their significant commercial and political influence to defend their privileged position of market domination. This has not been in the public interest and its continuance cannot be justified on any public interest ground.

However, in a democratic society it is also the rights of interest groups and the responsibility of regulatory bodies to carefully assess the validity of claims and to argue for policy that is in the public interest.

Finally, the Government has a responsibility to consider these arguments and to determine policy that is in the best interests of the Australian economy.

Airey comments on the UK experience:

*“It is a market whose overwhelming characteristics are freedom and choice rather than restrictive rules and spectrum scarcity. Yet it is a market that many have been telling you for years cannot possibly exist.*

*The idea of a liberalized broadcasting sector isn’t merely an “untested economic experiment”, as it has been described in some of the more extraordinary policy documents issued by the commercial broadcasters in this country.*

*In the UK it is a fact of life. And regardless of its impact on one network or another, it is the viewer who is the ultimate beneficiary of more television, more innovation, more channels and more choice than ever before.”<sup>14</sup>*

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<sup>14</sup> Ibid

## 6. THE THREE PILLARS

### 6.1 AUSTRALIAN CONTENT AND PROGRAMMING QUALITY

The position of the commercial television networks in regards to defending the moratorium on the number of commercial FTA licences, datacasting and anti-siphoning was clearly outlined in the joint Nine and TEN submission on the ACCC Report on Emerging Market structures<sup>15</sup>

*“The Australian Parliament has restricted the number of free-to-air services to ensure the delivery of high levels of quality Australian (including adult and children’s drama and documentaries) free of charge to viewers. This is achieved by limiting the number of free-to-air commercial licences to three in each licence area and limiting each licensee to one primary service. The three commercial networks spend more than \$700 million per annum on Australian programs, including over \$125 million on Australian drama.”<sup>16</sup>*

This position was reinforced in the recent Nine Network response to DCITA on multichannelling:

*“The content of free to air television services and the quantity of free to air services/programs is regulated in Australia to ensure high quality free broadcast services are delivered....and in particular local programming”<sup>17</sup>*

#### Quantity of Services

The quantity of free to air services is undoubtedly regulated.

When television was introduced in Sydney and Melbourne in 1956, the Australian population totalled 9.5 million people, with 3.6 million in Sydney and Melbourne. By 1964 three commercial services existed in Sydney, Melbourne, Adelaide and Brisbane and two in Perth. By that time, the Australian population was 11.3 million, with the five capital cities accounting for 6.1 million people.

Forty years later, with an Australian population of over 20 million, there are still only three commercial channels in each of the five major metropolitan markets and most of regional Australia. Thus, the population has increased over three fold with no increase in the number of free to air channels.

Over the last 25 years the population in the five metro markets has increased from 8.5 million to over 12 million with no increase in services.

The revenue in the five capital city markets has grown from \$325 million in 1978/79 to \$2.756 billion<sup>18</sup> in 2002/03. This is an eightfold increase in revenue to be split amongst the

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<sup>15</sup> Nine and Ten Networks comments to DCITA on the ACCC Report to the Minister on Emerging Market Structures in the Communications Sector, July 2003

<sup>16</sup> *ibid*

<sup>17</sup> Nine Network Response To DCITA Issues Paper, Provision of Services Other Than Simulcasting by Free To Air Broadcasters on Digital Spectrum, August 2004

same three commercial networks.

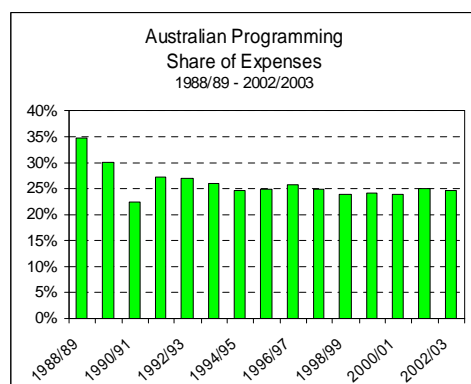
## Programming Expenditure

The Nine and Ten networks repeatedly argue in both submissions on emerging Market structures and Multichannelling<sup>19</sup> the relationship between programming expenditure and programming quality.

Most detailed expenditure items have only been collected by the ABA since 1986/87 so we will restrict the analysis of programming costs to the last 14 years.

Over this period advertising revenue has grown for the Australian market at a compound growth rate of 5.0%, total revenue at a rate of 5.9% and total expenses have grown at 4.7% per annum.

The combination of high advertising growth and lower growth of expenditure has resulted in PBIT growth of 17.4% each year since 1988/89.



Australian programming expenditure has only grown at a rate of 2.1% per annum.

Australian programming share of total expenditure has fallen from 34.7% in 1988/89 to 24.6% in 2002/03.

In the 5 Capital City markets the growth rate of Australian programming has been 2.6%. Australian programming share of total expenditure has fallen from 32% to 24.1% in only 14 years.

In real terms Australian programming has actually declined since 1998/99 by -0.7% per annum.

Expenditure on overseas programming has grown by only 1.4% and in real terms declined by -1.4% per annum.

On the basis of programming expenditure as argued by the networks, the quality of “free to air” programming must be declining, negating the need or rationale for continued protection.

<sup>18</sup> ABA, Broadcasting Financial Results

<sup>19</sup> Ibid

The major increases in expenditure have been salaries and wages 5.5%, interest paid 9.4%, television licence fees and agency commissions (direct proportion of revenue growth) and intra group management fees.

The profitability (PBIT) of the five capital cities has gone from a loss of -\$52 million in 1998/99 to a profit of \$581 million in 2003/03, a growth rate of 33.6% per annum.

Over the last 14 years government protection has not served to encourage greater expenditure on Australian programming but has encouraged growth in expenditure on executive salaries and shareholder profits. Continued government protection cannot therefore be justified on public interest grounds.

Overseas and Repeat Programming on FTA

“It is very likely free to air multichannels would be channels more like those provided by the multi-channelled Pay TV industry dominated by overseas materials and repeats.”<sup>20</sup>

**Overseas and Repeat Programming on Free To Air Prime Time 7-00-10.30 pm**  
**Oct 3-9, 2004 US Programs(pattern) and Repeats(shaded)**

		ATN7 Sydney	TCN9 Sydney	TEN10 Sydney
SUN	7.00-7.30	W.A.U: SOUTH PACIFIC:	RL GRAND FINAL	AUSTRALIAN IDOL
	7.30-8.00	JAG		
MON	8.00-8.30			
	8.30-9.00	M-TITANIC		LAW & ORDER: CI
	9.00-9.30		THE ANIMAL	NCIS
	9.30-10.00			
	10.00-10.30			
	7.00-7.30	HOME AND AWAY	FRASIER RPT	THE SIMPSONS
	7.30-8.00	THE GREAT OUTDOORS	MALCOLM IN THE MIDDLE	AUST IDOL -LIVE VERDICT
TUE	8.00-8.30		WHO ....MILLIONAIRE	
	8.30-9.00	CROSSING JORDAN		QUEER EYE: GUY
	9.00-9.30		SEX AND THE CITY	
	9.30-10.00	THE PRACTICE		LAW & ORDER RPT
	10.00-10.30			THE SIMPSONS
	7.00-7.30	HOME AND AWAY	FRASIER RPT	THE SIMPSONS
	7.30-8.00	DANCING....STARS	SURVIVOR: NANUATO	EVERYBODY: RAYMOND
WED	8.00-8.30		CSI RPT	THE O.C.
	8.30-9.00	ALL SAINTS		ROVE LIVE
	9.00-9.30		COLD CASE	
	9.30-10.00	THE PRACTICE		
	10.00-10.30			
	7.00-7.30	HOME AND AWAY	FRASIER RPT	THE SIMPSONS
	7.30-8.00	HOT PROPERTY	MCLEOD'S DAUGHTERS	THE ALL NEW SIMPSONS
THU	8.00-8.30	BLUE HEELERS	CSI MIAMI RPT	MARTY & JESS:
	8.30-9.00		WITHOUT A TRACE	LAW & ORDER WED RPT
	9.00-9.30	FORENSIC INVEST		THE PANEL
	9.30-10.00			
	10.00-10.30			
	7.00-7.30	HOME AND AWAY	FRASIER RPT	THE SIMPSONS
	7.30-8.00	MY WIFE AND KIDS	GETAWAY	INSIDE IDOL
FRI	8.00-8.30	SIMPLE LIFE 2		
	8.30-9.00	PLAYING IT STRAIGHT	RPA	L&O: SVU
	9.00-9.30		BODY WORK	L&O: SVU
	9.30-10.00	TRADING SPOUSES	THE FOOTY SHOW	
	10.00-10.30			
	7.00-7.30	HOME AND AWAY	FRASIER RPT	THE SIMPSONS
	7.30-8.00	AUCTION SQUAD	BURKE'S BACKYARD	EVERYBODY: RAYMOND
SAT	8.00-8.30	BEVERLY HILLS COP	GALAXY QUEST RPT	BRIDGET JONES ..
	8.30-9.00			
	9.00-9.30			
	9.30-10.00			
	10.00-10.30			
	7.00-7.30	M-TOYSTORY 2 (R)	ELECTION 2004	MONK
	7.30-8.00			
8.00-8.30				
8.30-9.00	M-DIE HARD 2		MUMMY RETURNS	
9.00-9.30				
9.30-10.00				
10.00-10.30				
<b>US</b>	43.5hrs/59%	13hrs/53%	12.5hrs/51%	18hrs/73%
<b>Rep</b>	28hrs/38%	7.5hrs/31%	7hrs/29%	13.5hrs/55%

<sup>20</sup> Ibid

The one week period analysed above was for Sydney for the first week of October 2004, one of the major ratings weeks for the negotiations of advertising rates for the next year, hence a competitive programming week on free to air.

- US programs were scheduled for 43.5 of the 73.5 hours available on commercial “free to air” between 7.00pm and 10.30pm
- US programs made up 59% of programming time against the 41% contribution of Australian programming.
- There were 28 hours of repeat US programming.
- US repeats filled 38% of the programming available.
- 64% of the US programs were repeats.
- The Nine and TEN networks were both programming repeats on each week night at the premium hour of 7.00pm.
- In the following week US programs made up 65% of programming time, Australian 35% and repeats 26%.

### **Programming Quality**

Television programming quality is a very subjective issue, with the “free to air” networks claiming the high ground while, in reality, television is a commodity today with programmers aiming to win viewers in order to attract advertisers.

Generally recognised quality US programs—such as *CSI* and *CSI: Miami*, *Law & Order CI* and *SVU*, *Without a Trace*, *ER*, *Friends* and *Cold Case*—are regularly in the top 10 rating programs even when some are repeats.

Apart from news and sports coverage, some of the most successful Australian programming this year has comprised reality programs such as *Australian Idol*, *The Block*, *Big Brother*, *My Restaurant Rules* and *Popstars*.

No one could claim these programs as being high quality (by comparison to Australian drama), but they are extremely popular, inexpensive and highly profitable for the networks.

The “free to air networks” are highly critical of the quality of programming on Pay TV, although the most popular channels—such as Fox 8, UKTV and TV1—frequently feature many of the same programs as “free to air”. Further, channels such as Discovery, National Geographic, the History Channel and the 24 hours News channels are popular, informational, often educational, and provide diversity.

In homes that have subscription television, viewers watch more Pay TV than “free to air” programming, demonstrating the consumers’ preferred choice for quality and diversity.

The level of viewing of “free to air” television has fallen in Australia by about 10% over the last 8 years while total television viewing has increased. In the US and the UK similar trends apply.

Dawn Airey says

*“In Britain, the average number of hours of television viewing is steadily declining. The ordinary household watches 23 hours of TV every week. But in Sky Plus households, when people can watch whatever they want at their own convenience, weekly viewing has risen to 27 hours a week. Not only that; more than half of them are watching a wider choice of channels than they did before.”*<sup>21</sup>

### **Programming Awards**

In the US, the introduction of a fourth commercial television network—Fox—led to new and innovative programming that also became popular when subsequently imported into Australia, with examples including *Ally McBeal*, *Beverly Hills 90210*, *Married with Children*, *the Simsons*, *X-Files*, *American Idol*, *Boston Public* and *Melrose Place*.

The cable channel HBO has introduced outstanding new programs including *The Sopranos*, *Sex in the City* and *Six feet Under*.

In the 2004 Prime Time Emmy Awards HBO lead the nominations with 124 against NBC 65 and CBS 44. HBO dominated with 32 awards, followed by Fox with 10, NBC with 8, and ABC 7 (the most watched network) with only two. HBO won nearly twice as many awards as the three traditional networks and the relative newcomer, Fox, won more awards than the Big Three networks.

These awards were won for outstanding quality drama and acting performances. The HBO mini-series *Angels in America*, which won 11 awards, was shown on the ABC in Australia. *The Sopranos* won Best drama and acting awards; Sarah Jessica Parker from *Sex in the City* won best actress in a comedy series; and Cynthia Nixon best supporting actress, and James Spader best actor in a drama for *The Practice*.

It is clear from the US experience that new competitors have introduced highly successful and innovative quality programming to US television.

The argument made by Nine “*that a wider range of programming which would lead to more programming available for free but lower quality programming overall*”<sup>22</sup> is demonstrably disingenuous.

### **Australian Programming Requirements**

Australian commercial television licensees are required to provide a minimum level of Australian content, children’s programming and documentaries.

The minimum requirement for Australian content between the hours of 6.00am and midnight is 55%, with all Australian television networks generally exceeding this limit. In 2003, the

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<sup>21</sup> Ibid

<sup>22</sup> Ibid

Seven and Ten networks averaged about 57% Australian content and the Nine network approximately 63%.

The requirement for first release Australian drama is determined by a points allocation system, with the minimum level being 250 points. The Ten Network with 400 points, and Seven with 394 points, far exceeded the minimum level required, while Nine with 299 points also exceeded the required amount. All licensees generally meet their obligations for children's programming and documentaries.

The Nine network is the clear leader in Australia on ratings and revenue share, has highly successful Australian and overseas programming and chooses to schedule more expensive Australian programming well beyond the minimum levels mandated.

All networks more than meet their requirements for relatively expensive Australian drama and Ten and Seven choose over 50% more than required.

The bottom line is that Australian programming is highly popular with the viewers and, despite its cost, the networks benefit from the level of viewing and the consequent generation of advertising revenue.

## 6.2 DIGITAL CONVERSION

### The Objectives of Digital Conversion

The declared objectives of the Government in introducing Digital television included:<sup>23</sup>

- improved technical quality;
- achievement of an appropriate return to the Government for the use of television spectrum;
- achievement of spectrum efficiency gains to ensure new services; and
- increased viewer choice and diversity of product.

The major requirements of the digital television regulatory framework included:

- SDTV to commence from January 1, 2001 in metropolitan areas, and before January 1, 2004 in regional areas;
- Continued simulcasting in analog for at least 8 years; and
- The provision of 1,040 hours per annum of HDTV within 2 years of start up (the period later being extended).

In recognition of the “*high conversion and operating costs of digital*,”<sup>24</sup> broadcasters were given the following assistance and protection:

- 7 MHz channels for the digital transmissions were loaned free to each of the broadcasters for the length of the simulcast;
- A moratorium on new commercial channels until the end of 2006;
- Commercial television broadcasters not allowed to multichannel;
- No other parties allowed to provide multichannel TT services; and
- Datacasting not allowed in any manner that would circumvent moratorium on new commercial television licences.

The introduction of digital television has so far been a failure, with a penetration of less than 5% of homes after three and a half years.

The AANA does not intend to pursue this point here, but refers to the discussion of this area in its submission on multichannelling.

The existing commercial broadcasters were protected for at least 8 years, and will most probably seek a substantially longer period of protection against:

- any new commercial television competitors;
- the provision of any new competitive channels by existing competitors;
- provision of datacasting services including video content of a similar nature; and
- continuance of the existing protection from sports siphoning to Pay TV

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<sup>23</sup> Commonwealth Governments 1998 Regulation Impact Statement

<sup>24</sup> DCITA web site, Broadcasting and Online Regulation, Regulatory Framework

Obviously, each of these protective measures contradict the stated government objective of increasing viewer choice and diversity of product.

### **The Economics of Digital Conversion**

The major point to be made in relation to the economics of digital conversion is the huge anti-competitive benefits given to the networks on the basis of the claimed high costs of digital conversion.

It is therefore necessary to examine the extent of the costs of conversion, recognising the areas of potential increase in costs for digital television conversion as production, presentation, transmission, back office and the consumer.

Early expectations were that digital might increase production costs by perhaps by 10 to 20 per cent, but as the cost world-wide of digital cameras and other production equipment has fallen the increase in costs have been only marginal.

The increased picture quality may have required better set production, make up and wardrobe but these also appear to have proven largely inconsequential.

The presentation area has been converting to digital for a number of years, motivated not by legislation but the advantages of editing, sound, graphics, switching and distribution, which are faster, easier and more efficient in digital.

The size of servers needs to be enlarged particularly for the storage of HDTV and may increase costs by 20%, but server costs, like all other hardware costs, are falling dramatically.

Even where a new studio may need to be built for HDTV, with cameras, studio and control room, this is a one-off expense to be amortised over many programs and years.

The coverage of sport in HDTV will be more expensive with new outside broadcasting vans needing to be built. At the moment HDTV is in its infancy, and as demand grows the outside production companies that provide most of these services to the networks will need to invest in HDTV equipment. However, only a few production companies provide this service for the television networks, gaining efficiencies from collectively covering the different sporting events.

The back office has been a major winner from digital conversion, with increased efficiencies and effectiveness. Though servers have needed to be enlarged, the increased efficiencies from having programming in digital, the ease of storage, copying, retrieving and forwarding, as for all digital material on computers, is substantial. In the US some networks are centralising certain functions, reducing duplication in areas such as programming presentation, programming distribution, monitoring and master control, sales support, traffic and scheduling.

The digital revolution that has hit the operations of all other businesses has now reached the television industry, introducing new economies of scale, greater control of inventory, improved sales and traffic management and allowing reductions in staff and related costs.

In Australia, the Seven Network has built a centralised presentation centre in Melbourne from which it controls programming distribution and transmission around Australia.

The television networks have been installing digital equipment for distribution by cable, microwave or satellite to transmitters around Australia. The major area of expense is providing digital transmitters and aerials. This is fairly minor for the capital city stations that largely have one transmitter and perhaps a couple of repeaters to cover the metropolitan areas. The regional broadcasters, who cover much larger geographic areas, need more transmitters and repeaters.

The Broadcasting Financial Results from the ABA are derived from financial information as provided by the television licensees. Unfortunately, the Assets category is not split into types, but property, plant and equipment are included with intangible assets and investments. It is not possible from this to identify the investment in digital equipment. However, the ABA does itemise depreciation under expenses and from this it is possible to calculate some indications of possible equipment costs for the networks.

Most television networks write off plant equipment over the length of the useful life of between 3 and 10 years, averaging about 20% per year. It can be argued that that transmission equipment using MPEG 2 has a longer life, but with the obsolescence period shortening on the basis of rapid new product development and the introduction of MPEG-4 and the MS Media 9 Series Player (SMPTE VC-9), a shorter period could be used.

**Commercial Television Expenditure on Depreciation and Amortisation \$M**

Stations	No	1999/00	2000/01	2001/02	2002/03
Australia	48	68.9	67.6	70.9	82.4
Metro	15	42.6	42.4	44.6	53.7
Regional	33	26.4	25.2	26.2	28.7

Installation of digital transmission equipment occurred from the middle of 2000 for commencement of broadcasting on January 1, 2001 in the metro markets, resulting in digital capital expenditure occurring in the 2000/01 financial year.

According to the ABA returns, depreciation actually decreased in 2000/01 from the previous year, and in the first full year increased by approximately \$3 million.

In the metro markets, depreciation increased by \$2 million in 2001/02 and if a 10% depreciation is applied, indicates expenditure by metro stations of about \$20 million on all plant and equipment, including digital.

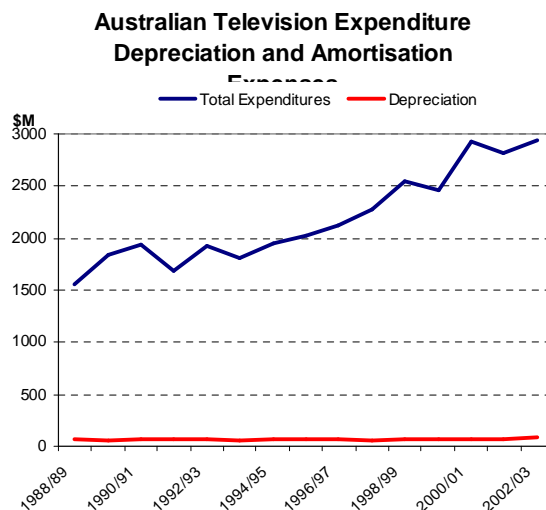
An examination of the markets by cities shows that the only city that recorded increased depreciation in 2001/02 was Melbourne, while that of Sydney actually fell alongside those of the others remaining constant. The increase in Melbourne in that year was due to the commissioning of the new state-of-the-art Seven studios and national digital presentation and playout facilities.

The Seven Annual Reports to the stock market show a growth in capital expenditure on plant and equipment of \$60m in 2001, \$53m in 2002 and \$33m in 2003. This will have included some capital expenditure in non television assets of Seven. Both the Seven and TEN Annual reports show the depreciation rate on plant and equipment to be an average of about 20%.

The substantial increase in metro depreciation in 2002/03 of \$9 million was again largely due to Melbourne with \$5m, and Sydney \$3.4m.

The total capital investment by the 15 metro stations in Australia over the period 1999/00 to 2002/03 was a maximum of \$100 million, and at 20% depreciation far less.

Depreciation's total share of metro television expenses was 2.8% in 2002/03 and the annual cost of depreciation for new digital equipment at a maximum of \$11 million was only .03% of total expenses.



The regional markets do not have to provide a digital service until 2004, although a number of regional markets already have the service running.

Depreciation has increased in the regional markets by only \$2.6 million in 2002/03.

However, this may not be related to digital conversion at all as the Government is providing \$260 million to regional commercial broadcasters to assist with the digital conversion process.

The amortised costs involved with digital conversion are so low that it is easy to see how it can be argued that the savings in efficiency and staff can actually outweigh the costs involved.

The Nine response to the Multichannelling issues paper made this point:

*"The development of digital technology had enabled television to be broadcast in a digital format. This has enabled broadcasters to deliver their services more efficiently and more effectively, bringing better quality and a wider variety of services."*<sup>25</sup>

Unfortunately, so far there has been no increase in the variety of services as the Nine network is the main opponent of increased services and a major beneficiary of the increased efficiency.

The end result is that capital city commercial television did not need special protection on the basis of the costs of digital conversion, and that any marginal increases in costs are no different to any other industry needing to upgrade technology and operating systems as a normal business expense.

<sup>25</sup> Nine Network Response To DCITA Issues Paper, Provision of Services Other Than Simulcasting by Free To Air Broadcasters on Digital Spectrum, August 2004

### 6.3 FINANCIAL VIABILITY

The commercial television networks acknowledge that:

*“it has been long standing bipartisan policy that free to air television should deliver certain public benefits and to achieve this it has been heavily regulated to ensure these benefits are delivered.”<sup>26</sup>*

This would infer that the networks should be guaranteed some financial capacity to ensure these “certain public benefits” are provided.

In the past, viability was a licence criterion. But when the Broadcasting Services Act 1992 was introduced, the objects of the BSA purposely did not include any requirement for the viability of the industry—program program suppliers or licensees.

However, the industry has continued to convince Governments that the guarantee of viability not only remains an absolute necessity, but that the networks should be guaranteed protection to make the maximum possible profit.

The networks argue that any regulations that could possibly reduce the maximum profitability should be compensated by a moratorium against competition.

It is therefore established that while the networks produce more Australian content than is required by regulations, they have been reducing the proportion of Australian programming expenditure to increase profitability, and that digital conversion is such a small cost as to count as inconsequential.

Further requirements such as regulations concerning advertising contents and some time constraints are no different to the health, safety, environmental or technical regulations encountered by most other industries where they are regarded as just part of the normal costs of doing business.

It is therefore important to examine the financial performance of the industry to determine the cost of this protection and the capacity to provide additional channels.

The basic economics of the Australian commercial television industry include:

#### Population

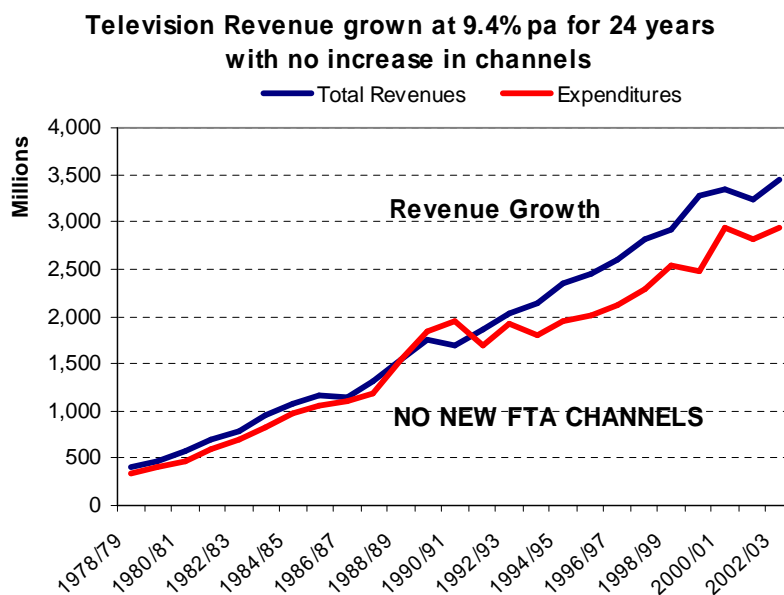
- The Australian population has doubled from 9.5 million in 1956 when television commenced to over 20 million people in 2004;
- The number of stations in the 5 capital cities has not increased from three per market for 40 years;
- The number of stations in regional markets has reduced since 1979 under aggregation, to a current maximum of 3 per market except in Victoria. There are now 2 fewer stations in Australia than in 1979;

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<sup>26</sup> Ibid

## Revenue and Expenditures

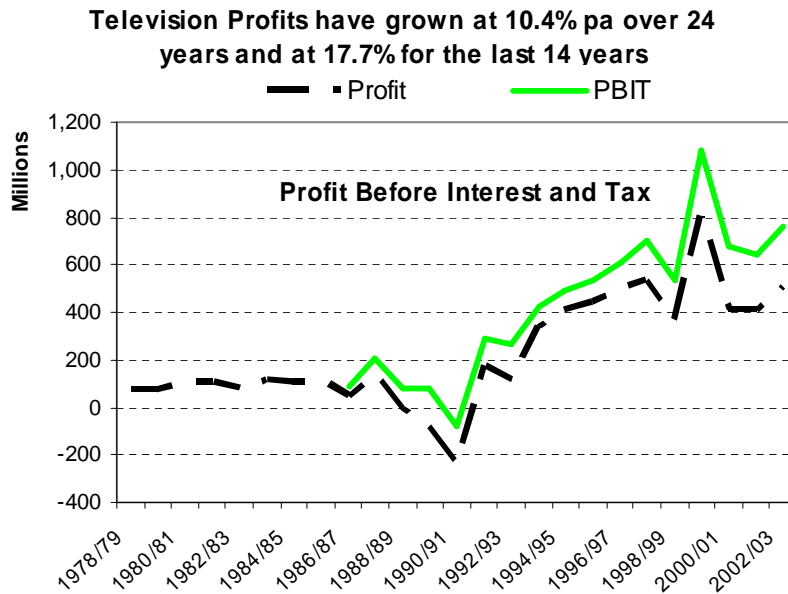
- Revenue has grown in the 24 years since 1978/79 by 9.4% per annum, from \$400 million to \$3.5 billion.



- In the 14 years since 1988/89, revenue has grown at 5.9% per annum, from \$1.5 billion to \$3.5 billion;
- Expenses (not including interest) have grown at 4.4% per annum over the same period, to \$2.689 million;
- The major expenses to increase have been salaries and wages, at 5.3% per annum (excluding sales commissions and licence fees linked to revenue), and intra group management fees and affiliation fees payable by regional licensees; and
- Programming and depreciation for digital conversion have had the lowest rates of growth, at less than 2%, with negative real rates of growth.

## Profits

- Profits (PBIT) have grown by 17.4% per annum, from \$80 million in 1988/89 to \$761 million in 2002/03;
- Over the last 14 years, the only year in which a PBIT loss was incurred was in the recession of 1990/91;



- Over the last 24 years since 1979, losses have only incurred in four years and three were between 1989 and 1991, when new owners of the networks incurred excessive expenses;
- The average PBIT for the last 10 years has been \$645 million;
- 2002/03 was the second highest profit in history, at \$761 million, and 2003/04 is anticipated to be significantly higher again; and
- The commercial television networks share price PE ratios are above the market and sector averages, reflecting an expectation of above average performance into the future.

## 7. ADVERTISING EFFECT

Advertisers provide 85% of the \$3 billion revenue of Australia's 48 commercial television stations, with nearly 80% of that advertising placed by advertising agencies.

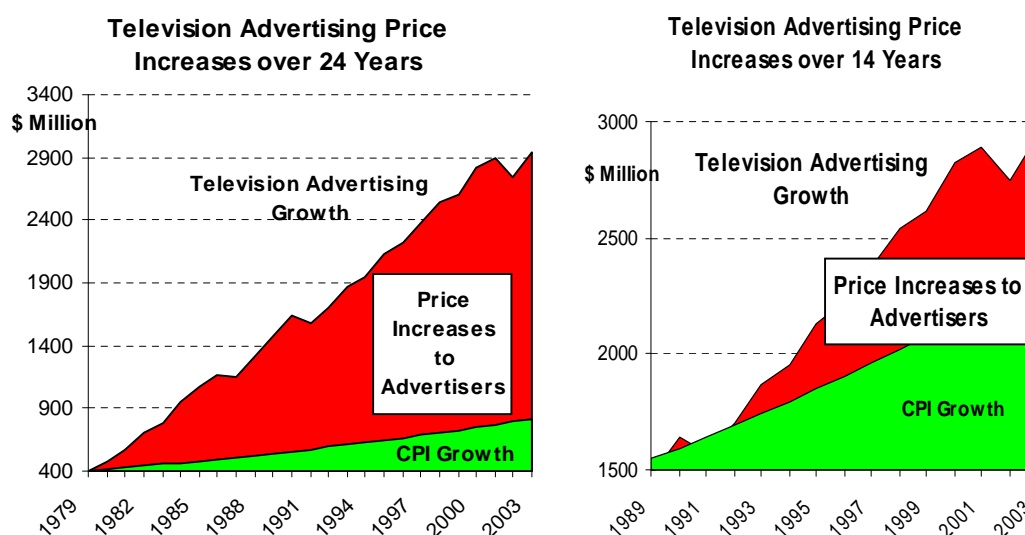
The AANA is the peak industry body directly representing the majority of the largest national advertisers and generally the advertising and marketing interests of a diverse range of manufacturing and service industries.

The television market is determined by the laws of supply and demand. The inventory of advertising time is fixed because of the limits of only three networks and a basic 13 minutes per hour (less station promotion time). Because inventory (supply) is fixed, increases in demand result in increases in the price paid by advertisers.

The average rate of growth of television advertising over the last 24 years has been 9.4%, while inflation has averaged only 3%. The growth in advertising revenue beyond the rate of CPI increase has been funded by increased costs to advertisers, and ultimately to their customers.

The graphs illustrate the huge growth in revenue attributable to increased advertising prices caused by the artificial restriction in supply of advertising from only having three commercial "free to air" networks.

These increases in prices are directly charged onto consumers in increased costs of products and services. "Free To Air" television is not free; it is paid for by consumers.



One of the drivers of demand had been a small annual growth in the population, averaging 1.2%, adding to inflationary pressures.

However, the number of people viewing free to air television has fallen by about 10% over the last 8 years since the introduction of Pay TV, growth of the internet and rising uptake of DVD equipment.

Further, the take up of Pay TV is in higher income households leaving free to air with the lower demographics.

The increased advertising prices combined with falling viewing levels means advertisers are **paying more for less; thus the public are paying more for less.**

The effects of demand exceeding supply for television advertising time is well illustrated each year during negotiations for the ad rates for the following year.

In most years, the networks ask for a rate increase of between five and ten per cent averaging out in reality at about 5%. This net result may be achieved by direct price increases or through yield management. This is somewhat similar to airlines trying to optimise the yield achieved on any flight. The networks are free to reduce or drop discounts, reduce the number of bonus spots or gazump booked clients for higher paying customers.

Over the last year, the networks have been achieving double-digit rate increases and are currently asking for price increases of between 10% and 20% for 2005.

Harold Mitchell, Chairman of Harold Mitchell & Partners, one of Australia's largest buyers of advertising predicts that *"ad spending will jump by 10 per cent in the June 2005 half and by 11% in the December half."*<sup>27</sup>

All of this increased ad spending is from higher prices paid by advertisers.

In a recent article in "The Australian," AANA Chairman Ian Alwill stated:

*"Australia's television's big three appear intent on making a case for the fourth network they don't want."*<sup>28</sup>

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<sup>27</sup> Neil Shoebridge, TV Ad boom fortifies networks, The Australian Financial Review, October 1, 2004.

<sup>28</sup> Simon Canning, Rate Rise feeds case for new TV player, The Australian, October 7, 2004

## 8. RADIO INDUSTRY COMPARISON

The Australian population has increased by an average 1.8% per annum since 1947 and the number of commercial radio stations has increased by 1.7% per annum<sup>29</sup>.

Most of the increase in stations incurred since the introduction of commercial FM radio in 1979, with the number of FM stations having increased by 32.1% since that time, and the number of AM stations by 1.9%.

Commercial radio revenue increased by an average of 8.05% per annum between 1978/79 and 2001/02, against the 9.5% average of television.

The increase in the number of radio stations has led to increased supply of advertising spots and a reduction in the unit price of radio. As radio has become more affordable to additional advertisers, the growth in demand has compensated for the price decline (or reduction in the rate of increase), with radio maintaining a similar rate of growth to other media including television and generally maintaining its share of the advertising market.

As Steve Allen Of Fusion strategy has been quoted as saying: “...*new players have drawn more attention to the medium, and with it new advertisers.*”<sup>30</sup>

In the five year period 1996/97 to 2001/02, PBIT for the radio industry has grown from \$100.0 million to \$125.9 million.

In that period the number of stations increased by 65 stations from 183 to 248, or by over a third. The number of profitable stations (including provision for interest) increased from 122 to 157, generating a total profit of \$163 million.

The number of unprofitable stations increased from 61 to 91, with total losses of \$53 million mostly due to a number of new stations returning losses in their early years of operation.

In the same period of 1996/97 to 2001/2002, the number of regional television stations has marginally reduced.

The number of stations making profits (after interest) increased from 40 to 42, generating \$422 million, and the number making a loss increased by 2 to 6 for a negative total of \$10.9 million. The average profitable radio station makes just over \$1 million while the average profitable television station makes over \$10 million.

The Government has opened up the radio industry to foreign competition and greatly increased the number of stations providing more services to the Australian people.

This was despite the fact that many radio stations were already operating at a loss.

Yet television, with high profitability and very little losses, is protected from competition—foreign and local—with no new metro networks in 40 years.

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<sup>29</sup> Australian Broadcasting Authority, The Commercial Radio Industry 1978-79 to 2001-02, Nov 2003

<sup>30</sup> Simon Canning, Rate Rise feeds case for new TV player, The Australian, October 7, 2004

## 9. THE FOURTH NETWORK

In 1979, the radio industry underwent a revolution with the introduction of commercial FM radio and two new commercial stations in Sydney and Melbourne.

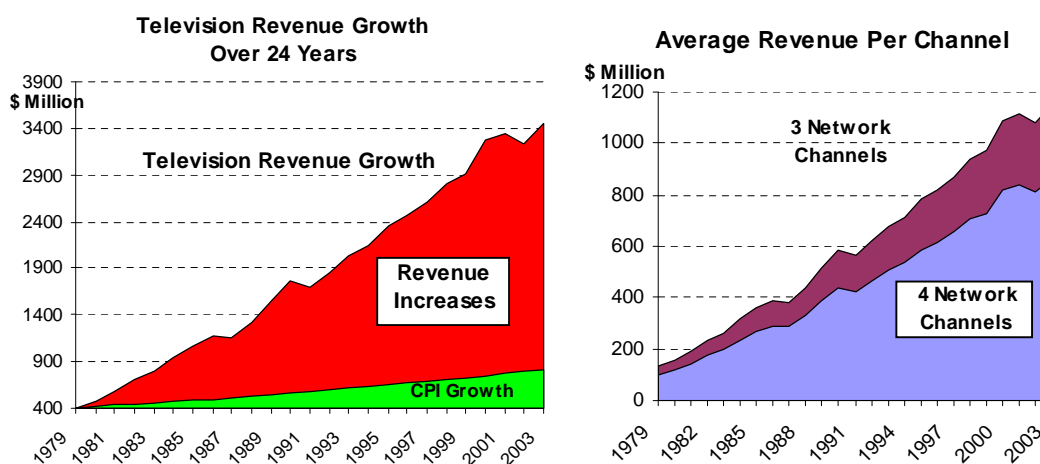
The revenue of the Australian radio industry in 1979 was \$130 million and the Australian television market \$403 million.

Over the next 25 years, television revenue grew at 9.4%, three times the rate of inflation. If revenue had grown at the rate of inflation then revenue would have doubled to reach \$819 million in 2002/03. The actual revenue in 2002/03 was \$3,451, a difference of over \$2600 million.

Advertising price increases accounted for \$2.1 billion or 85% of this growth, with the remaining revenue growth of \$500 million including program sales, affiliation fees and other revenue.

The average revenue for a hypothetical national network in 1979 was \$134 million, which would have grown at CPI to \$273 million by 2003.

The revenue above CPI growth of \$2.6 billion could have supported many new channels of similar size.



Another approach in assessing the impact of a fourth network is to divide total revenues over 4 networks rather than 3.

The average revenue today for a 3 network market would be \$1.1 billion per network, but if 4 networks had commenced in 1979 then the average size of networks would have been \$860 million in 2003. This would have made the average network a similar size by revenue to the Ten Network.

The networks do not evenly split the revenue market with one network receiving a premium share for being the top rating station and the lowest rating station normally having a reduced share. In reality, the new entrant would have had a low share of revenue in the early years and struggled to gain ratings and revenue. This is what happened with the last entrant, the Ten Network, which has only this year finally earned the second highest revenue share.

However, Ten carved out a niche market in recent years by targeting the 18-39 year olds, making it the highest profit margin-to-revenue network, and the second most profitable network in 2002/03.

The three commercial networks have announced their financial results for the 2003/04 year.

		Revenue (\$M)		EBIT (\$M)	
Seven	5 metro +1 reg	\$815.9	+4.4%	\$160.3	+9.3%
Nine	3 metro	\$862.8	+12.8%	\$261.5	+30%
TEN	5 metro	\$756.1	+14.4%	\$272.1*	+29.3%
Total		\$2434.8		\$693.9	

\*Ten EBITDA includes about \$16m in depreciation.

The EBIT for 13 capital city stations (and one regional) is nearly \$680 million for 2003/04. The increase in EBIT for the year was \$120 million, or to the total budget for the SBS national network.

Nine reported increases in operating costs of 5.2% (not including selling and licence fees) against revenue increases of 30%. Seven maintained expenses increases at only 2.7% and Ten at 7.5%. The operating margins for Ten at 34%, Nine 30% and Seven 20% are very high in comparison to most companies in Australia.

With the networks asking for price increase for 2004/05 of 10% to 20%, and costs increases being kept to a minimum, the EBIT margin may grow to nearly \$1 billion in 2004/05—even before adding in the profits of two smaller metro cities and regional networks.

With the inventory of television advertising time fixed, the increases in revenues and profits of hundreds of millions of dollars are being paid for by advertisers and the public through increased costs.

An increase in the number of commercial television channels would increase the inventory available to advertisers and reduce prices (or the rate of price rises).

Dawn Airey commented on her experience of the results of competition in commercial FTA television in the UK:

*“I played a part in the launch of Britain’s fifth terrestrial television network in 1997. Not only are the two commercial broadcasters that were there before Channel Five still in business; the launch of a new competitor forced them to pick up their game. So even in an age of 400 channels, ITV1 and Channel Four are still among the most-watched broadcasters in the country.”<sup>31</sup>*

As a recent editorial in The Australian claimed *“and bizarrely, nobody is allowed to upset the existing owners with a new TV broadcaster to meet a market need. Good for their profits. Bad for competition, consumer choice and diversity of debate.”<sup>32</sup>*

<sup>31</sup> Ibid

<sup>32</sup> Editorial, The Australian, 15 October 2004

## 10. DEMAND FOR MORE CHANNELS

The demand by consumers for more choice in products and services—and in particular entertainment, communications and information choices—is so self evident that there is need for only a summary to be included in this submission.

The AANA submission to DCITA on multichannelling looked at the demand for multichannel services in the US, the UK and Australia, together with their economic models.

It showed that in the US well over 90% of homes not only have multichannelling but are prepared to pay for a wide range of channels. Pay TV, as we know it, is provided by cable to over 70% of homes, with another 20% taking delivery by satellite, SMATV or MMDS systems. Despite having 6 major commercial FTA networks and a multiplicity of local FTA stations, most homes in the US treat Pay TV as a utility like electricity, water or the phone.

In the UK, multichannelling has been a huge success with a penetration of 60%. Sky now directly reaches over 7 million homes by digital satellite with a penetration rate of 28%. Pay TV subscribers, including cable with 2.5 million homes, total 9.5 million or nearly 40% of the homes in the UK.

However, the most extraordinary success has been achieved by *Freeview* which offers at least 30 digital terrestrial channels including all the BBC channels and some Sky Channels.

*Freeview* has grown over the last two years to 4.1 million households at June 2004, and is continuing to grow at over 150,000 households or 4% per month. The number of homes taking *Freeview* increased by 12 per cent in the June quarter to produce a market penetration rate of 17%.

Largely due to the success of *Freeview* digital TV, market penetration in the UK is 55% and growing in a manner allowing the Government to consider an analogue switch-off date. With “free to air” digital penetration in Australia at only about 6%, the Government has a major problem in achieving a switch-over and thereby being able to free up and sell off the highly valuable spectrum. The UK has demonstrated that digital “free to air” multichannelling is the only feasible way of getting households to switch over to digital.

In Australia, Pay TV services have been in operation since 1995, reaching an apparent plateau of 1.5 million homes, or just over 20% market penetration, for the last two years. However, with churn averaging over 20% during most of the last 8 years, nearly 50% of Australian homes with the capacity to receive Pay TV have actually subscribed at some time to the service.

This demonstrates that half the households were prepared to sample paying for the service and hence the proportion prepared to take up a free digital “free to air” service could be expected to be well above that level.

The Seven Network undertook consumer research in Australia for their submission on multichannelling to DCITA in 2004 and conclusions included<sup>33</sup>:

- 91% of people support free multichannelling;
- 86% support introduction of multichannelling;
- 59% of people say they would pay something to receive multichannel services;
- 57% of viewers think there is not enough variety on “free to air” television; and
- More content with greater choice is the most compelling reason to support multichannelling

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<sup>33</sup> Seven Network Submission, August 2004 to the DCITA Multichannelling Review