

(1)  
PRIME MINISTER

LWT


The chairman of LWT, Christopher Bland, has asked me to let you have the case he has prepared against ITV tendering and for an alternative system.

The alternative would effectively convert the present fixed term, renewable leases into long leasehold on payment of a consideration to the Exchequer of £500million over 10 years - reflecting the windfall gain to shareholders from the new security of franchise.

Mr Bland, who is often mentioned for bigger jobs in broadcasting, would like to meet you in the autumn to discuss their proposals and other broadcasting issues.

Do you want to meet him?

With the Home Sec

Mr 

BERNARD INGHAM

25 July 1988

THE 1992 FRANCHISE PROCESS

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March 1988

## I. SUMMARY

### THE CASE AGAINST TENDERING

1. The introduction of tendering is unnecessary: the major changes within ITV which the Government wants to introduce are already under way
2. The prospect of tendering - even in 4½ years time - is commercially destabilising
3. The outcome of the tendering process is entirely unpredictable; sound commercial judgements about appropriate tendering levels are almost impossible to make
4. A tendering system is likely to discriminate unfairly against the existing ITV companies, unless the rules are changed now
5. Programmes are impossible to specify with the precision required for a satisfactory tendering process
6. No other broadcasting system uses tendering to allocate broadcasting franchises

### THE ALTERNATIVE

1. A five-yearly formal public review of the performance of each franchise holder, against clearly identified and objective criteria, should be established from 1992 onwards, beginning in that year
2. Failure to perform should be penalised by compulsory divestment
3. Ownership of television companies should in future only be controlled through monopolies and mergers legislation and the rules of The Stock Exchange
4. The levy system should continue: its level should be reviewed each year, although its basis should be fixed for five year periods
5. A charge of £500 million should be made for changing the basis of the ITV franchises and giving the existing companies significantly increased security of tenure



## II. THE CASE AGAINST TENDERING

### 1. The Introduction Of Tendering Is Unnecessary: The Major Changes Within ITV Which The Government Wants To Introduce Are Already Under Way.

- . Increased competition for the supply of advertising time will accelerate in the early nineties through additional minutage - from BSB, from Astra, and possibly from the 5th and 6th Channels. The cost per advertising minute will fall.
- . Tendering doesn't increase competition within the system, but only, and for a moment, for the right to hold the franchise for a specified period.
- . Increased access to the system at the programme-making level is already under way, for both independents and regional companies.
- . Industrial relations within ITV are changing rapidly, as a direct consequence of
  - independent access
  - successful management services organised by Thames, Ulster, Tyne Tees and TV-am in response to strikes.

By the end of 1988 the ITV work-force will have been substantially reduced, major productivity gains will have been achieved, and the National Agreement will have a significantly reduced importance.

### 2. The Prospect Of Tendering - Even In 4½ Years Time - Is Commercially Destabilising

- . Each of the 5 major ITV companies, and several of the others, is a PLC with a wide range of institutional and individual shareholders. All, except Granada, depend almost entirely on ITV for their commercial existence.
- . The export record of ITV is excellent, in spite of the strength of the American producers. The UK, including the BBC, is the world's second largest provider of international programming. ITV's total exports in 1986 were £65 million.



- . Nevertheless, the ITV companies are small in international terms. The market capitalisation of the four 'pure' television companies' (Thames, Central, LWT, Yorkshire) totalled £511 million on February 29th. Warner Brothers, one of half-a-dozen major US programme makers, is alone capitalised at approximately £1,700 million.
- . The ability of the ITV companies to make a commercial response to the prospect of tendering is limited. In particular
  - they are unable to merge with or be taken over by a larger partner
  - until last autumn they were not allowed to make significant acquisitions themselves: their low PE ratios (averaging 10.3 on 2.3.88, compared with a leisure average of 16.2 and a consumer group average of 14.9) now rule out that possibility
  - their public service obligations continue for another 4½ years

3. The Outcome Of The Tendering Process Is Entirely Unpredictable; Sound Commercial Judgements About Appropriate Tendering Levels Are Almost Impossible To Make

- . Assessing the appropriate tendering level requires an ability to assess
  - A. future operating costs
  - B. future capital requirements
  - C. future revenue and cash flows

A & B are relatively easy. C is notoriously difficult under existing conditions; with competition beginning to intensify by the end of 1992 but not yet at maximum levels, revenue will be almost impossible to predict with the required degree of accuracy.

- . The potential competition (the Atlantic Richfield, Conrad Black factor) from uncommercial tenders is hard to gauge and difficult to counter. Large international groups have always been fascinated by the media, and, if they wish, can afford to tender at levels which cannot be matched by companies wholly dependent on television for their livelihood.



4. A Tendering System Is Likely To Discriminate Unfairly Against The Existing ITV Companies, Unless The Rules Are Changed Now

- . Tenderers will presumably not be required to own studios or employ programme-makers, and will rely entirely or extensively on acquisition, and, if allowed, on low-cost imported programming.
- . The existing companies are contractually prevented from adopting this approach for 4½ years - unless the IBA rules are changed now. While extensive dependence on commissioning and imports would maximise short-term revenues, it would have a long-term and adverse impact on programme-making ability.

5. Programmes Are Impossible To Specify With The Precision Required For A Satisfactory Tendering Process

- . Tendering is a satisfactory process provided that a detailed and precise specification can be provided; only in such circumstances (construction contracts are the obvious example) can competing tenders be satisfactorily compared.
- . Television programmes cannot be specified with the required degree of precision. For example, Weekend World ("a one-hour current affairs programme addressing the political issues of the week") costs approximately £75,000 per week to make. A programme apparently meeting a similar specification could be made for a quarter the cost - without research, ENG inserts, three cameras etc.
- . LWT produced a detailed seven-page specification for tenders for its local news service (10½ minutes per week). It selected the fourth lowest bid, because experience and quality requirements outweighed the purely financial considerations, although these were not ignored.

6. No Other Broadcasting System Uses Tendering To Allocate Broadcasting Franchises

- . This is not an argument against tendering: it only underlines the difficulties of assessing, in the absence of international comparisons, the impact of tendering on ITV and on UK broadcasting as a whole.
- . One reason why tendering has not been adopted elsewhere in Europe is that it is a system that has to allow all EEC companies to compete on equal terms. At present no UK broadcaster can own other than minority stakes in other EEC television companies - in practise only in France have minority stakes become available.



### III. THE ALTERNATIVE

If tendering is considered an unsatisfactory system, what alternative approach can meet the objectives of ensuring

- (i) regular review, on an objective and transparent basis of, the franchise holder's performance, with the sanction of termination
- (ii) expansion of the ability to own and control television companies
- (iii) stimulus to efficiency
- (iv) returns to the Exchequer at satisfactory levels

Against a background of increasing competition from new channels, and a substantial amount of programme production by independents in the early nineties, these objectives could be achieved by the approach summarised below

1. A Five-Yearly Formal Public Review Of The Performance Of Each Franchise Holder, Against Clearly Identified And Objective Criteria, Should Be Established From 1992 Onwards, Beginning In That Year

Each franchise holder's performance should be formally and publicly reviewed every five years against established, clearly identified and objective performance criteria. These criteria should be quantified where possible, under such headings as

- network programme output by category, hours and expenditure
- local programme output by category, hours and expenditure
- compliance with the rules on the portrayal of violence
- compliance with the rules on taste and decency
- compliance with Family Viewing Policy
- compliance with the rules on accuracy and impartiality
- compliance with the rules about advertising
- technical quality



. Subjective assessments of programme quality, or shareholding structure, or the comparative appeal of the existing franchise holder's performance with the promises of rivals, would not be relevant.

. The first review should be held in January-July 1992, against performance criteria established by the end of 1990.

2. Failure To Perform Should Be Penalised By Compulsory Divestment

. Any television company failing to perform should be forced to divest itself of its franchise through sale within six months. Each television company would require a holding company/television subsidiary structure to make this possible.

. Failure to perform should be clearly defined; five breaches of performance criteria during the five years should be considered enough to force divestment.

. There should be a formal appeal against the review/divestment process.

3. Ownership Of Television Companies Should In Future Only Be Controlled Through Monopolies And Mergers Legislation And The Rules Of The Stock Exchange

. Control of quoted and unquoted television companies should in future be allowed to change hands in the same way as any other company

. Change of control should be subject only to the limitations imposed by

- monopolies and mergers legislation, and the Government's policy on the desirability of newspaper groups owning or being owned by television companies.
- Stock Exchange regulations.
- Government policy on non-UK or non-EEC ownership.



Under this system television companies would be free to acquire as well as be acquired, subject to the rules set out above.

The regulatory authority should have the right to approve appointments to the Boards of television companies.

4. The Levy System Should Continue: Its Level Should Be Reviewed Each Year, Although Its Basis Should Be Fixed For Five Year Periods

In return for increased commercial certainty (although reduced security of tenure/ownership) provided by this system, a monopoly rent in the form of a Levy should continue.

The basis of the Levy (revenue based, profits based or a mixture of both) should be fixed for five year periods. The levy percentage or rate should be reviewed annually.

As competition for advertising revenue increases and the monopoly erodes, it would seem likely that by the mid nineties the requirement for a Levy will have significantly reduced or disappeared.

5. A Charge Of £500 Million Should Be Made For Changing The Basis Of The ITV Franchises And Giving The Existing Companies Significantly Increased Security Of Tenure

The proposals outlined above would effectively change the basis of the ITV franchises from the present fixed-term, short leasehold basis, renewable under certain circumstances, to a long leasehold (with an annual levy), transferable through acquisition or compulsory divestment.

The share prices of the ITV companies reflect the insecurity of the franchise and their invulnerability to takeover, and as a result ITV company P.E.s are substantially lower than Stock Market averages.

A charge of £500 million, reflecting the gain that would otherwise accrue to shareholders, should be made by the Home Office and apportioned between the 15 ITV companies. It should be payable through an increase in the rental over, say, a 10 year period. The basis for the calculation is set out in Exhibit I following this page.



EXHIBIT I

A POSSIBLE BASIS FOR  
CHARGING ITV COMPANIES  
FOR CHANGING THE BASIS  
OF THE ITV FRANCHISE

. The market capitalisation of the quoted "pure" ITV companies (Anglia, Border, Central, Grampian, HTV, LWT, Scottish, TVS, TV-am, TSW, Thames, Tyne-Tees, Ulster, Yorkshire) on May 23rd was £977 million, with Granada Television accounting for a further estimated (pro-rata to LWT) £121 million. Channel is not quoted and can be ignored for the purpose of this calculation.

. ITV has, therefore, a total stock market valuation of around £1,098 million.

. The average P.E.s of the companies (excluding Anglia, high in anticipation of imminent results) was 8.7, compared with an FT 500 P.E. of 12.8.

. If it is assumed that the difference is accounted for largely by franchise uncertainty, then a charge for removing that uncertainty of about £500 million to the industry as a whole would be appropriate.

. It should be emphasised that this is a simple - and perhaps simplistic - approach, but it is doubtful whether a more elaborate calculation would necessarily produce a better result.