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"Customer focus in the entertainment and communications marketplace"

It is a pleasure to be here again at the IEA's annual examination of the health of broadcasting.

I'm grateful to the IEA for inviting me and for the many years it has spent championing the cause of free enterprise.

We have already heard one diagnosis of how broadcasting looks from Ed Richards this morning. And I think it's reasonable to say that it was tinted with pessimism and worry about the future, in particular the future of Public Service Broadcasting.

From where I stand, that pessimism is misplaced. I see a competitive and dynamic marketplace which is delivering real benefits for consumers: more choice, more innovation, and more value.

In aggregate, we have a healthy broadcasting sector. So we should not fret that, as in every business sector, development and progress will sometimes mean that some organisations and business models are flourishing at the expense of others.

That is quite natural – indeed it is positively a good thing - because the beneficiaries of this evolution are the most important people in broadcasting – viewers. And despite the pessimists, viewers are able to see more and more public service content.

Like this... [showreel]

I am sure you will have noted the logos. What you have just seen is a sample of high-quality, original, UK-produced material from channels on the Sky platform:

from the History Channel, Discovery, Nickelodeon, UKTV, National Geographic and some of our own channels, including Sky One and Sky Arts.

Some of these channels are even available on Virgin.

None of this content was made at the behest of Ofcom or funded by the taxpayer. It exists because there is a demand for this kind of broadcasting in the UK and a willingness by millions of people to pay to have access to it.

Sometimes broadcasting commentators and regulators talk about subscription television as if it were a regrettable industry feature. Not surprisingly, I don't agree.

At a time when other models of funding quality content are beginning to show signs of strain, direct payment TV, mainly subscription TV, is going from strength to strength.

The key to this strength lies in its accountability. Subscription TV is directly, even brutally, accountable to its viewers. If you don't like it, you just cancel it.

Because of that accountability, pay TV channel providers and retailers are in a daily battle to make sure that what they offer is really what people want.

That drives spend on quality content of all kinds and requires flexibility in the way content is packaged and presented to people.

Now think about content funded wholly by advertising. Of course this model continues to produce some great television – and it is increasingly apparent that this is because such broadcasters see a commercial motive for doing so, and that much of the subsidy that was pumped into the model over many years was not really needed.

That said, television which is funded wholly by advertising will tend to be geared towards maximising reach, and so the model is drawn towards middle of the road programming with broad but often slightly shallow appeal.

And this inevitably means that interests that are a little off-centre will tend to go under-served.

Yes, we will get the very biggest entertainment formats which draw the 10m audiences, but after that, it all feels the same.

Now outside of the subscription world, the tendency towards lack of diversity from the wholly ad-funded channels is meant to be compensated for by the BBC.

And while, in principle, the BBC can respond to a more diverse range of demands, in practice the fact that the licence fee is a compulsory tax means that accountability remains limited.

No viewer can send the BBC a clear message of dissatisfaction by opting out of the licence fee (unless they are willing to go to jail), nor can they choose to pay for only a selection of the content on offer. So accountability is inevitably muted.

The success of subscription TV is built instead on genuine choice and on diversity.

Rather than a flight from quality, the sector is contributing to quality and providing niche audiences with content they love – anything from extreme sports to domestic cookery, from opera to death metal, from Islamic sermons to children's stories.

And that in turn is driving more subscriptions. Sky has a little under 9m subscribers today and is on track for its public target of 10 million by 2010.

And I don't think that anyone should assume that 10 million is the limit of our ambitions, a magic point at which we will take a breather.

Anyone who is aware of the US market will know that pay-TV penetration there is over 80%. That is not a formal target for Sky or even for the pay sector of the industry in aggregate.

But nor do we agree with the lazy dismissal of people who simply say that the UK will never be like that. Just have a look at the value that is being offered in the subscription world today.

These days, for £16 per month, Sky customers can enjoy an extensive TV package, a quality broadband connection, a highly competitive voice package and also enjoy the functionality of Sky+. That is more value – for less money – than we have ever provided before.

Critically, a broadband connection is increasingly regarded as an essential component of modern life. Certainly it is essential if you are to get full value for your BBC licence fee – the iPlayer is not a lot of use to you if you do not have a decent broadband connection.

But many people today are paying £15 to £20 for their broadband connection, which means they can join Sky, enjoy a superior TV service and still save money by choosing Sky Broadband and Sky Talk.

For these people, coming to Sky is now cheaper than sticking with Freeview.

And our consistent experience is that once people sample what our platform has to offer, they trade up to get access to more channels, to premium channels and to additional services like HD and Multiroom – and then they stay with us, as demonstrated by our churn rate, at 10.5%, which is now at its lowest for four years.

And – despite all the hype – we have added 2.2 million net new subscribers since Freeview launched, and our ARPU is now at a record £424 – up £40 from a year ago.

These factors combined lead to year on year revenue growth of 10%, despite a difficult consumer environment.

Increasing aggregate revenue means more money to spend on more and better content – a virtuous circle, if you will, of customer satisfaction, driving renewed and increased subscriptions, in turn providing the resource to invest in more quality content.

And so on, and so on.

This bright future is in contrast to the position of so-called free-to-air broadcasters, who depend entirely on either advertising or the licence fee.

To see the basic problem, think about the pool of money available to fund quality content.

It is difficult to imagine any long-term real growth in TV advertising as internet advertising – search and display – continue to expand, as PVRs become more pervasive, and as on-demand viewing with fewer ads becomes more common. It's also an increasingly bizarre spectacle to see ITV encouraging their viewers online when the advertising rates there are lower.

A real terms structural decline in TV advertising revenue is more probable, even before we start to worry about short term economic issues.

The licence fee is also unlikely to exhibit any further real growth. Although I would be the last person to underestimate the BBC's lobbying power, the steady decline in the consumption of its services as viewers respond to the choice and diversity provided by the broader market, must make any substantial above-inflation increase in the licence fee politically unlikely.

Despite these revenue headwinds, we continue to see the PSB in-crowd trying to squeeze more from the old model. But the strains are starting to show.

One sign of systemic financial stress is the recent premium rate scandals. These are the canary in the mine of traditional PSB decline.

Falling revenues, a perverse determination to eschew the success of direct payment, and muted accountability mean that the PSBs have become increasingly desperate for new and more marginal sources of cash – and then got themselves into hot water in the process.

In the meantime, costs are rising as there is greater competition for talent, for formats, for acquired programming, and for sports rights. All this represents a further squeeze on funds available for PSB content.

And I'm afraid things are only going to get worse as HD increasingly becomes the new video standard that all of us feel we deserve.

Why is that another problem?

It's a problem for the determinedly FTA crowd because moving to HD is expensive, and there is no other revenue to compensate. At best HD looks like a cost burden that soaks up money that would otherwise have funded more programming.

But the alternative might be even worse – because it appears to be a false economy to try perhaps to limit the cost damage by leaving some of the terrestrial sister channels in SD for the longer term.

Second tier channels in second rate video quality looks like the road to oblivion.

For those people who care about breadth and depth of choice as well as the picture quality of what they watch, subscription television is increasingly going to be the natural choice – because the subscription world has the bandwidth and the revenue model to meet these demands going forward.

All this means that I believe that the outlook for subscription television is bright and will become steadily brighter over the coming years. The subscription model will see steady improvements in its ability to fund content, despite the policy framework being titled against it, while the FTA model gently suffers the opposite fate.

The sensible policy response to this seems obvious. It is to embrace this new dynamic, to work with the flow to see how much more quality content can be coaxed from the world of direct payment.

Unfortunately, our converged regulator Ofcom sees things rather differently.

In its eyes, this is an unmitigated disaster and we must fight to preserve the state directed, paternalistic past against all odds.

To judge by the hand-wringing tone of its recent mammoth publication, the second Public Service Broadcasting Review, television in this country is in a pretty feeble state and only a substantial injection of public money can save it.

To support this point of view, Ofcom has to sustain an impressive high-wire act of impressive illogicality. And while I do not have time to deconstruct every page of the review – and you would not thank me if I did – there are a few critical assumptions and logical absurdities which I would like to expose.

Many of the claimed problems stem from Ofcom's insistence on focusing on inputs rather than outputs.

Ofcom seems disinclined to examine what content is, in fact, being made available to viewers in aggregate. Instead, it focuses on the degree of public subsidy and, having noted this is in decline, immediately jumps to the conclusion that there is a problem that must be remedied.

The possibility that the world of 2008 might be able to get by with a little less public subsidy, does not even seem to be in the consideration set.

This reveals a deep-set mistrust of the market and an unhealthy reliance on using the levers of public subsidy and control to try to drive outcomes that conform with the prejudices of the broadcasting establishment.

This manifests itself, for example, in the systematic underplaying of the contribution to public service represented by the internet.

Ofcom manages simultaneously to celebrate this, and then to disregard it as irrelevant to policy. It appears to operate on the following maxim: if we do not regulate it, then it doesn't count.

Ofcom's approach to subscription TV is just as blinkered and old-fashioned. It is obsessive about the concept of so-called "free" television and after several years of tip-toeing around the question has now come right out of the closet and been very clear that, in its view, only content that is made available free-to-air can count as PSB.

Anyone who spends some time in the real world will recognise this as nonsense. We live in a world where people are perfectly well accustomed to paying for entertaining, informative and educational content.

They pay for newspapers and books, they buy DVDs, they pay to download films and TV shows from the web, and some even still pay for music.

So there is no big deal about paying for content, no reason in 2008 to maintain that it is somehow morally dubious to pay for television.

There is much talk of how much content is available for free on the internet, with services like the iPlayer and 4OD gaining much recent attention. But this is not really free, because a home needs a decent broadband connection to gain access to this content and this has to be paid for month after month.

So people are paying for access to the iPlayer, it's just that they are paying the likes of BT or Virgin.

In some circles, this is well understood. We have even had Ashley Highfield, on behalf of the BBC, urging broadband ISPs to regard the BBC iPlayer as a business opportunity that increases their ability to charge for their 'top package' internet connections.

So we start to see some cracks in the flaky logic around what is really free.

Content from the BBC is not free – the increasingly threatening and Orwellian messaging from TV Licensing reminds us that we all have to pay our licence fee.

Those who seek to ignore this inconvenient fact, often re-phrase their position to say that once you have paid your licence fee, then the content is free at the point of consumption. So that's OK then.

But of course precisely the same can be said of a subscription to pay channels like Sky Arts, Discovery and National Geographic – once you have entered into the subscription

arrangement – and almost half the country has done so – that content is free at the point of consumption.

But in Ofcom's world, it appears to be a problem that half the country do not choose to subscribe, so the content is not free at the point of consumption for those people.

So we seem to have arrived at the extraordinary intellectual position whereby making something a compulsory tax means it has greater merit, while allowing people the choice of whether to opt in or opt out means something less and has become a bad thing.

If Ofcom had a genuinely open mind, it would recognise that the range, diversity and quality of content being made available with public service characteristics is flourishing – on television and online.

To see this, all you need to do is look beyond the world of subsidy, get over the artificial, contrived hang-ups about forms of payment, and take a broader view that includes the internet and that includes the world of subscription.

When you include these areas, you see an environment which is truly accountable to viewers, which is acutely responsive to their needs, increasingly delivering original content, and is growing.

So, to close, I offer one basis for pessimism and one for optimism.

I am pessimistic because Ofcom does not appear to have an open mind. It is not the job of a regulator to protect the interests of a small group of favoured broadcasters. They should not be trying to prop up a model which has history and tradition on its side, but which faces substantial challenges going forward.

But all the recent evidence is that Ofcom will continue to do just that – trying to perpetuate the outdated system which it and the PSBs have a vested interest in protecting.

They will continue to ignore the subscription sector, they will continue to pander to the calls for more subsidy, for more special favours for the old guard at the expense of the new. They will continue to focus on trying to use artificial means to fix a model that is unavoidably in decline.

But despite all this, I am optimistic. It might be irritating to see so much intellectual effort being expended on the wrong questions and the wrong answers – but in the longer term, it matters little.

Because the evidence is that consumers – real people, not the imaginary citizen-consumers of regulatory fantasy – are pretty happy with the way the market is working. In broadcasting, as with other sectors, the free market is in the ascendant, true power has passed into the hands of viewers and they are exercising that power with their remote controls and with their keyboards.

If history is your teacher, then the clear lesson is that this level of power in the hands of consumers will always win out over sustained attempts by a controlling elite to manage outcomes.

The superabundance of choice today cannot be disputed. We really have never had it so good. And that is something to celebrate as we consider the future of broadcasting here today.

Thank you.