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News Corp's proposed takeover of BSkyB

Background

News Corporation has proposed to buy the 60.9% of BSkyB that it does not already own. This transaction would give the parent company unprecedented control over TV and newspapers in the UK. Our understanding is that News Corp is intending to file details of the transaction with the European Commission by the end of August and is seeking fast-track regulatory approval by the end of November 2010. The UK Secretary of State of Business, Innovation and Skills (Vince Cable) has the authority under the Enterprise Act 2002 to ask for an investigation by the Competition Commission, aided by Ofcom, into the implications of this transaction for the public interest and, in particular, can choose to ask the Commission to look into the impact of the deal on media 'plurality'. We believe that the case for an investigation is strong: UK media legislation was drafted to ensure that single entities such as News Corp would face close examination if they ever gained such a large share of the TV and newspaper markets.

This note looks at News Corp's growing presence in the UK TV and newspaper markets and the plurality concerns that may arise should it acquire 100% ownership of BSkyB. In terms of audience, BSkyB represents a relatively modest addition. BARB data show that wholly owned BSkyB channels contributed a 6.9% share of total TV channel viewing among all individuals aged 4 years and above. However, this grossly understates the power of BSkyB in the TV sector. BSkyB already accounts for over a third of TV sector revenues and its share is rising rapidly. This has enabled it to become increasingly prominent in the provision of news across its own and other channels. More than this, as gatekeeper to the pay satellite distribution platform BSkyB occupies a strong position of control across the entire non-PSB (Public Service Broadcasting) pay TV sector, where its market share of revenues, however defined, already exceeds 70%. However, it is not simply in TV broadcasting that its influence is felt. BSkyB is able to exert a major influence over almost all sporting bodies in the UK and likewise international film distributors through its market power in sports and films.

Collectively, these factors place News Corp and its constituent parts in a position of great and unprecedented power in terms of their ability to influence the agenda for news, analysis and opinions on any subject in the media. This in turn raises serious issues with regard to the maintenance of plurality both as regards a healthy democracy and in the widest sense as the foundation of a vibrant economy and public interest concerns.

Competition law in the UK recognises the importance of having multiple and distinct participants in an industry. A reasonable number of competitors is thought to help maintain innovation and active product development. The small number and feeble state of active participants in the main media industries threatens the UK's strong position in the global market for creative services.

To address these issues in greater depth, this note is divided into three sections. Section 1 looks at current TV market trends and the growing power and ability of BSkyB to influence other players in the market. Section 2 provides an overview of News International and its growing market share in the newspaper sector, while Section 3 considers the plurality issue and public interest concerns.

News Corp worldwide and in the UK

News Corp, a US listed media company, controls a large range of media assets throughout the world. In the UK the principal assets are News International which owns The Times newspapers (comprising The Times and The Sunday Times) as well as The Sun and The News of the World. The other significant UK based assets are a 39.1% stake in BSkyB and full ownership of HarperCollins, one of the top four book publishers in the UK. Non-UK assets include the Wall Street Journal (the leading global business newspaper) along with Dow Jones (acquired in 2007); The New York Post and Fox Television, 100% of the Italian pay TV company SKY Italia as well as a 45.4% stake in Sky Deutschland; and a large range of TV stations and channels and global film and TV studios in the US, and newspapers and pay television in Australia.

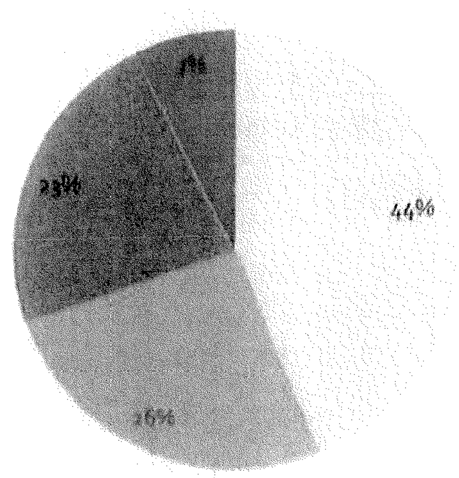
Section I – UK TV and newspaper markets through to 2014

UK TV market development

The UK TV market totalled approximately £11.4 billion in 2009, comprised of three significant sources of revenue as outlined by Chart 1 below, the licence fee (23%), advertising (26%) and pay subscription revenues (44%). The remaining 7% came from a variety of other sources, including global programme sales.

The BBC is principally funded by the licence fee, with a small contribution from BBC Worldwide, the commercial arm of the BBC. The other public service broadcasters, ITV, Channel 4 and Five, rely on advertising revenues. Pay TV operators (including BSkyB, BT and Virgin Media) rely on subscription payments. BSkyB and Virgin Media also generate a fraction of their revenue from advertising on their channels.[1]

Chart 1: UK TV revenue distribution, 2009



Pay subscriptions   Advertising   Licence   Other   [Source: Enders Analysis based on industry data]

Definitions of revenue:
Pay – Estimated revenue generated from the provision of television services, excluding any payments for telecoms services, or wholesale revenues.

[1] [illegible] of BSkyB's total revenue, excluding revenue from broadband or [illegible], came from advertising in calendar year 2009.

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Advertising – revenue generated by television groups from the sale of advertising. Excludes any revenue received from programme production divisions
Licence – Revenue allocated to television activities. Excludes radio and other activities
Other – Includes estimates of net TV shopping as well as sponsorship, product placement, interactive revenue (e.g. premium rate telephony), programme sales and S4C grants from the DCMS and non-UK subscription revenue from BSkyB

For some time, the dominant theme of the UK TV market has been the steady surge in pay revenue, in contrast to TV advertising. The total revenue to pay TV operators rose by approximately 39% between 2004 and 2009, taking their share of total TV market revenue from 37% to 44% during the same period. In contrast, advertising revenues fell by 14.5% in nominal terms between 2004 and 2009 resulting in the contribution of advertising to total TV revenue falling to 26% from 35%. As a result of the licence fee settlement in force from April 2007 to March 2013, the BBC's revenue has steadily increased, albeit at a much lower rate than pay revenues, resulting in license fee revenues contributing an increasingly smaller portion of income to the total TV market (22.8% in 2009 down from 23.4% in 2004).

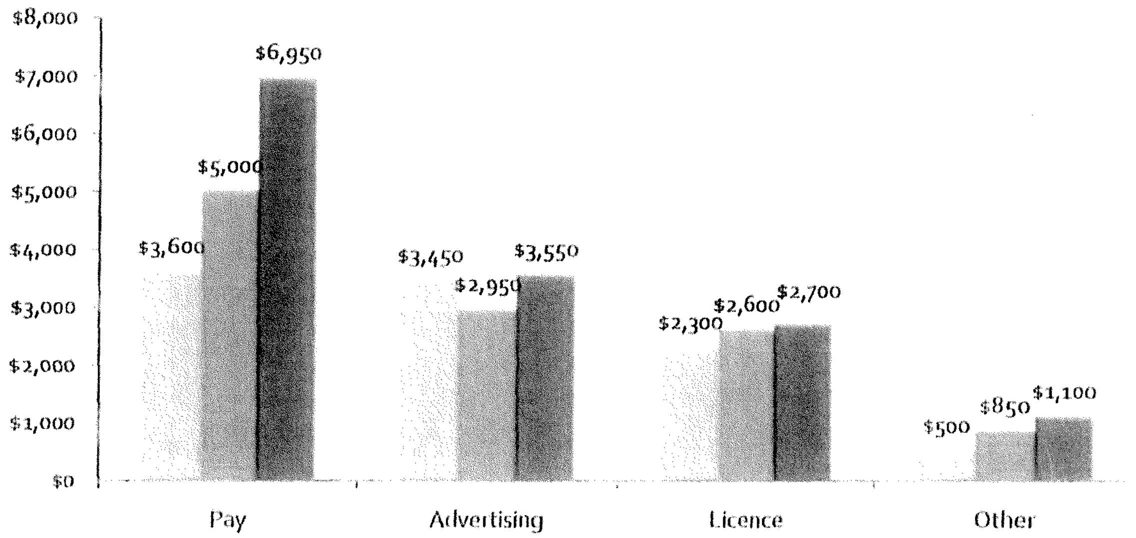
During the next five years to 2014, pay TV revenue is expected to grow at the same relative rate, taking total revenues to £6.95 billion, 48.6% of the total UK TV market in 2014, according to our calculations. TV advertising is expected to recover from the historic low in 2009, but structural change and a continued weak economic environment will result in nominal TV advertising revenue again reaching a similar level in 2013 to that in 2004, a large decline in real terms. The current funding of BBC TV channels and its other activities by the licence fee after the current licence fee settlement expires in 2013, is under consideration. The government has signalled that there will be a significant cut in the BBC's income leading to a further decline in position of the BBC relative to BSkyB in particular.[2]

The government has also announced plans for a new Communications Act in 2012 and previous indications from David Cameron and other senior Conservatives were for a substantive revision/elimination of the powers of Ofcom as the independent regulator.

Chart 2 below provides actual and forecast (2014) revenues by type of funding.

[2] In an interview with The Daily Telegraph, Jeremy Hunt was questioned about the licence fee. "Responding to a question over whether the fee could fall at the next settlement, he says: "Yes I could. Absolutely. I think that's the discussion that we need to have. "The BBC should not interpret the fact that we haven't said anything about the way licence fee payers funds are used as an indication that we are happy about it. We will be having very tough discussions."
http://www.telegraph.co.uk/culture/tvandradio/bbc/[illegible]/Licence-fee-for-wasteful-BBC-will-be-cut.html

Chart 2: UK TV revenues by funding type (m)

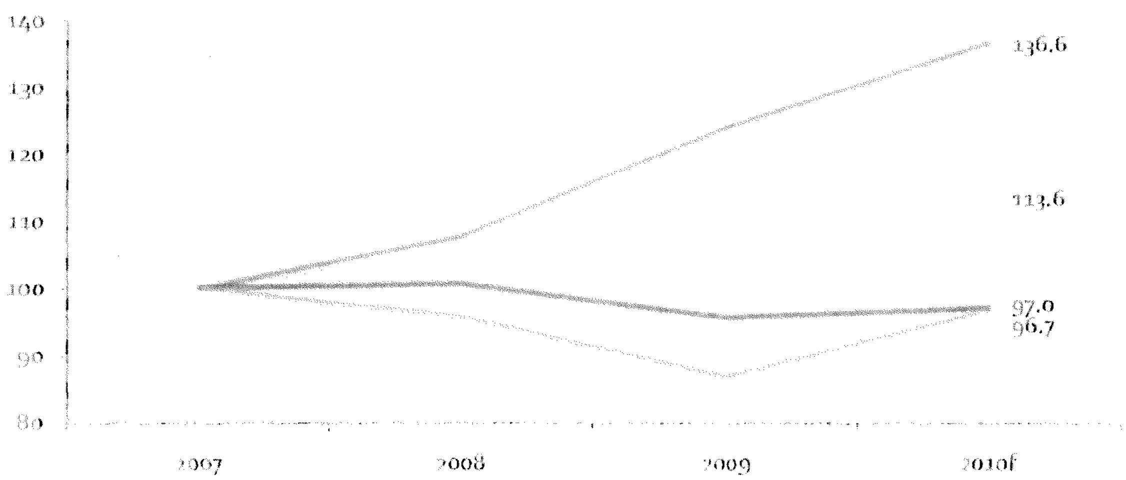


[Source: Enders Analysis based on industry data]

Note: Definitions of revenue are the same as for Chart 1 above.

Chart 3 below indicates that BSkyB and the BBC have experienced relatively strong growth in revenue during the recession, while ITV NAR (Net Advertising Revenue) has suffered. The trends reflect the difference in funding structures for the three companies. The BBC is the recipient of stable funding in real terms through to end of March 2013, while ITV relies almost totally on NAR, which is both subject to the variability of the macro economy and has experienced strong downward pressures due to structural changes in the wider advertising market. In contrast, the vast majority of BSkyB's revenue is the result of residential subscriptions on 12 month contracts. As the Chart 3 illustrates, in 2010 ITV's NAR will recover somewhat, but will still be 3.3% below its 2007 level, a loss of £43 million in nominal terms and of about 12% in real terms. In contrast, BSkyB's revenues in 2010 are likely to be 36.6% above their 2007 level.

Chart 3: Sector and company revenue growth rates (2007=100)



[Source: Enders Analysis]

BSkyB: driving Pay TV revenue growth

BSkyB has followed a two pronged strategy to drive revenue growth: increase the total number of subscribers and sell more products to each subscriber. The products additional to pay-TV principally comprise multiroom, HD and PVRs (now provided for free) in entertainment; and broadband, line rental and telephony in telecoms. BSkyB has been willing to invest in these additional products, with residential telecoms recording operating total losses of £503 million to date.[3] In order to achieve its two-pronged growth strategy, BSkyB has focused on three areas

- Set-top boxes
- Marketing
- Packaging of products into bundles

This strategy has enabled BSkyB to achieve total revenue of £5.4 billion in its last financial year (ending June 2009).[4] In contrast, no company in the commercial TV, radio or newspaper sectors has been able to materially diversify its revenues, nor has any of these companies had access to the same or similar level of capital in the last decade. All companies in the traditional commercial media sector (newspapers, radio and television) are burdened with combinations of pension deficits and debt as well as long term decline in revenues.

In order to generate growth in the total number of subscribers, one area of BSkyB's strategy has focused on reducing the price of signing up through the gradual reduction in installation fees while subsidising the price of set-top boxes. The acquisition of set-top box supplier Amstrad in September 2007 enabled BSkyB to reduce the cost of boxes to it through an improved supply chain process, thus allowing a more aggressive entry level price for BSkyB products.

BSkyB has supported the strategy with significant sustained marketing activity. Between 2005 and 2008, BSkyB was the fourth largest advertiser by spend in the UK, see table 1 below. The figures in the table should be viewed as a strong indicator of the level of spend rather than precise values. It indicates that BSkyB increased its advertising spend between 2003 and 2007 and while spend fell by 18% in 2008, this in part is likely to have been the result of the lowering of advertising rates during the recession. The table also lists the advertising spend of BT and Virgin Media, when the data is available. BT has also been one of the top ten advertisers in the period analysed. However, BT has many lines of business outside of the residential sector and hence only part of the spend listed is likely to be in direct competition with BSkyB.

Table 1: BSkyB and competitors advertising spend, 2003-2008

	2003	2004	2005	2006	2007	2008
BSkyB advertising spend (m)	£41.7	£65.5	£111.2	£117.2	£155.1	£127.0
Ranking of total advertising spend	21	10	4	4	3	4

[3] As of the end of March 2010.
[4] BSkyB's total revenue including: wholesale payments from other TV services, advertising revenues, subscription payments from Irish customers, residential and business telecoms revenue.

BT advertising spend (m)	£96.4	£81.9	£80.4	£91.9	£92.1	£87.6
Ranking of total advertising spend	3	5	9	6	6	8
Virgin Media advertising spend (m)	-	-	£32.4*	£37.6*	£68.8	£60.5
Ranking of total advertising spend	-	-	45	36	13	16

*NTL spend

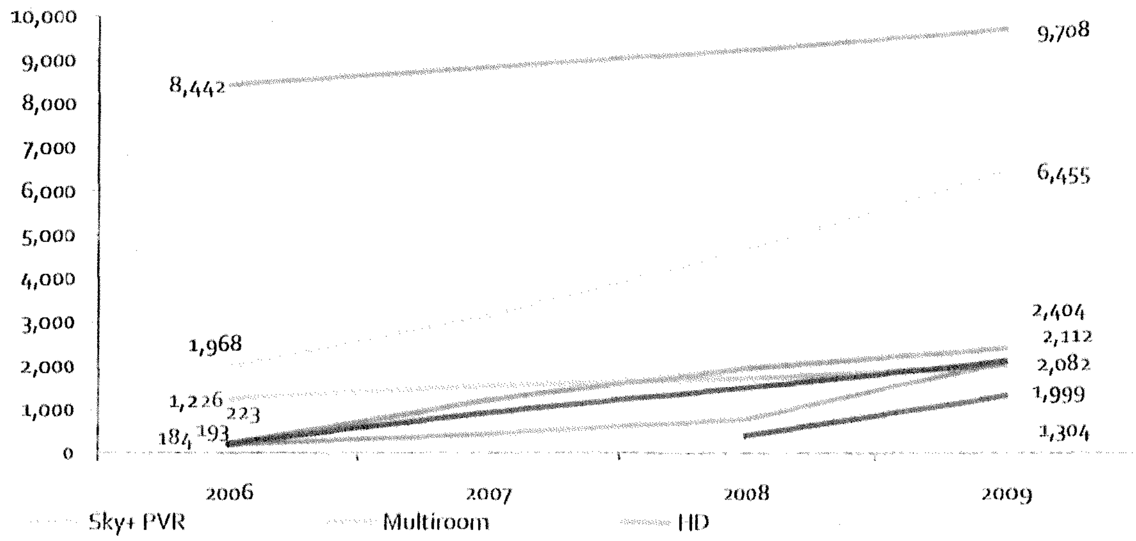
[Source: The Nielsen Company, The Advertising Association Year Book]

The second prong of BSkyB's strategy has been to increase the number of products being taken by new and existing customers. Chart 4 below shows the growth in subscribers to additional BSkyB services since 2006.[5] During this period the penetration of Sky+ PVRs has risen from 23.3% of subscribers in 2006 to 66.5% by the end of 2009. BSkyB does not charge a monthly fee for a PVR, with the only customer cost being the price of the box (often provided for free), but PVRs are an important product to add value to the service and retain customers. As Chart 4 indicates, the number of customers taking HD has grown strongly during 2009, with total customer numbers rising to 2.1 million at the end of 2009 from 0.8 million at the end of 2008. The importance of the growth in HD subscriptions is that each customer pays an additional monthly fee of £10 (including VAT).

Outside television, BSkyB has been building its presence in telecoms. Chart 4 shows that the number of customers taking broadband or telephony has steadily increased since broadband was launched in 2006 and in 2008 line rental was added.[6] By the end of 2009 24.8% of BSkyB customers took broadband while 21.8% took telephony and 13.4% purchased line rental from BSkyB. The addition of telecoms products has helped grow BSkyB's revenue, with residential telecoms contributing £514 million to BSkyB's revenue in calendar year 2009.[7]

[5] Figures are for BSkyB as a whole, not adjusted to be UK specific.
[6] BSkyB launched broadband in July 2006. Sky Talk was relaunched alongside broadband.
[7] BSkyB owned Easynet, a provider of business telecoms products. On the 21st July 2010, BSkyB announced that it had sold Easynet to Lloyds Development Capital. During calendar year 2009, Easynet contributed £204 million revenue to BSkyB.

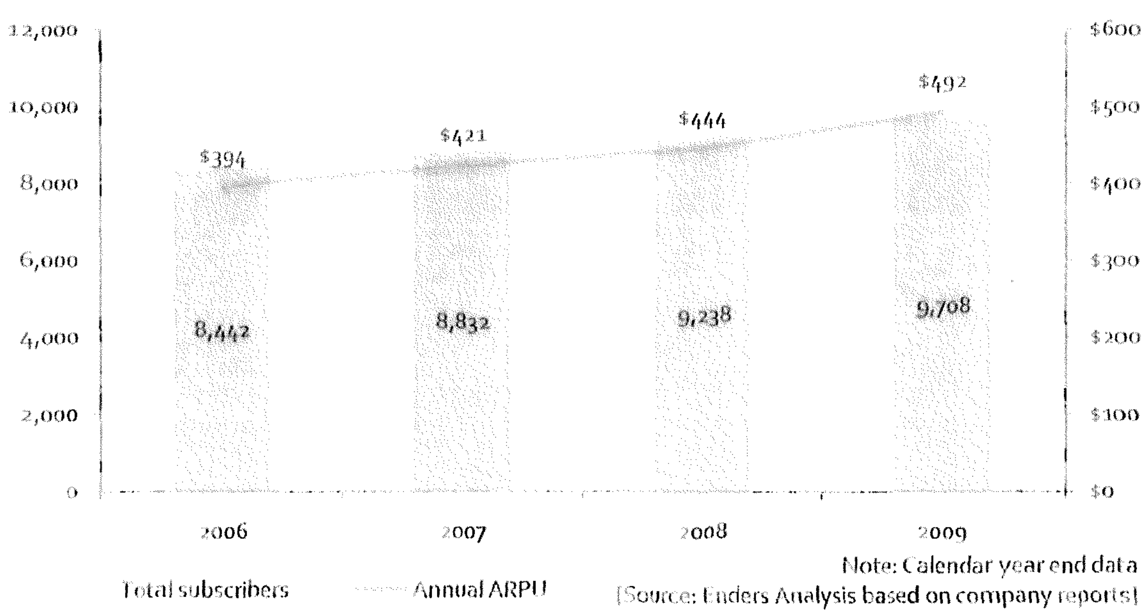
Chart 4: Multiproduct subscribers ('000)



Note: Calendar year ends
[Source: Enders Analysis based on company data]

The growth in penetration of additional products has driven growth in BSkyB's average revenue per user (ARPU). Chart 5 below shows that BSkyB had increased the annual ARPU from £394 in 2006 to £492 by the end of 2009. This growth equates to a compound average growth rate of 7.7%. During the same period the total number of subscribers to BSkyB services has rose to 9.7 million in 2009 from 8.4 million in 2006. This has resulted in total revenue of £5.6 billion in calendar year 2009 compared to £4.4 billion in calendar year 2006.

Chart 5: Total subscribers ('000) vs. annual ARPU

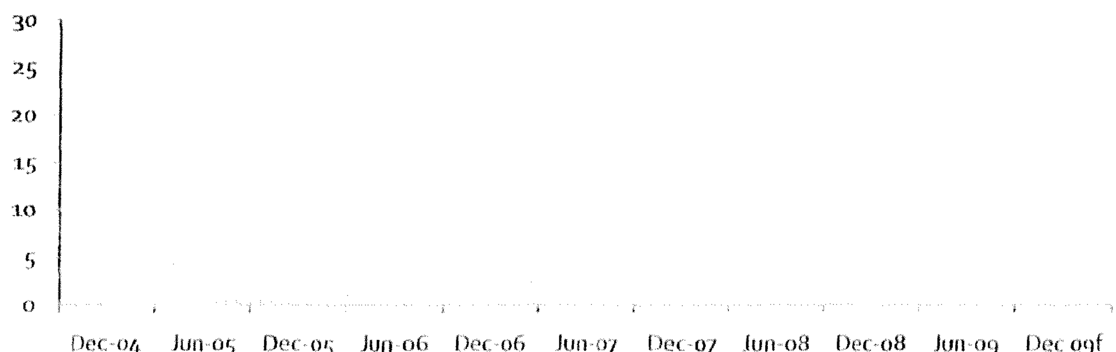


Note: Calendar year end data
[Source: Enders Analysis based on company reports]

To further aid product adoption, BSkyB announced in January 2010 that it would provide HD capable boxes as standard equipment to new subscribers either for free or subsidised depending upon which package is taken. This enables new customers to upgrade to HD without having to replace their set-top box. For BSkyB, by distributing a single box they remove the need for an additional amount of subsidy when a customer decides to upgrade.[8] The increasing subsidisation of set-top boxes has a significant impact on the wider industry in that it becomes harder for others to retail set-top boxes if the dominant player significantly subsidises the cost thereof.

Since 2006, the number of HD capable digital televisions in UK households has grown from approximately 3 million to 27 million by the end of 2009 (total UK households number 26 million) as Chart 6 illustrates below. One of the main drivers for the accelerated replacement cycle was the Digital Switch-Off. Freeview decoders are incorporated within the set, removing the need to buy a separate box.

Chart 6: Total UK HD ready TV sets (m)



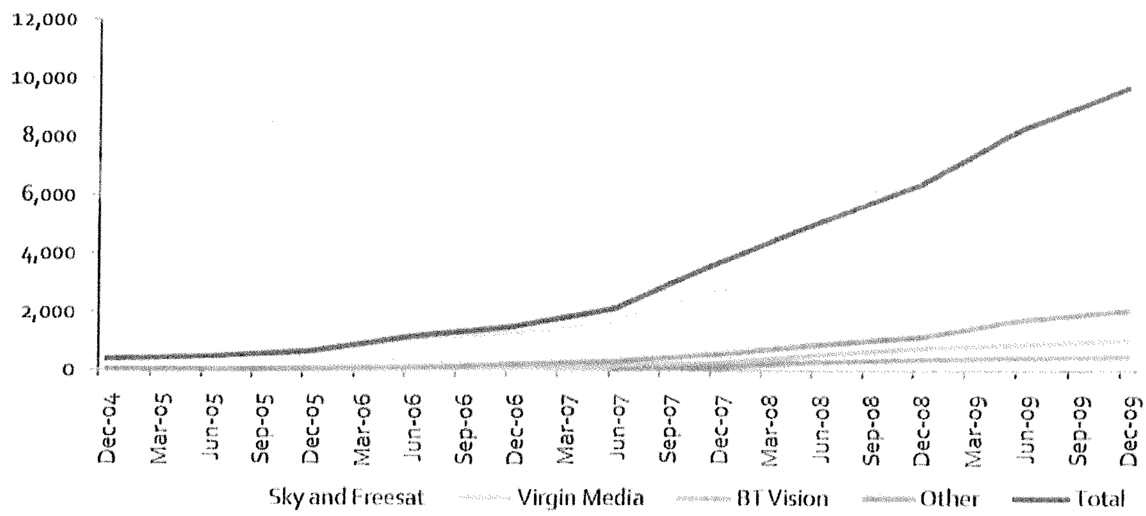
[Source: GfK, Enders Analysis]

The combination of a TV replacement cycle and increased subsidies by BSkyB of set-top boxes has thus reduced the consumer desire to pay for set-top box hardware. In turn, this has reduced the potential channels to market for new entrants (e.g. Canvas). In order for new services to generate reasonable levels of adoption they will likely have to follow one of two paths, incorporation into TV sets or be given away as part of a package. Services that decide to give away or subsidise hardware as part of their package face higher upfront customer acquisition costs.

The take up of PVRs in the UK provides another indicator in the level of adoption of hardware under various strategies. As Chart 7 below illustrates, the number of BSkyB's customers taking a PVR in the UK has steadily grown, although a small part of recent satellite PVR growth is attributable to Freesat. Virgin Media charges customers a monthly fee of £5 for a PVR unless they opt for their top tier content package. By the end of 2009, Virgin Media had 862,000 customers taking a PVR, 23.6% of their TV base. Out of the approximately 9.5 million PVRs in the UK, we estimate that less than 20% were bought on a standalone basis (either for use with Freesat or Freeview).

[8] There will be a cost incurred when upgrading a customer; however it is likely to be small covering any administration costs and the cost of a new viewing card to enable the HD channels. In contrast the current cost of upgrading a customer to HD who does not have an HD box is stated as £200.

Chart 7: Total UK housedholds with PVRs by platform (000)



[Source: BARB/InfoSysTV; Enders Analysis]

BSkyB's broader activities

Outside its core pay-TV operations, BSkyB is a growing presence in other parts of the market. Its areas of influence may be grouped under five headings:

- News provision
- Freeview presence
- Advertising sales
- Third party channel provision
- Premium sports and films

News provision: Sky News is one of three substantial providers of UK TV supplying its own channels and also Five. The other two TV news providers are the BBC and ITN. ITN is 40% owned by ITV and provides news to ITV and to Channel 4. Sky News is also one of two substantial providers of UK radio news. In March 2009, Sky News increased the number of commercial radio stations it supplied with news content to over 300 (essentially the vast majority of all radio stations) following an agreement with IRN (Independent Radio News).[9] The other significant radio news provider is the BBC as ITN no longer supplies radio news.

Freeview presence: BSkyB also has three channels on Freeview: Sky News as well as Sky 3 (general entertainment) and Sky Sports News (which BSkyB have announced will become a pay only channel and replaced by Sky 3+1 on Freeview). The number of fully owned BSkyB channels on Freeview will increase to 4 (out of a total of 47, excluding 4 HD channels) following an agreement to purchase the VMtv channels from Virgin Media which was completed on the 13th July 2010. This transaction is being examined by the Office of Fair Trading with a decision expected by the 14th September 2010.

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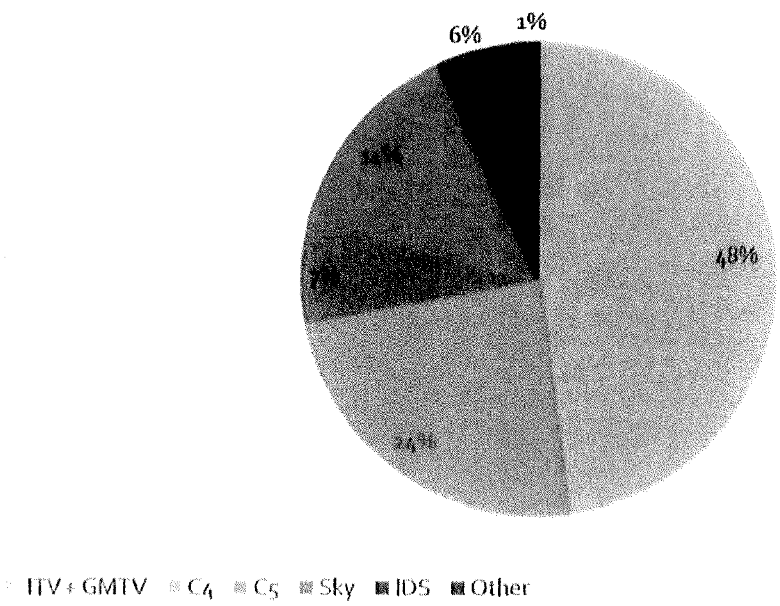
[9] http://www.skypressoffice.co.uk/SkyNews/Resources/showarticle.asp?id=2668&year=2009#

Advertising sales: As a result of the increasing penetration of its platform and of its channels, BSkyB has been growing its share of total TV advertising sales. In 2010 it is estimated that BSkyB will account for approximately 14% of UK TV advertising sales, the third largest group as shown in Chart 8 below. Assuming the acquisition of VMtv is approved by the OFT, BSkyB's share of advertising sales will rise to circa 16% in 2011 as the current agreement with IDS for handling advertising sales ends.[10] Within the non-PSB commercial sector, its share of TV advertising will be over 50%.

Chart 8: Share of TV new advertising revenue, 2010



[Source: Enders Analysis]

Third party channel provision: Outside the public service broadcasting circle that comprises the BBC, ITV, Channel 4, and Five groups, the vast majority of channels rely on a mixed advertising/subscription model. We estimate that BSkyB currently accounts for 67% of UK residential subscribers to subscription pay TV services, as well as a significantly higher share of subscription pay TV revenues. The other retail provider of pay TV, Virgin Media with circa 30% of UK residential subscribers to pay TV, previously had a range of TV channels comprised of VMtv, sit-up (three home shopping channels) and a 50% stake in UKTV but has been slowly exiting full channel ownership. In April 2009 Virgin Media sold sit-up to AURELIUS of Germany while VMtv was sold to BSkyB in July 2010. Virgin Media retains a 50% stake in the UKTV joint venture with BBC Worldwide but has signalled that this stake will be sold.[11]

The withdrawal by Virgin Media of its involvement in content ownership puts BSkyB in a totally commanding position over the market for pay channels, including third party basic channel carriage fees. As gatekeeper of the satellite platform, BSkyB is able to dictate terms that allow its third party channels only just enough oxygen to breathe, while it extracts the profits. At the same time, BSkyB is in the position to offer, if it chooses, other

[10] IDS currently sells advertising for the VMtv channels as well as UKTV, a joint venture between BBC Worldwide and Virgin Media. UKTV reached an agreement with Channel 4 to become its advertising sales company from January 2011 increasing its share of TV advertising to 28%.

[11] "It is not a strategic investment [and] as with any investment we look at it from time to time,". "There are ways and means we could realise [value]. We could realise it through holding [the UKTV stake] as investment and if there are ways and means of realising it through divestment we would [look at it]." http://www.guardian.co.uk/media/2010/jul/28/neil-berkett-virgin-media-uktv

non-PSB channels incentives to stay exclusively on the pay TV platform. Even the most powerful third party suppliers, such as Disney/ESPN, may be viewed as vassals of BSkyB, constrained by its commercial policies.

Premium sports and films: BSkyB now occupies an uncontested position of dominance in the provision of televised sports in the UK, reflected in its budget of over £1 billion for this programming segment (out of an expected £1.9 billion total) in fiscal 2010, almost matching the total programme budget of BBC1. Sports is a major source of news and media attention, and no sport more than football, where there no longer exists any serious rival to BSkyB in terms of bidding for live televised Premier League (PL) matches. Moreover, BSkyB's position is further strengthened by the poor financial state of many of the PL clubs, which make them increasingly dependent on its willingness to back them.

Twenty years ago, when BSkyB (then Sky Television) launched, films were the major attraction and outlay of programme spend. That has changed considerably over the years. Although BSkyB prices its film channels almost as high as its sports channels, its current budgetary outlay on film content (£278 million in fiscal 2009) is only about a quarter of its outlay on sports and has fallen substantially at current prices in recent years (e.g. it was £343 million in fiscal 2005). Since the very beginning, Sky has held exclusive contracts with the six US studio majors for films within the subscription pay TV window, and has contracts with other leading suppliers. It also enjoys a position of market power since the film contracts are staggered. This along with its position of retail market power, has placed BSkyB in an unassailable position as wholesale purchaser, able over time to negotiate successively lower fees as the film contracts fall due for renewal. For the film suppliers, there is no alternative place to go. Their position is made still more problematic by the bundling of subscription video on demand (SVOD) with broadcast rights. BSkyB has up to now made almost no use of its exclusive SVOD film rights, opening itself to the charge of warehousing those rights, which might otherwise be better exploited on the interactive cable and broadband platforms. Indeed, Ofcom has just consulted on whether to make a referral to the Competition Commission (CC) and is to announce its decision shortly. Whilst the film suppliers might welcome the prospect of becoming available on other platforms, their position is weak (hence a notable lack of expressed appetite for a CC investigation, with Time Warner coming out against it in its consultation response to Ofcom) and BSkyB is the party able to determine consumer choice. Although films may be regarded as less newsworthy post cinematic release than live sports, they retain a high cultural importance.

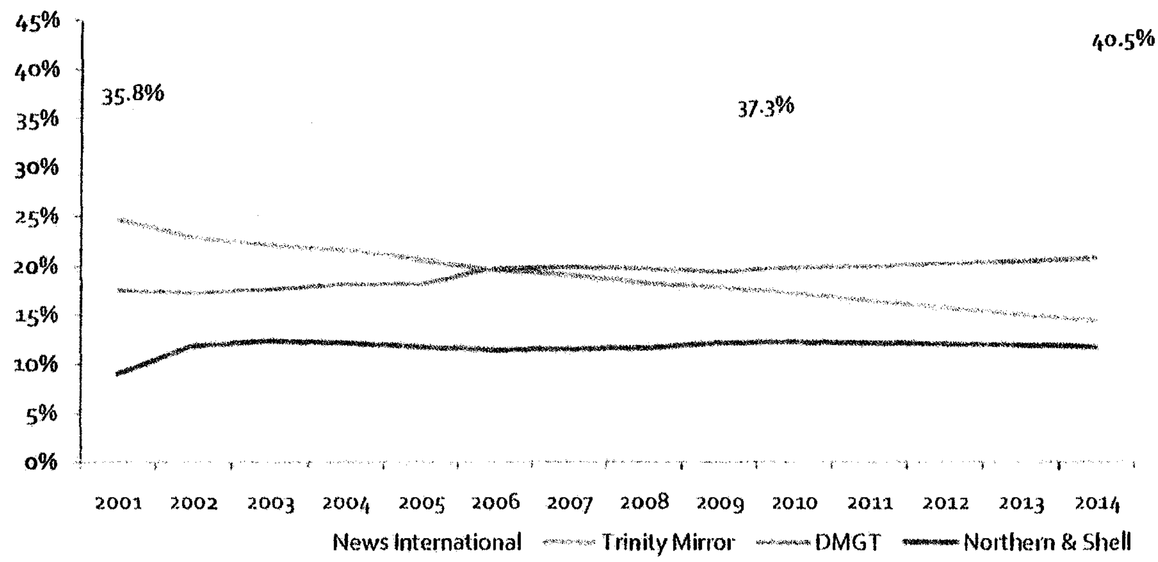
News Corp's UK newspapers

In the UK, News Corp publishes four key national papers, The Times, The Sunday Times, The Sun and the News of the World. The latest ABC data for June 2010 indicates that The Sun has the highest circulation amongst UK papers at 2.98 million copies, while The Times has circulation of 504,000. In terms of the Sunday titles, the News of the World had circulation of 2.83 million, also the highest figure for any Sunday title, while The Sunday Times has circulation of 1.09 million, second behind the Mail on Sunday (1.91 million) in terms of quality titles.

In 2009, News Corp's papers accounted for over 37% of national newspaper circulation in the UK, the same share as the two next competitors, Trinity Mirror and Daily Mail and General Trust (DMGT), combined. News

Corp has been slowly gaining share in the UK national newspaper market as a result of: good consumer, advertiser and socio-political positioning; sustaining quaiity; discounting; and product Improvements, frequently adding pagination. Scale and efficiencies in printing and distribution have also helped. As Chart 9 illustrates, we predict News Corp's share of national press circulation will steadily increase to more than 40% by 2014, assuming there are no material supply changes to the market. Given the breadth and intensity of pressures that all newspapers are under, with rising costs and long-term downward pressure on key revenue streams, we consider it inevitable that organisations able to absorb losses will gain market share over those that are forced to make significant cost savings to sustain margin. In other words, the strongest companies will become stronger still. However, if the industry undergoes a material structural change in terms of supply, then the outcome could be more severe still. We will return to this point when we consider some of the strategic options that News Corp might conceivably initiate in the medium term.

Chart 9: UK national press circulation by publisher



[Source: ABC and Enders Analysis forecasts]

When the individual News Corp titles are analysed against some of their competition it can be seen that they command the majority of readership in certain demographics as Table 2 below highlights. The Sun is the most widely read newspaper in the UK, reaching 15.6% of UK adults. Although the Daily Mail (9.8%) is the second most read daily, The Mirror is closer in nature and reaches 8.6% of adults. When analysed by socio-economic segment, 22.0% of C2DE adults read The Sun while 11.9% read The Mirror. The situation is very similar with the Sunday edition, with 15.4% of adults reading The News of the World, rising to 20.8% of C2DE's reading the title.

In terms of quality titles, The Times and The Daily Telegraph have similar levels of readership amongst adults at 3.6% and 3.7% respectively. When the Sunday titles are compared, The Sunday Times is read by 6.5% of adults and 9.9% of ABC1's, while The Sunday Telegraph is read by 3.4% of adults and 5.2% of ABC1 adults.

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Table 2: Select UK newspaper readership

	Paper	Total share of readership	ABC1	C2DE
Quality daily	The Times	3.6%	5.5%	1.1%
	The Daily Telegraph	3.7%	5.8%	1.1%
Quality Sunday	The Sunday Times	6.5%	9.9%	2.2%
	The Sunday Telegraph	3.4%	5.2%	1.0%
Tabloid daily	The Sun	15.6%	10.5%	22.0%
	The Mirror	8.6%	6.0%	11.9%
Tabloid Sunday	The News of the World	15.4%	11.1%	20.8%
	Sunday Mirror	7.7%	5.8%	10.0%

[Source: NRS readership estimates, April 2009-March 2010]

News International has a history of resorting to discounting cover prices to grow market share and reduce circulation decline. The Sun is currently discounted to 20p in London, Birmingham and Oxford (full price is 35p) while its national daily circulation hovers around the three million mark, which the publisher seems to recognise as a critical indicator of scale for advertisers and social and political analysts against competitors. If this is the case, The Sun may remain discounted for some time. The Sun competitor the Daily Star is currently discounted to 10p. The Daily Mirror, which Trinity Mirror declines to discount, is facing severe circulation decline (-7.0% in June 2010). In the past The Times has likewise attempted to take quality press share (in particular from the Daily Telegraph) by discounting at the newsstand. The stark reality is that demand for newspapers continues to fall, and consumers are poorly 'locked-in', with just 500,000 UK households subscribing to a daily quality newspaper (The Times, The Daily Telegraph, The Guardian, The Independent, Financial Times); two thirds of the subscriptions are to one title, The Daily Telegraph.

In theory at least, purchasing the outstanding BSkyB shares it does not already own provides News Corp with the financial resources to sustain its newspapers for the very long term. News Corp would be able to experiment with media discounting and bundling in a much broader manner, for example offering print and digital editions of The Sun or The Times to Sky subscribers (we will return to this issue).

Furthermore, the possibility of further 'free' print newspapers has not entirely vanished. News International stopped publishing its free London evening title, The London Paper, in 2009 at the same time as Rupert Murdoch announced his intention to switch the digital Times to a subscription strategy. The title was losing £1-2m per month through distributing 400,000 free copies across the capital. We assume these changes were part of a strategic initiative to underline the 'value' of news provision to consumers, and to promote audience quality to advertising partners at the expense of audience scale. However, a discounted Sun, and free access to Sky News and the Sun online, remain anomalies in this strategic framework, implying tactical variations will always be mobilised to develop competitive advantage over weaker participants. This is not to suggest a free Sun will hit the streets anytime soon; but that free editions and press and digital bundles for households could become critical developments for News Corp's UK operations as a whole in the future.

Finally there is the question of newspaper distribution. A variety of factors are significant here. We believe paper prices will increase about 10% in H2 2010 compared to H1, a pricing shift we consider unlikely to reverse in the foreseeable future. The wholesaler Dawsons exited the newspaper industry in August 2009 after losing a series of contracts valued at more than £500 million, leaving just two distributors, Smiths News and John Menzies. Combined with the retail environment, with long-term decline in sales through news specialist shops in favour of general and supermarket retailers, distribution is further squeezing the funnel to consumers for publishers. Availability and visibility are declining in the best environments for newspapers to flourish. There is no doubt that one of the reasons that circulation is declining is that buying newspapers is becoming more difficult for consumers (and particularly older consumers who are so important to the sector) at exactly the wrong time. While these issues affect all newspapers, those publishers able to absorb steep cost increases and overcome distribution challenges will clearly be better positioned to cope. For example, providing household deliveries is an onerously expensive enterprise especially outside of high density populations such as London. Not surprisingly, printing itself is becoming more concentrated too, with News International (which prints the Telegraph), Trinity Mirror and DMGT holding many crucial print contracts between them.[12]

As in the case of BSkyB, a core feature of News International's strategy is to market its titles aggressively through advertising. Table 3 below outlines the level of spend by News International Newspapers between 2003 and 2008. None of the other major newspaper groups were among the top 50 advertisers by spend.

Table 3: News International Newspaper advertising spend

(m)	2003	2004	2005	2006	2007	2008
News International Newspapers	£39.4	£33.6	£37.0	£37.2	£36.7	£45.7
Ranking of total advertising spend	23	32	39	34	37	30

[Source: The Nielsen Company, April 2009, The Advertising Association Year Book]

Table 4 below presents the revenue and operating profits of The Times newspapers and of The Sun/News of the World. The data shows that the two paper groups have made operating losses in the last two financial years. In 2009, the total revenue from all of the papers was £1.0 billion generating an operating loss of £87.4 million.

Table 4: The Times and The Sun and News of the World accounts

	The Times		The Sun/NotW		Total	
Year end June	2008	2009	2008	2009	2008	2009
Revenue (m)	£444.9	£385.5	£626.3	£617.9	£1,071.2	£1,003.4
Gross profit (m)	£83.4	£79.5	£148.8	£153.5	£232.2	£233.0
Operating profit before exceptional items (m)	-£42.8	-£71.9	-£18.5	-£15.5	-£61.3	-£87.4

[Source: Company House filings for Times Newspapers and News Group Newspapers]

[12] News International's printing subsidiary Newsprinters started printing The Daily Telegraph in August 2008. http://www.printweek.com/news/836881/First-editions-Telegraph-printed-Knowsley/

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In common with other newspaper publishers, News International experienced decline in advertising revenues during H2 2008 to about Q3 2009. These declines were severe: in the region 13% year-on-year in 2009. Our view is that, despite some strong growth in advertising in recent months, notably from retail advertisers, the long-term pattern for the newspaper industry in aggregate will be decline in advertising in real terms. This is partly due to the fall in demand highlighted earlier, exacerbated by over-supply, though a flat economy and flat consumption are also critical. Over-supply takes two forms: the number of national titles, and the scale of the inventory on offer within each title. The latter category exploded in the late 1990s, with pagination increases related to supplements and pull-outs; weekend editions in particular became unrecognisable from their equivalent editions 10 years earlier. In 2010, we believe aggregated advertising revenue will be roughly £1.3 billion, about 50% of the peak level and roughly in line with revenues achieved in 1995.

Nevertheless, for classic display categories such as retail, newspapers continue to provide advertisers with a very beneficial media environment, both in terms of physical layout and the tactical advantages to brands and agencies gained from the format's daily frequency, as well as consumer volumes and a much more attractive consumer mindset than when engaged with digital media. Unlike advertising classified categories, the main challenges to display advertising categories are not digital media substitution (though that certainly exists, too), but rather over-supply of titles and inventory. In this environment, the strongest titles (including The Sun, The Daily Mail and The Times) will gain further market share, as some lesser titles fall off the roster for an increasing volume of campaigns. However, a still greater threat for publishers of non-leading titles would be a longer-term option for News Corp's UK operations, assuming it owned BSkyB outright, to offer advertisers print, online and digital TV bundles. Such packages would be impossible for other newspaper publishers to emulate, risking a more rapid decline in the breadth of newspaper usage by consumers and therefore agencies and marketers than would otherwise be envisaged due to market dynamics alone.

Online news subscriptions, or 'paywalls', may play an important role in determining the pace and scale of business model development. The online Times shifted to a subscriber model in July 2010, making it the first UK general newspaper brand to do so. The Financial Times already operates a subscriber model for its digital services, as does News Corp's Wall Street Journal. Both these titles provide business and financial news into professional communities. Therefore, despite their print editions being categorised as newspapers, their online subscriptions are effectively in the B2B space rather than the B2C space. The key general news titles to have set up digital subscription services are the New York Times, which abandoned its Times Select model in 2007 generating approximately $10 million per year (a new iteration of the subscription is to be launched in Q1 2011), and Le Monde, which we estimate generates €5.5 million from its online subscription. The New York Times abandoned Times Select both because the revenue generated was too small (advertising revenues are to a large degree correlated to traffic), but also because general news journalists considered themselves 'cut off' from the digital network, which is increasingly the environment that makes the news brand relevant for a large audience. News aggregation and key communication and social services (Google News, Facebook, Twitter, YouTube, blogs and so on) provide word-of-mouth distribution networks for news provision, comment and analysis, and are increasingly perceived to be critical elements of the news ecosystem by editors, writers and publishers.

However, early indications as to the scale of the traffic using the Times online subscription are not good. Prior to implementing the paywall, Times Online was achieving traffic in the region of 6 million unique visitors per month, and in the early weeks of the subscription it would appear 15,000 consumers have accessed the service. Even if all these subscribers signed up for an entire year they would generate £1.5 million per year for the Times, perhaps as little as 1% of the £130-150 million generated by consumer sales of the print edition.

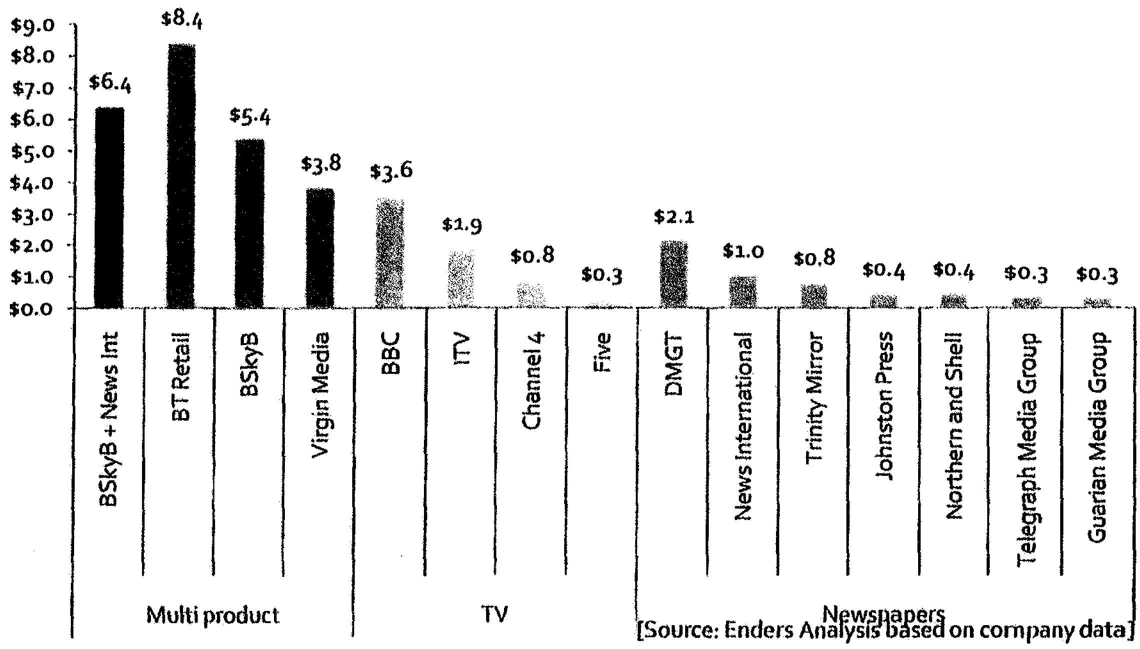
Furthermore, prior to the Paywall, we estimate Times online was generating £25-30 million in advertising revenue. Even assuming that advertising volumes and revenues decline by substantially less than the traffic has (because the audience is self-selecting, highly targetable and very attractive to key product and service brands), it is difficult to see how the aggregated revenues of the subscription model will be in line with the free online model. This leads us to believe that the Times will inevitably consider further strategic developments.

One option available to the Times would be to switch back to a free model, and focus on developing a scale model as competitors such as the Mail Online are doing. However, we consider this an unlikely outcome, and believe News International and ultimately News Corp are much more likely to trial a variety of different approaches to the subscription, particularly in ways where they can evidence competitive advantage over other press and media groups. Switching the nature of content provision by aggregating services sourced from a variety of different assets and media, and so offering bundles such as the Times/Sky, Sun/Sky, Times/WSJ, (branded) News Corp sport, (branded) News Corp business, (branded) News Corp celebrity, and so on, would not only have natural appeal for consumers, but would create screen-based content channels for advertisers that are a great deal more optimal than a destination news site. In such a scenario, the question of monetising Times online as a stand-alone destination service would evaporate because consumers would be purchasing bundles. Furthermore, the concern that journalistic influence collapses as a result of the online subscription also vanishes, or at least diminishes, as the scale of access could be increased dramatically. Indeed, just as consumers could be accessing content through a variety of bundles, so journalists could be deployed more proactively across a variety of outlets. Such a strategy is not so different from that of the BBC, where Nick Robinson is the political editor, and provides expert comments on the BBC News at Ten, BBC News 24, Radio 4's Today programme, the BBC news site, his own BBC blog, and so on.

The scale of UK media and telecoms companies

Chart 10 below outlines the relative size of major competitors to BSkyB and News International and separates the companies into three groups: multi-product, TV and newspapers. Each company's total revenues are stated with the exception of BT where BT Retail revenue only is stated.

Chart 10: UK based media companies



[Source: Enders Analysis based on company data]

Notes:
BT Retail is for the calendar year 2009. BT group revenue was £21 billion in this period
BSkyB is total reported revenue for financial year ending June 2009.
Virgin Media revenue is for the year ending December 2009.
BBC is the total spend as stated in their 2009/10 annual report. Period runs from April 2009 to March 2010.
ITV revenue is for the year end December 2009.
Channel 4 revenue is for the year ending December 2009.
Five revenue is for the year end is December 2009.
DMGT year end September 2009 and includes revenue from non-consumer media. DMGT newspaper revenue totalled £876 million during the period.
News International includes the revenue from the UK newspapers for the year ending June 2009.
Trinity Mirror revenue is for the year end 3rd January 2010.
Johnston Press revenue is for the year end 2nd January 2010.
Northern and Shell revenue is for the year end December 2008.
Telegraph Media Group revenue is for the year end December 2009.
GMG revenue is for the year end March 2010.

News International faces competition from a range of independent newspaper companies, who, with the exception of DMGT, focus solely on publishing newspapers and related websites. Chart 10 above states DMGT group revenue as £2.1 billion in 2009, of this £876 million, 41.4%, was generated through newspaper activities. This places News International as the largest newspaper publisher by revenue. Of the companies shown, News International, Northern & Shell, Telegraph Media Group and Guardian Media Group publish national titles (Northern & Shell also publishes OK! and New! magazines). DMGT and Trinity Mirror publish national and local newspapers while Johnston Press only publishes local newspapers.

BSkyB also competes with the major UK TV public service broadcasters (PSB). As the Chart 10 illustrates there are significant differences in the revenues of the companies. The BBC is the largest of the PSBs with total funding of £3.6 billion in the year ending March 2010. This funding covers all of the operations of the BBC including radio and websites. ITV's total revenue in 2009 was £1.9 billion, only £52 million larger than BSkyB's programming spend in the same period. Part of ITV's revenues came from the sale of programming via ITV

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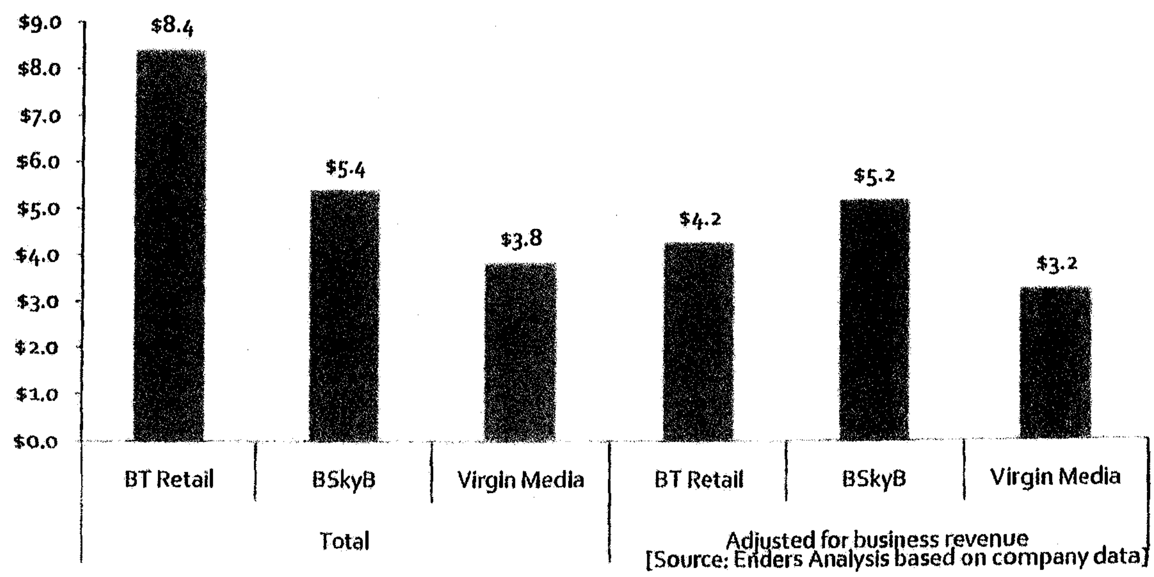
Studios; this contributed 17.8% of ITV's total revenue. Channel 4 generated revenue of £830 million, while Five is considerably smaller at £269 million.

In Chart 10 above, the multi-product companies' revenues including from business products. On this measure, BT Retail had revenues of £8.4 billion and Virgin Media of £3.8 billion in calendar year 2009 while BSkyB's revenue was £5.4 billion in their financial year ending June 2009. Chart 11 below shows each group with business revenue deducted. BSkyB has the largest adjusted revenue at £5.2 billion, while BT Retail revenue is £4.2 billion and Virgin Media revenue is £3.2 billion.

Chart 11: BT Retail, BSkyB and Virgin Media revenue excluding business



Notes:
BT Retail adjusted revenue is taken from BT Retail business unit revenue reporting – 'Consumer'.
BSkyB adjusted revenue is total group revenue minus Easynet, but includes channel wholesale revenue and revenue from pubs and clubs.
Virgin Media revenue is total group revenue (including content) minus total business revenues.

Although BT Retail and Virgin Media are two of BSkyB's closest competitors, BSkyB is also a vital supplier of premium and basic channels to both its competitors.

Based on the revenue data presented above, BSkyB and News International are already the largest companies in their respective sectors. Following the merger, the combined group will have revenues in the region of £6.4 billion.

Section II – The Potential Impact on Plurality

The importance of plurality

UK governments and regulators have consistently maintained that a healthy democracy requires a media industry in which a large number of competing voices can be heard by the public and in which no one company is dominant. In the language of media law, this diversity is usually called 'plurality'. Plurality, particularly in the provision of news and comment, implies a significant number of broadcasters (radio and TV) and newspapers, all with distinct editorial stances designed to appeal to 'a wide variety of tastes and interests', as the legislation puts it. Baroness Blackstone, introducing what became the 2003 Communications Act into the Lords, said that one of the main purposes of the legislation was 'to ensure the existence of a range of media voices, safeguarding the vibrancy of democratic debate'. In an Ofcom report of 2007, the regulator commented that 'Parliament considered that media plurality is important for a healthy and informed democratic society and, accordingly, that insufficient media plurality would be dangerous because of the ability for any person through control of too much of the media to influence opinions and set the political agenda'.[13] We believe that plurality is critical not only to a healthy democracy but also to the maintenance of a dynamic and innovative economy.

Over the last few decades, government has largely withdrawn from intervening in corporate takeovers and rarely comments on public concerns over monopolies. In almost all cases, it has handed authority over to the Office of Fair Trading (OFT) and other regulators. But, partly as a result of the efforts of Lord Puttnam, the 2003 Communications Act gave back some authority to the Secretary of State for Business over the buying and selling of TV, radio and newspaper companies. Lord Puttnam and others convinced the government of the day that standard competition law did not provide adequate protection for media diversity. Media was made a special case and the Secretary of State for Business (Vince Cable) has the authority to ask Ofcom to report on whether any takeover would adversely affect the degree of plurality in broadcasting or in newspapers.

This power was used by the previous government in 2007 after BSkyB had bought 17.9% of the shares in ITV. Ofcom reported then that 'there may not be a sufficient plurality of persons with control of the media enterprises serving the UK cross-media audiences for news..'.[14] If he is so minded after weighing Ofcom's advice, Mr Cable can order a Competition Commission investigation into News Corp's prospective takeover of BSkyB to assess whether it would unacceptably reduce the range of views expressed and the number of entities providing those views. In fact, at least as we understand the legislation, he is entitled to question the proposed deal on the basis that the transaction may prospectively reduce plurality at some stage in the future, not just at the moment the deal is completed.

In the detailed guidance notes from 2004 covering how it intended to use the unusual authority to block a newspaper or broadcasting takeover, the Department of Trade and Industry (now BIS) commented that 'it would be a concern for any one person to control too much of the media because of their ability to influence

[13] Ofcom 'Report for the Secretary of State pursuant to Section 44A of the Enterprise Act 2002 of British Sky Broadcasting plc's acquisition of 17.9% of shareholding in ITV plc, 27[th] April 2007

[14] Ofcom ibid, page 21.

opinions and control the agenda'. The document also provides some useful examples of past transactions that would have attracted the DTI's attention under the plurality provisions. *News Letter* is a Belfast publication that represents the views of determined Unionists in Northern Ireland. The owners of the more moderate *Belfast Telegraph* tried to buy the *News Letter* in 1989. The guidance notes comment that 'the merger would (have led) to the *News Letter* joining the *Belfast Telegraph* in the middle ground, leading to a loss of a distinctive viewpoint in representing Unionist opinion in Northern Ireland'. Similarly, in a 1999 proposal, the merger of two Unionist papers was thought to threaten the future advertising revenues of the *Irish News*, a Catholic title, and was also blocked because of the prospective threat to plurality of opinions on offer. In other words, the government is entitled to protect weaker participants in the media industry against more successful and efficient competitors because of the overwhelming importance of maintaining the diversity in the voices reaching the UK public.

Why the News Corp takeover of BSkyB should be questioned

When News Corp announced the proposal to buy the remainder of BSkyB on June 15th, Chase Carey, News Corp Chief Operating Officer, commented that the company did not 'think that this deal warrants a plurality review.'[15] No evidence was provided. What are the arguments that this opinion is unfounded?

One illustration of how BSkyB could increase its dominance yet further was provided by Sky Television's 2001 bid to provide ITV's national news services.[16] The incumbent provider, ITN, battled successfully to retain the contract and still holds it today. But if Sky had won, ITN would have had to dramatically reduce its costs and reduce its news gathering operations around the world. Eventually its other main customer, Channel 4 News, would probably have been forced to gets its material from elsewhere by using either Sky News or the BBC.[17] Five switched to Sky News as its news provider in 2005, meaning that the BBC and Sky News would have been the only two significant national news providers in the UK. When the contract comes up for renewal in future years, ITV could decide to switch to a consortium led by BSkyB at any time. Although it owns 40% of ITN, ITN's most recent accounts were heavily qualified, in part due to its pension deficit.[18] A duopoly of TV news providers in the UK is therefore a realistic future scenario. A duopoly of radio news provision already exists (the BBC and BSkyB, see earlier section on news provision).

UK merger law is clear that the proposed News Corp purchase of the remaining shares in BSkyB is open to assessment by regulatory authorities. By moving from a position of material influence to one of complete control, News Corp triggers the legal procedures for control of mergers. Nevertheless, the question frequently posed is why does News Corp's purchase of the remaining 60.9% of BSkyB make the situation "worse" than it already is today? News Corp already controls a greater share of UK media than it would be allowed to by law in the two other geographies where it is a significant actor (the US and Australia) and as a result, the UK already has a higher level of media concentration than is the case anywhere else in the developed world. The answer

[15] Speaking on the conference call with analysts following the announcement of the bid proposal.
[16] BSkyB was a partner in the Channel 3 consortium that bid for the ITV news contract. The other partners were Chrysalis, Ulster Television, Bloomberg and CBS.
[17] Channel 4 confirmed this in a submission to the House of Lords Communications Committee in 2008.
[18] The other share holders are Daily Mail and General Trust (20%), Thomson Reuters (20%) and United Business Media (20%). ITN provides video content for the website of the Daily Mail.

is that if a single entity owns all the shares in another company it no longer needs to take the financial interests of minority investors into account. It can run the business in a way that meets the short-term and long-term objectives of the entire organisation or of any constituent part, not of the external shareholders who currently hold shares in BSkyB. This may afford News Corp several important opportunities.

The first is to combine in packages products currently separately offered by BSkyB and News Corp titles. If as mooted by some, BSkyB were to launch a copy of Apple's hugely successful iPad in 2011, enabling users to move around the house watching TV, browsing the internet or reading an online newspaper, BSkyB's current 8.5m customers in the UK could be offered the device and a rational expectation is that News International papers could be provided as part of the household's monthly bill.[19] If this happens long-held reader loyalty to titles such as the Mirror, the Daily Telegraph and even the Daily Mail could be severely tested when a seemingly free edition of the Sun and the Times is sitting on the tablet in the kitchen. In other words, reader loyalty would be measured by an entirely new yardstick than previous competitor options, such as discounting or a new supplement, have ever thrown at it. As indicated earlier, the bundling of a News Corp newspaper into the Sky subscription may make good sense for its owners, but it could be potentially devastating to other newspapers and also to the local distribution network that sustains current sales.

Second, the widespread availability of fast broadband is encouraging the rapid convergence of press and television. Today's newspaper web sites contain increasing number of video clips and extended interviews. Once the News Corp purchase has been completed, stories from Sky News will presumably be carried more and more frequently on the Sun and the Times websites. Links to newspaper stories will appear at the bottom of the Sky News screen. Little by little, News International papers and BSkyB channels, particularly Sky News may merge into one stream of fact and opinion. If this occurred plurality will decline, even if the combined organisation continues to maintain newsrooms that are nominally separate.

Third, the loss of the independent shareholders will allow News Corp greater opportunity to influence, tacitly or otherwise, the editorial coverage of Sky News and other BSkyB channels. The 2006 investigation by the regulators of the BSkyB purchase of ITV shares found no evidence of proprietor intervention in Sky News. The presence of strong independent directors of the company, many of whom have substantial external reputations, helps protect the independence and diversity of what appears on screen, particularly on news programmes. In contrast to this, the Murdoch family openly admits that they have an active role at the Sun newspaper. One UK regulator concluded in 2007 that 'in relation to the Sun, whilst the editor's decisions on news content and stance are generally independently taken, the editor also has regular discussions with other parties, including with Mr (Rupert) Murdoch and News International Executive Chairman, Les Hinton, on a range of editorial matters.' The report further concluded that both 'News International (the UK newspaper holding company) and News Corporation are heavily involved in decisions affecting the circulation and profitability of their newspaper titles.' [20] The editorial independence of Sky News could be threatened by the lack of any need to respond to outside investors and independent directors.

[19] This figure excludes subscribers outside of the UK that take BSkyB products and are included in their total reported figures.
[20] Appendix J of the Competition Commission's report on the 2006 purchase of ITV shares by BSkyB.

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At the time of the acquisition of The Times and The Sunday Times, the government of the day and Mr Rupert Murdoch agreed on the creation of an independent editorial board (with members appointed by News Corp and key aspects of operation determined by News Corp) to safeguard the independence of the editors of those titles from the acknowledged danger of proprietor intrusion. We have been unable to discover in the pubiic record any specific instances of this board considering and resolving contentious matters of the type envisaged initially.

The combination of News Corp's interests in the UK will of course lead to other business synergies which will allow the organisation to sustain its loss-making newspaper activities for longer than any other newspaper company in the UK. BSkyB is forecast to very substantially increase its cash generation as its historic investment cycles in HD and broadband end in 2010. in addition, the combined entity will have the opportunity to become more tax efficient.

Of the small number of voices raised against this proposed transaction, few have focused on plurality. Most have worried instead about the possibility of Sky News moving towards more active support of right-wing causes. News Corp's US TV channel Fox News, with its systematic anti-liberal stance, is offered as an example of what might happen in the UK. Those who support News Corp's takeover of BSkyB usually counter this concern by stating that the impartiality of Sky News is guaranteed by UK legislation that prohibits news providers from straying far from objective truth in their reporting.

This is not a sufficient response; although all the news that makes it on to the screen must be dealt with impartially, there is no requirement for any particular event to be covered. As importantly, the degree of importance ascribed to the elements of a news story is entirely a matter of journalistic judgment on TV as it in newspapers. As an illustration, reporting the investigation into the University of East Anglia climate emails, the Daily Mail's headline was 'Secretive and unhelpful. But scientist in Climategate storm STILL gets his job back'. By contrast, the Independent's story was headed "Conspiracy theories finally laid to rest' by report on leaked climate change emails'. Both headlines are in some sense accurate and impartial, but the reader would be left with very different impressions about the content of the report on the day after its publication.

As Ofcom stated in its 2007 report into the purchase of a block of ITV shares by BSkyB, 'we do not consider that these (impartiality) regulations address the plurality concerns raised because they are not designed to remove the ability of broadcasters to set the agenda by selecting the issues and events that are covered in news broadcasting or by determining the relative importance given to each of these'. In other words, the fact that BSkyB is impartial in its news coverage is not enough by itself to maintain the plurality of fact and opinion reaching the British public. If, for example, it did not wish to report a potential scandal involving a supportive politician, it would be under no legal or regulatory requirement to do so. And if it chose to cover a minor infraction by an antagonistic MP with extreme severity and repetition, there is also no regulatory comeback whatsoever. Powerful media proprietors can exert considerable influence over the politics of any democracy and over the choices -- whether political or economic -- available to and made by consumers.

Some commentators have been tempted to conclude that the widespread availability of alternative news outlets, including blogs and other online sites, protects the UK public and its political leaders against the excess influence of one group. This is a weak argument. A strong democracy requires the press and TV to hold powerful institutions to account and to defend the truth against manipulation by the unscrupulous. Bloggers do not have the resources, financial or otherwise, to do this. Printed newspapers and television news programmes still provide the only real systematic news gathering operations in the UK and there is little immediate prospect of this changing.

There is ambiguous research evidence on the extent to which newspapers and TV influence voting during elections. Although some studies have shown that newspaper endorsements can increase the votes given to a party, others have suggested very limited influence. This is not necessarily important. The crucial, and almost unarguable fact is that newspapers and TV affect political and economic life by deciding which stories are most important and how information, analysis and personalities are portrayed. Iyengar and Kinder's pathbreaking book News That Matters states this very clearly 'television news powerfully influences which problems viewers regard as the most serious'.[21] They go on to write 'by priming certain aspects of national life while ignoring others, television news sets the terms by which political judgments are rendered and political choices made'.

This effect is not just seen in television. Some suggest that newspapers are even more important in pushing readers into seeing some issues as vitally important and others as irrelevant. Peter Kelner, the president of the international polling company YouGov, commented that 'the news of newspapers matters much more than endorsements'. [22]

Similar issues apply to coverage by Sky News and/or News Corp's titles of product launches and pricing innovations from competitors. BSkyB has, for example, a very high level of control over sports rights. An attempt by a competitor to launch an alternative offering, or to compete directly against its channels could be impeded by the failure of the News Corps titles to publicise the availability or pricing of competing services; or any systematic slant against its competitors and in favour of entities with the News Corp stable and/or entities that are known to be supportive of News Corp. More generally, the ability of the UK to continue to be the European leader in the creative industries depends in part on entrepreneurial companies having the opportunity to get their products in front of customers. News Corp's dominance of subscription TV and national newspapers as well as its strong position in book publishing and broadband provision give the company the role of an extremely powerful gatekeeper, This will enable it to block or slow down those innovations not likely to be commercially beneficial to the company. As well as influencing the future of British democracy, the gradual increase in the power of News Corp's UK interests affects the UK's economic prospects.

The same argument also applies to regulatory control. The experience of the past few years, particularly during the recent three year Ofcom pay TV investigation, suggests that regulating powerful companies is now

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[21] Shanto Iyengar and Donald Kinder, News That Matters: Television and American Opinion, University of Chicago Press, 1989. (still in print)
[22] Peter Kelner quoted in the Times of 30th September 2009

extraordinarily challenging, expensive and time-consuming. Despite a widespread sense for the last decade that BSkyB was becoming too powerful it has proved almost impossible to introduce effective regulation to maintain a fair and level marketplace. The proposed BSkyB transaction is liable to exacerbate the problems that even highly skilled regulators such as Ofcom have in maintaining the competitiveness and dynamism of the UK creative industries. The anticipated reduction and/or elimination if Ofcom's powers post a 2012/2013 Communications Act should be of extreme concern.

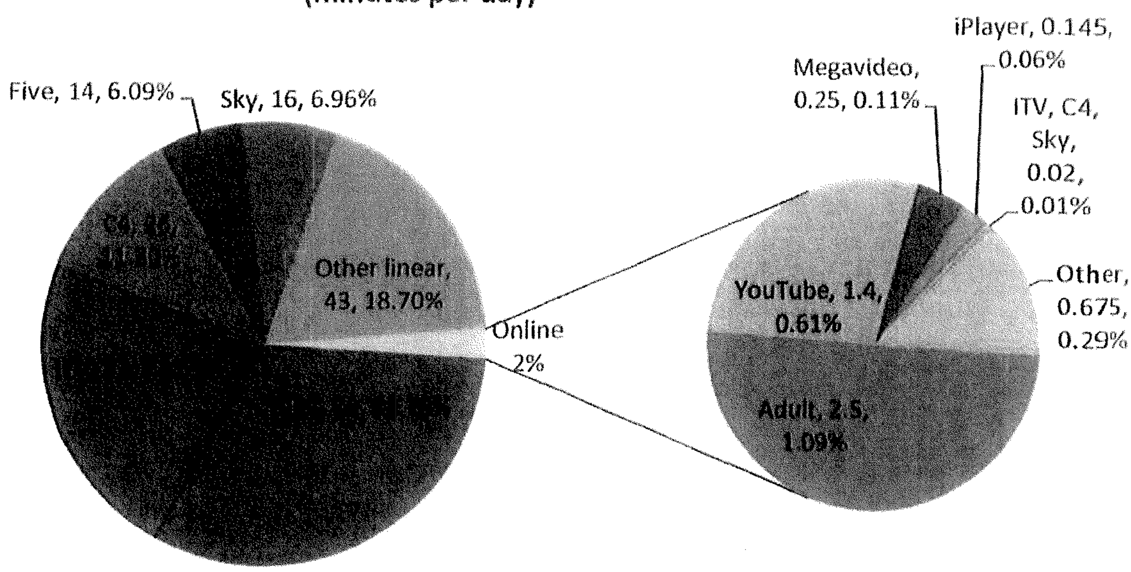
BSkyB often contends that it is vulnerable and far weaker than contended by its adversaries. We conclude differently. In our view, BSkyB has a position of almost unchallengeable strength and stability in the UK TV market and News Corp's share purchase can only strengthen this. In News Corp's announcement of its proposal to buy BSkyB's shares, it noted that the benefits of the deal included 'reducing our exposure to cyclical advertising revenues'.[23] Jeremy Darroch, the CEO of BSkyB, noted in last year's Annual Report 'By delivering on our plans and remaining focused on customers, we have the potential to build a larger, *more durable* [our italics] business and create significant value for shareholders'.[24] No company is immune from change but BSkyB is one of the most resilient companies in Britain. After over 20 years of operation, there is no prospect, in our opinion, of any known organisation replicating the scale and scope of BSkyB. Nor is it possible, in our opinion, for the historic trends in concentration of newspaper circulation being materially reversed. We therefore suggest that the UK government should take a precautionary stance on this transaction, acknowledging that News Corp's position in UK media is very likely to strengthen further in the decades to come. This moment may be the last opportunity to arrest the continued growth in the influence of one company over the UK media industries and over the news and opinion reaching UK citizens.

BSkyB itself paints a different picture of the future. It states that the future is "unknowable" and asserts that its competitors now chiefly comprise Google and Apple and other Internet-enabled models. However, so far these assertions are belied by the evidence of the last decade: BSkyB's revenues have grown regardless of growth in search income for Google or Apple's increased share of consumer electronics sales in the UK. These global giants have hitherto made no investment whatsoever in content, whereas BSkyB controls, for varying number of years, all UK pay TV rights for major sports events and for Hollywood movies. It is theoretically possible that the policies of Apple and Google could change in the future but, for now, Internet-enabled television options have gathered very little traction in the UK.

With circa 72% of UK households now on broadband, the Internet market is reaching greater maturity. Evidence suggests that internet viewing of video has had no impact at all on the absolute amount of conventional linear TV consumption, which is at record historic levels. As Chart 12 highlights, online video consumption accounted for 2% of all minutes viewed per day in December 2009. There is accordingly no material challenge to BSkyB coming from the Internet space in the next five years.

[23] Press announcement by News Corp of the proposal to buy the remainder of BSKyB's shares, June 15 2010
[24] Jeremy Darroch's letter to investors in the BSkyB Annual Report for the financial year 2008-2009.

Chart 12: UK broadcast and online video consumption, December 2009 (minutes per day)



(Source: BARB, Enders Analysis based on ComScore)

BSkyB is a phenomenally capable company, innovative and still hungry after twenty years of near-ceaseless growth. It can proudly lay claim to being one of the best managed and most innovative companies in the UK. But it is precisely these characteristics that make the combination with News Corp's significant UK newspaper businesses a potential threat to the political and economic diversity and strength of voices in UK media. We can be certain that News Corp will go on to control even more of the UK's TV and newspaper business by wearing down all those companies that compete with it, or which represent a threat to its dominance. This approach is also clearly manifested in News Corp's and BSkyB's reactions to all regulation (e.g. its reactions to Ofcom's conclusions in its pay-TV consultation). The impact will be to reduce yet further the range of information, opinions, media and other choices for the UK public, as well as to reduce the ability of regulation to control, or check the increasing concentration in media ownership. In the period 2015-2020, our forecasts indicate that News Corp will obtain a dominant position in both UK TV as well as in newspapers.

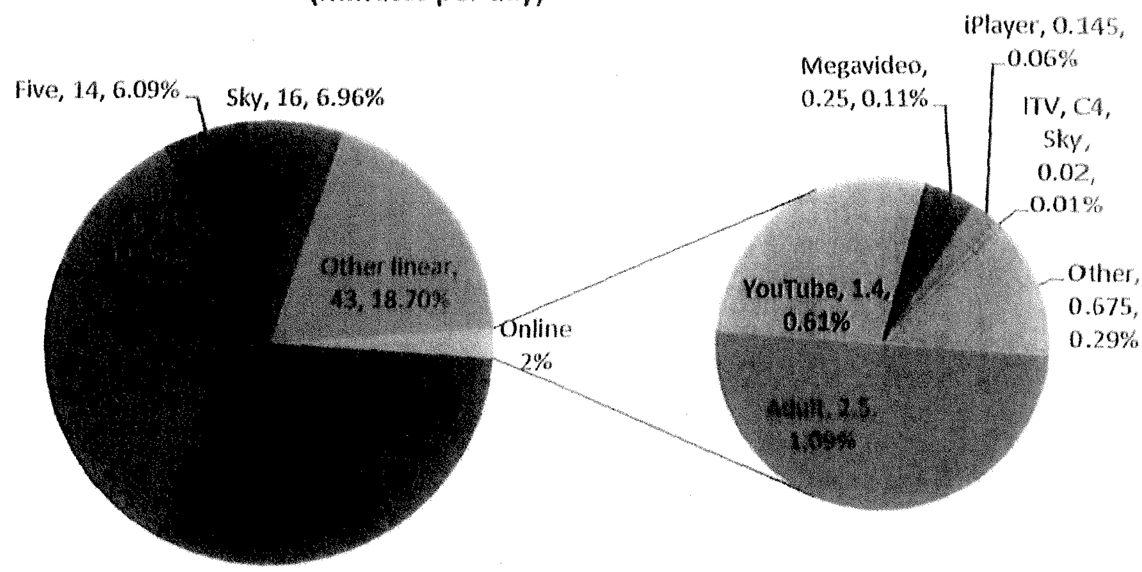
Vince Cable, the Secretary of State for Business, has the right under the terms of the Enterprise Act 2002 as amended by the Communications Act 2003 to make a decision to ask for full investigation into whether the public interest is served by News Corp's purchase of the remaining shares of BSkyB during the period that this deal is being looked at by Brussels. This may be the last time that such an intervention is legally possible and we believe that Mr Cable should take this opportunity.

As mentioned earlier (page 11), we predict News Corp's share of national newspaper circulation will steadily increase from about 37% today to above 40% by 2014, assuming there are no material changes in terms of market supply. Clearly, a national title or national titles owned by other newspaper entities could fold in that timeframe, which would immediately affect shares. More importantly, however, News Corp would have a variety of options at its disposal that it could use to accelerate this position if it chose. Discounting titles is the obvious example, and bypassing distribution channels that support all other media, and the newspaper group has a long track record of this approach in the UK. By taking over the remaining shares of Sky, and therefore creating a locus of UK content media from newspapers, TV channels and online media, News Corp's UK operations could have a substantially greater impact on UK newspaper market shares by shifting the supply framework.

Competitively aggressive examples of this approach could include either giving away copies of the Times or the Sun to Sky subscribers, or providing a tablet with access to a range of News Corp content as part of a broader bundle. There is no doubt that strategic initiatives of this nature could lead to a much more rapid decline in competitor newspaper circulations, and so grow News Corp's newspaper market share substantially beyond 40%, and perhaps beyond 50%, by 2014. Magazine publishers already know something about this: Sky distributes 7.4m copies every month of its magazine to subscribers of its TV services, making Sky the largest circulation magazine in the UK based on ABC data. There are no monthly TV-centred lifestyle magazines in the portfolios of traditional newsstand publishers, so the industry is only marginally affected by this; though we note that the impact of Sky and supermarket own-brand magazines in aggregate have contributed to some general magazine circulation decline in recent years, in our view.

However, free print and/or tablet-based online news access to News Corp titles would be a much more direct assault on UK newspaper publishers. Furthermore, if such a strategy was launched, the flow of advertising revenues would migrate away from competitor newspapers, not just because News Corp titles would have greater market share, but because the group could offer advertisers cross-media packages that no UK media competitor could emulate. The consequences for media competitors could therefore be devastating, and the effects would be felt within a relatively short time-frame if News Corp's UK operations chose to exploit its competitive advantage through a series of initiatives such as those briefly described here.

Chart 12: UK broadcast and online video consumption, December 2009
(minutes per day)



[Source: BARB, Enders Analysis based on ComScore]

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