David Elstein—supplementary written evidence (FCF0024)

House of Lords Communications and Digital Committee inquiry into the future of Channel 4

Further comments following the oral evidence session on 7 September

1. During our introductions before giving verbal evidence on September 7th, Lord Burns made remarks about Channel 4's potential need for injections of capital that surprised me, but – thinking I had mis-heard them – I made no comment at the time. However, reviewing the video, and also the draft transcript, I now realise I had heard correctly. What he said of Channel 4 was: "It would only need capital if it were to make its own programmes...the capital is basically with the independent production sector".

2. This formulation is misleading in a number of ways. Were Channel 4 to decide to create an in-house production arm, virtually no capital would be involved. When I launched my production company, Brook Productions, in 1982, no capital was required other than my doing without a salary for a few months. An office was borrowed against the expectation of a services contract, and no staff hired until a commission was confirmed and cash flow had started. Within a year, my company was one of Channel 4's top ten suppliers, with a turnover of over a million pounds a year.

3. Some production companies invest speculatively in literary rights, or in development teams, but that is very rarely based on either equity injections or even bank debt: accumulated production fees are the main source of such funds. As companies acquire track records, IP and reputation, they can become targets for larger businesses, and may swap equity in their own businesses for a mixture of cash and equity in a larger business. Any new capital that is raised – typically by third parties, usually financial entities or media companies – is in the expectation of growth in earnings and asset value.

4. Despite its disastrous forays 20 years ago, Channel 4 still – in a much more limited fashion – deploys capital on non-programme ventures. It is allowed to invest in small production companies (more than a dozen so far), as well as in such collective digital ventures as YouView, in its online service, All4, and in associated data analytics.

5. Such investments are, of course, dwarfed by the immense sums spent by the streaming services on new and licensed content, mostly funded by reserves and borrowing, replaced in due course by increased earnings as millions more customers are attracted by the programming generated from this investment. Like Sky before them, which dug deep to acquire sports and movie rights, and then used the dynamism of subscription funding to drive revenue sufficient to fund that new content – the classic virtuous circle – the streamers have a weapon that free-to-air broadcasters so signally lack.

6. Indeed, the streamers have an edge on even territorially-limited pay-TV services such as Sky, in that their potential customer base is worldwide. But the Sky revenue engine is still far superior to that of the BBC (flat licence fee, often not inflation-proofed) and ad-funded broadcasters like ITV, Channel 4 and Five, heavily dependent on the vagaries of the TV advertising market.

7. ITV has sensibly diversified, by expanding its historic production base through a series of acquisitions, mostly in the US. This has indeed required capital (as explained in para c), invested in expectation of earnings growth and increase in entity value. ITV sensibly allows its two divisions – broadcasting and production – to operate independently: the broadcast business needs to spread its commissioning bets, and have access to the full range of talent and ideas available in the market. Insofar as ITV Studios can meet the broadcast needs of ITV Broadcast, well and good: and it, too, needs more than one outlet for its talent and ideas.

8. In the last several years, prices in the UK's High-End TV (HETV) market – which is heavily weighted to drama, and attracts significant tax breaks – have been soaring, as the likes of Netflix and Amazon take full advantage of the range and quality of workers and facilities which the UK has to offer (even if the tax benefits were not further heating the market). The Treasury has ended up subsidizing major US companies to the tune of hundreds of millions of pounds, with the five so-called public service broadcasters now responsible for barely 15% of HETV spending.

9. Putting aside the wisdom of such a tax regime, the simple fact is that HETV budgets are inflating at some 30% per annum. The BBC has recently reported that its drama costs have risen by 35% in a single year, with some drama doubling in price. Given its wide range of activities, and long-term programme of internal cost-savings, the BBC can probably absorb that extra £100 million a year for a while: but a time will come when it has to reconsider its output portfolio.

10. ITV can to some extent hedge its bets, as its own productions will have greater value in the programme market. Sky – like Netflix and Amazon –is hedging in a different way, by investing in studio capacity: a strategy designed to contain costs within a manageable framework. Five has only limited exposure to the HETV genre, but Channel 4 is very much in the prestige drama business, and will have to consider its options if the inflationary trend continues.

11. It can maintain its volume of high-end drama by deploying its reserves: but that would only work for a few years, and leave the broadcaster in a much more vulnerable situation. It can also re-configure its programme portfolio, limiting or eliminating its exposure to the highest risk genres.

12. What it cannot expect is – as Lord Burns' remarks about the symbiotic relationship between the two entities seem to imply – for the independent sector to raise extra capital to fill the gap between what Channel 4 can sensibly afford and what high-end drama costs to make, now and – especially – in the future. That is not how the market works. Nor can

Channel 4 realistically offer to give up more IP (either to the producer, or a third party) in order to secure some limited rights on a show that is rising in price: that would undercut its growing online distribution service.

13. Ideally, Channel 4 would have access to enough capital (its reserves and borrowing powers are limited whilst it is in public ownership) to expand the rights it obtains when purchasing high-end productions, so as to compensate for the raised licence fees competition and inflation have generated. Such rights would at least offset the impact of increased costs, and retain value over the years: otherwise, capital injected simply to pay for extra costs would be dead money.

14. The most misleading aspect of Lord Burns' formulation is the treating of "the independent sector" as a single phenomenon. That is very much not the case. More than half the money Channel 4 spent with independents last year was with non-qualifying companies (those with significant levels of ownership by other media companies). Channel 4 owes these companies no duty: they are there to make a profit and acquire valuable IP for their (mostly American) owners.

15. For Channel 4 to own a production division (or be bought by an entity already owning one) would allow it to displace commissions currently given to the non-qualifiers with productions where all the IP was retained, capable of being deployed internationally as well as domestically. In theory, Channel 4 – were the 31-year-old legislation preventing in-house production to be amended – could launch such a division now, with only modest capital investment. However, all the evidence is that its previous major commercial ventures have been failures, and the evidence of weak internal cost control raises considerable doubts as to the present version of Channel 4, in public ownership, being able to manage such a strategic pivot.

16. Of course, as stated in my previous evidence, Channel 4 is in no immediate financial danger, given that it can reduce its programming costs by massive amounts without endangering its very weak remit, or even its audience appeal. However, settling for stasis, or slow decline, seems a very odd way to deal with a scarce public asset, when the option is available of exploring a private sale, whereby its public service obligations could be strengthened, its inefficiencies eliminated and its long-term financial security assured.

15 September 2021