Why Advertising on CBC/Radio-Canada is Good Public Policy

Prepared for

CBC/Radio-Canada

Prepared by

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1. Consulting Mandate for Nordicity

Over the last few decades there has been periodic debate as to whether CBC/Radio-Canada should rely on airtime advertising as a source of revenue to finance its operations. In order to shed light on the implications of eliminating or substantially reducing advertising, CBC/Radio-Canada commissioned Nordicity to conduct an independent review of the merits, or lack thereof, of adopting such a policy for CBC/Radio-Canada.

Nordicity serves the broadcasting, production, and distribution sectors

Nordicity undertakes strategy, policy, and economic analysis for the media and communications sectors. Nordicity has been contracted to conduct analyses for stakeholders across the spectrum of interests in the broadcasting and production sector over the last 30 years. The firm has been engaged by all relevant federal and most relevant provincial cultural agencies – including Telefilm Canada, the Canada Media Fund, Canadian Heritage, Industry Canada, and the CRTC at the federal level. Nordicity has produced studies for private broadcasters, many of them for the former Canadian Association of Broadcasters. Nordicity produces the annual economic profile of the independent film/TV production sector for the two national associations, and has completed economic, strategy, and policy analyses for these associations as well many of their provincial counterparts. Finally, Nordicity has prepared studies that were made public for broadcasting distribution undertakings (BDUs) individually, as ad hoc consortia, and for the now defunct Canadian Cable Television Association.

Nordicity tapped publicly available data bases and interviewed major ad agencies

As the sponsor of the project CBC/Radio-Canada was involved as to scope and direction, and as a source of information. However, Nordicity is an independent consultancy and the firm stands by the data and analysis presented in this report. While CBC/Radio-Canada is responsible for the accuracy of the data it has supplied, Nordicity used many other independent data sources that are in the public domain. Nordicity's team also directly consulted the advertising industry for insights into the possible outcomes should CBC/Radio-Canada leave the advertising field. As an independent consultancy in the media, entertainment and communications sectors, Nordicity then is solely responsible for the contents of this report.

Ad elimination scenarios assume no replacement funding from government

For this study, two specific advertising reduction scenarios are considered: (i) the total elimination of advertising in all CBC/Radio-Canada TV and digital platform vehicles, and (ii) the reduction of advertising for non-sports programming only.

For the purpose of this report, it is assumed that the federal government would not make up any of the lost advertising revenue currently earned by CBC/Radio-Canada. Thus, it is assumed that the public broadcaster retains its mandate, but has no other public source of revenue to make up the shortfall from the elimination of advertising.

Elimination of advertising would be bad public policy

After systematic research and analysis, this report has three broad conclusions:

1. There is no good public policy reason to eliminate or seriously reduce advertising on the TV services of CBC/Radio-Canada. It does not detract from its public broadcasting mandate.
2. Without advertising revenues and no replacement in CBC/Radio-Canada's budget, the effect on the public broadcaster would be devastating. It would make it exceedingly difficult for CBC/Radio-Canada to fulfill its public broadcasting mandate.
3. While private broadcasters would benefit from some of the windfall of advertising forced to seek new TV outlets, there would be significant negative implications for Canadian programming, independent producers and indeed for the Canadian economy as a whole.

2. Background to Advertising in Canada, in Broadcasting and on CBC/Radio-Canada

Canada's broadcasting system has been shaped over decades by well-considered regulations that are based on a dual public and private broadcasting system. Private and public broadcasters are encouraged to compete openly for Canadian audiences, and both are expected to contribute to the development and exhibition of Canadian programming.

As mandated in the Broadcasting Act and their broadcast licences, private and public broadcasters must support the creation of high-quality, original Canadian programming. CBC/Radio Canada gets public funding to do so and has been permitted to sell adverting on television since the outset of television. Private television has benefitted from market protection and other measures to support access to advertising revenue. It also has indirect access to public funding through the Canada Media Fund and federal tax credits which help pay for the Canadian programming aired by private broadcasters.

CBC/Radio-Canada has always complemented its public appropriation with advertising revenue. In the same way Canada's private broadcasters have complemented their commercial revenue with public support.

Advertising is accepted by Canadians but we have imposed constraints

In total, advertisers contributed nearly $11.4 billion to the Canadian economy in 2010,[1] while the total amount of advertising on television is $3.3 billion. Canada is roughly in the middle of the pack in terms of TV advertising intensity among Western nations, far behind the leading country – the US (0.24% of GDP in Canada vs. 0.47% in the US).

The benefits of advertising, however, are not perceived in Canada to be absolute. Canada has historically taken a cautious approach to advertising; while we accept it as an economic necessity, we monitor and regulate it (more so than many other countries) to guard against potential harms. For example, TV advertisements in Canada must receive 'pre-clearance' from

[1] Source: PricewaterhouseCoopers, *Global Entertainment & Media Outlook*, 2011-2015.

an industry-led committee before being aired. Canadian advertisers and broadcasters practice self-regulation, adhering to industry codes, e.g. restrictions on the amount of advertising to programming aimed at minors.

Although Canadian advertising regulations apply to all broadcasters – private and public – CBC/Radio-Canada further self-regulates. For example, CBC/Radio-Canada does not include advertising in any children's programming, and mostly limits advertising to only 12 minutes per primetime hour - even though all advertising time restraints were removed by the CRTC in 2009. In contrast, private broadcasters generally fall in line with US practices of 16 minutes per hour. Since American programs acquired by private broadcasters are designed for 16 minutes of advertising per hour, it makes it all the more logical for Canadian broadcasters to follow suit.

Conclusion # 1: Canada favoured and implemented a sensible approach to advertising that is evident in the advertising regulations applied to all private and public broadcasters' digital services. CBC/Radio-Canada's additionally judicious approach to advertising is an extension of overall national policies and self-regulation.

Most public service broadcasters around the world earn advertising revenue

While advertising on television is broadly accepted by viewers as a way to subsidize the cost of television programming, the issue as to its appropriateness for CBC/Radio-Canada television services has long been questioned in Canada – by presidents of CBC/Radio-Canada as well as by various commissions and Parliamentary committees.

The evidence of international practice does not back up any argument that the norm is that public service broadcasters (PSBs) have no advertising. In fact, the PSBs of most industrialized countries carry advertising (See Figure 1 below). In terms of the share of national public broadcasting revenues garnered from advertising, Canada is 7th out of 18 western countries (See Figure 2 below). While some argue that advertising somehow detracts from the quality of public broadcasting, the fact is that most western countries (13 out of 18), and the majority of public broadcasters in these 18 countries (20 out of 32) count on advertising as part of ongoing funding for public broadcasting.

Figure 1: Advertising share of total PSB revenues by country

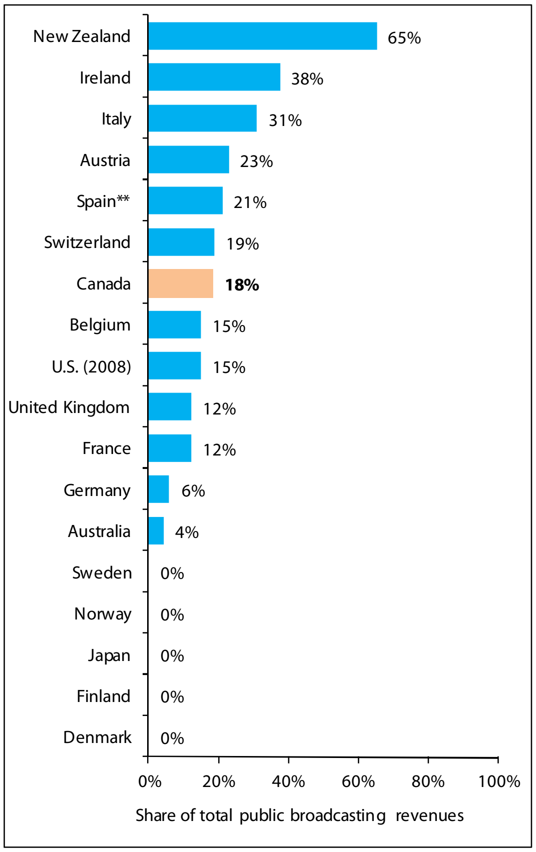
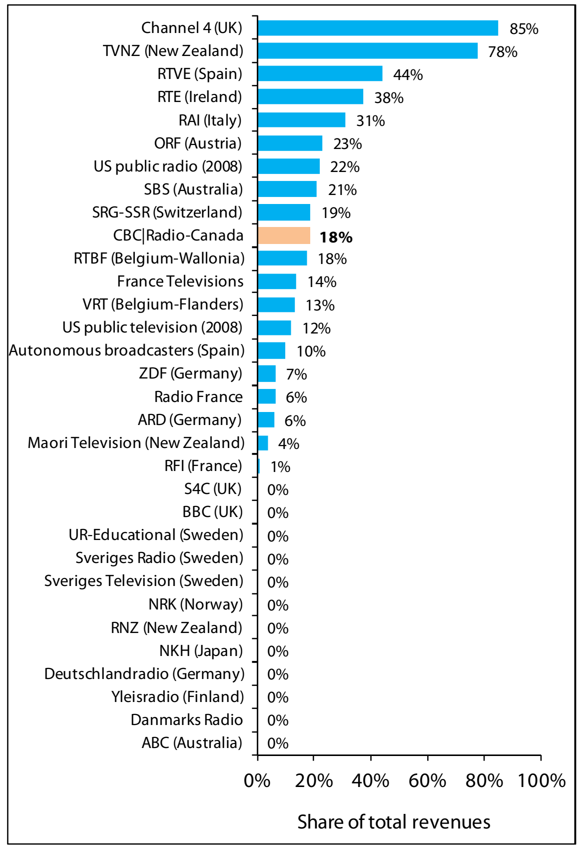


Figure 2: Advertising share of total revenues by public broadcaster



Source: Nordicity, *Analysis of Government Support for Public Broadcasting and Other Culture in Canada*, April 2011.

There is no one model of funding, it seems. For example, in the UK, public broadcasting leads via the BBC Group which has no advertising (in its home territory). However, the UK also established another public broadcaster – Channel 4 – which is entirely ad supported.

While BBC earns substantial commercial revenues, they are largely divorced from its broadcasting operations

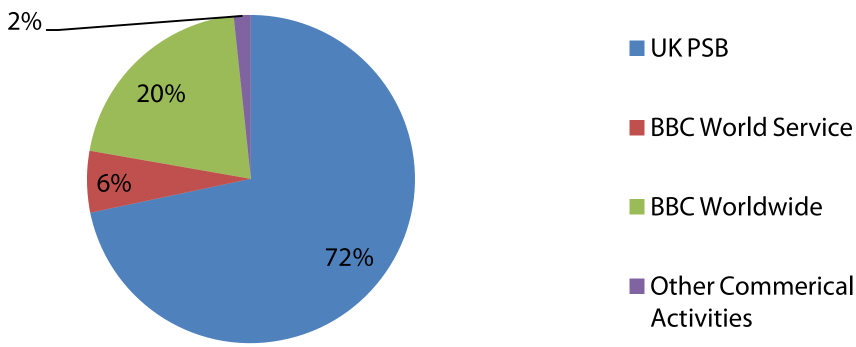
The BBC earns the majority of its revenue– £3.5 billion of £5 billion - through British tax payers via the public license fees on their home TV receivers. The BBC Group also earns substantial commercial revenues from its operations. Overall, the BBC Group is comprised of four principal business segments:

- **UK PSB:** The business unit that provides the UK TV and radio services, and the recipient of the license fees from the public;
- **BBC Worldwide:** The operator of various commercial business for BBC, including its international broadcasting concerns;
- **BBC World Service** and **BBC Monitoring:** Which account for the BBC’s broadcasting and media monitoring services; and

- **"Other Commercial Activities":** A basket which account for commercial broadcasting activities not controlled by BBC Worldwide.

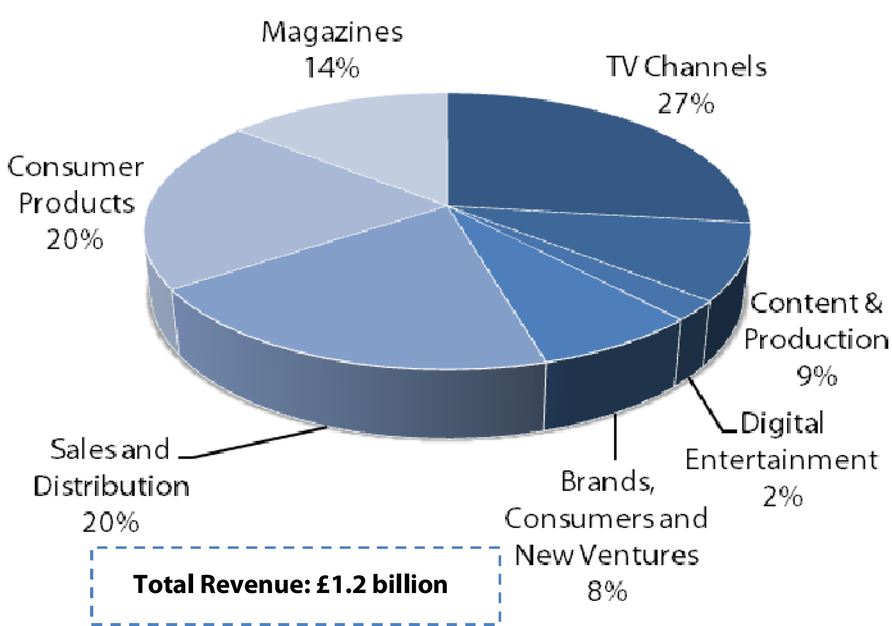
The following Figure 3 illustrates the contributions of BBC Group's various business segments to this overall revenue total for fiscal 2011:

Figure 3: Sources of BBC Revenue by Business Segment (% of 2011 Revenue)



As the above pie chart indicates, BBC Worldwide – which is the largest commercial business unit in the BBC Group – generated roughly 20% of all BBC Group revenues in 2011, or just under £1.2 billion. Figure 4 (below) illustrates the various service lines that BBC Worldwide operated in 2011 and their relative contribution to BBC Worldwide's 2011 revenues:

Figure 4: BBC Worldwide total revenues by business line (percent of 2011 sales)



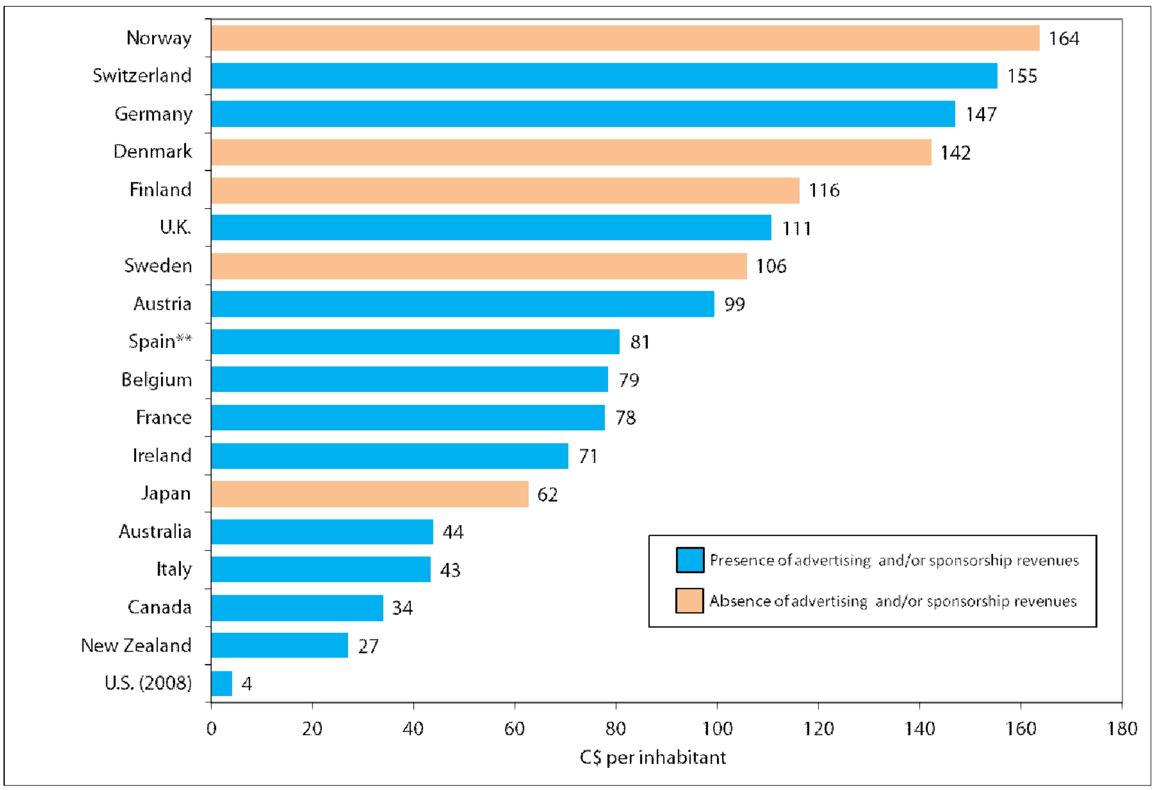
While these businesses are leveraging the content assets and relationships of the BBC, they are separate from the BBC's public broadcasting operations. There is a direct financial benefit to the extent that BBC Worldwide is profitable and returns a dividend to the BBC Group. Indeed, in 2011, BBC Worldwide generated sufficient profit margin to remit £182 million in dividends to the BBC Group. However, it is a relatively small amount compared to the £3.5 billion BBC receives in licence fees.

As the example of the BBC Group shows, success in commercial activities can earn substantial revenues to a public broadcaster. However, while profits can be "ploughed back" to the main public broadcasting operator, they are not as effective as advertising as a revenue source. Revenue from advertising, aside from sales commissions, can all go to help pay for public broadcasting operations..

There is no relationship between advertising and the amount of public funding

Finally, a review of PSBs in western countries (see Figure 5 below) reveals that the presence of advertising revenues has no relationship to the amount of public funding the broadcaster receives.

Figure 5: Advertising and sponsorship revenues and public funding of PSBs per capita



That is, advertising revenue is not used to shore up relatively poorly-funded public broadcasters. For example, Switzerland and Germany are among the highest per-capita public funded public broadcasters, but both also sell advertising and earn sponsorship revenue. Therefore, it does not follow that CBC/Radio-Canada only sells advertising to make up for any public funding shortfall based on it being almost last in per capita terms among Western countries.

In summary, the three points above show that a) there is no standard advertising model for PSBs in industrialized countries; b) while some PSBs have significant commercial revenues, these activities do not generate substantial contributions to the public broadcasting operations; and c) that there is no relationship between the presence of advertising on a PSB and its level of public funding.

Conclusion # 2: All public broadcasters are subject to their own individual mandates and operating structures, the majority of which include advertising as a revenue source. Even when PSBs can generate significant revenues from commercial revenues, the net profits that can be ploughed back to the broadcasting operations are limited. There is also no correlation between use of advertising revenue and the amount of public funding a public broadcaster receives.

Achieving audience success is not counter to PSB mandates

In Canada part of the critique of advertising on CBC/Radio-Canada is that it can lead to programming that is too commercial, too pre-occupied with ratings, and is therefore not always deemed an alternative to private broadcasters. Again, international practice suggests that programming to appeal to audiences is in fact a pre-occupation of PSBs however they are financed. SVT in Sweden is entirely publicly financed and aims for higher audience appeal – and toward a younger audience. RTVE in Spain, which has recently switched out of advertising, has increased its audiences through professional sports. Public broadcasters, whether or not there is reliance on advertising, try to schedule programming that resonates with audiences.

CBC/Radio-Canada, like all PSBs, abides by its mandate to "reflect Canada and its regions to national and regional audiences" and "contribute to shared national consciousness and identity." The *Broadcasting Act,* then, obliges CBC/Radio-Canada to create and commission programming that appeals to Canadians. That stipulation is there, whether or not CBC/Radio-Canada finances itself partly through advertising.

Recent changes to the Canada Media Fund (CMF) - whereby higher audiences increase the size of the broadcaster "envelope"[2] - directly incents CBC/Radio-Canada to develop and commission programming that is popular with Canadian audiences. The appeal to advertisers is symbiotic with the development of programming which appeals to audiences. And advertisers appreciate CBC/Radio-Canada viewers. At the end of the day, there is no public broadcaster without a public. This is fundamental to its relevance.

Conclusion # 3: All public broadcasters seek to reach national and regional audiences regardless of their financing models.

The Public Broadcasting System in the US is not a viable alternative model

The American Public Broadcasting System (PBS) is highly unique to the United States. PBS is unlike the other public service broadcasters in Europe and Commonwealth countries – which are roughly similar to CBC/Radio-Canada in terms of structure and programming orientation

[2] In the past, CBC/Radio-Canada received a fixed amount from the CMF, regardless of audience success.

While it might seem alluring to show the parallels between CBC/Radio-Canada and PBS, the latter is vastly different from any other broadcasting operation that exists in Canada. These differences become quite apparent in a brief review of the three main elements of the PBS.

PBS Operational Structure: Whereas CBC/Radio-Canada is a crown corporation, the national PBS is a private, non-profit corporation, with a self-electing board of directors. More importantly, local PBS stations were built on the premise that the power and the resources would remain with the local stations, and that they would share programs among themselves. Unlike CBC/Radio-Canada's centrally owned and operated regional and local station structure, the PBS system is not a single, centrally-organized broadcasting network. It grew from a local, grass roots heritage, as an expression of the local community. The PBS system now consists of over 350 stations across the USA, each one locally owned and operated.

Briefly, the roles of the national and local elements are as follows:

- **The national PBS** supports its member stations which pay dues to the national PBS, and in turn benefit from PBS promoting public broadcasting support from Washington. Most importantly the national PBS distributes programming which is produced by the larger member stations to all member stations (big and small). PBS also develops and commissions some 1200 hours a year of children's, primetime, educational, and cultural programming for the benefit of member stations.
- **The member stations** are completely independent organizations, as they select, present, and schedule programming they air, and raise money locally as well as receive the lion's share of public broadcasting funding from Congress. They work with local governing boards, community advisors, volunteers, and local partnerships to keep their programming relevant to the needs of their communities.

The PBS system is a product of the 1960s and broadcast technologies have changed substantially since then. It is now more efficient to operate a station group in a more centralized fashion, as programming can be distributed and delivered much more easily than in the past. Many functions are subject to scale economies, e.g. programming acquisition, technical distribution and operations, rights negotiations, content management systems, and marketing. But apart from the programming that national PBS produces, the PBS system still largely operates in its decentralized fashion.

Therein derives its great strength and weakness – strong ties to the local communities, yet unable to take full advantage of the efficiencies of technology in its operational structure. The decentralized PBS operating model is vastly different from the model maintained by CBC/Radio-Canada – one that would be a significant step backward in today's technological environment. One former senior executive of PBS said in a confidential interview for this study that "the 1960s model for PBS worked then, but sure doesn't work now."

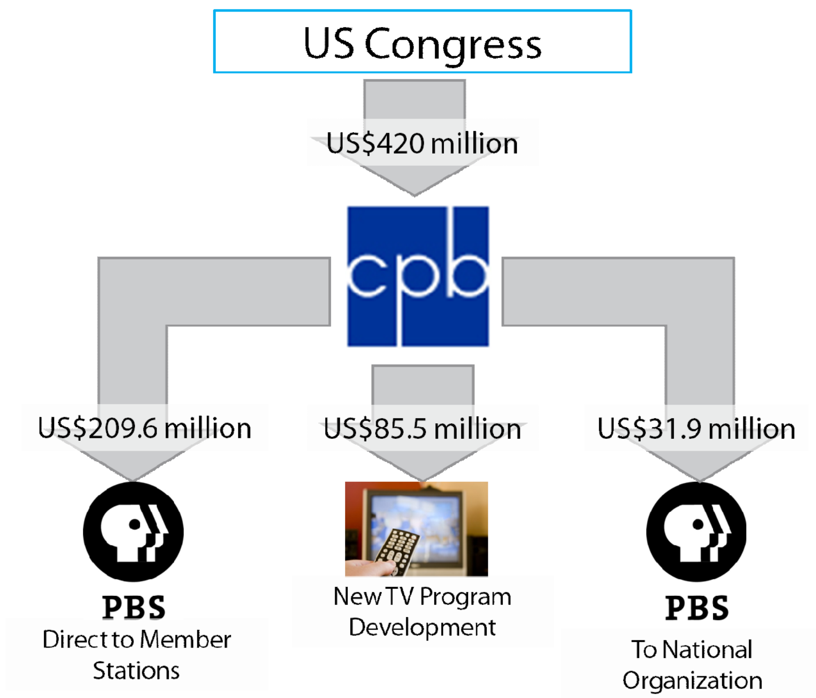
Revenue Model: PBS' revenue model is as complex as its organizational structure. Its main elements are as follows:

- **National level:** The total revenue for national PBS in 2010 was US $571 million, and most of it comes from the dues paid by member stations. PBS national receives some funding from the Corporation of Public Broadcasting (CPB), which is the umbrella organization that receives the annual funds from the US federal government. PBS does receive some funding from foundations, but the national PBS does <u>not</u> actively raise funds from the viewing public - that source of revenue is left to PBS member stations.

- **Local level:** The sum of the revenue for all US-based public broadcasting stations is US $1.7 billion (2009). PBS member stations receive funding directly from the CPB, in total about ten times as much as the CPB allocates to the national PBS, again reinforcing the organizing theme of local responsibility and control. These funds are allocated on public broadcasting stations meeting threshold criteria, which does not include their being members of PBS. The CPB also funds programming directly to encourage minority and diversity production. However, local PBS member stations obtain most of their financing locally from a number of philanthropic, governmental, and sponsorship sources. Indeed, the mix of funding sources varies widely among stations.

The following Figure 6 depicts the fiscal 2010 allocation of federal funds flowing through the Corporation for Public Broadcasting, and illustrates the pronounced policy emphasis on funding member stations directly.

Figure 6: PBS Revenue Structure (2010 data)



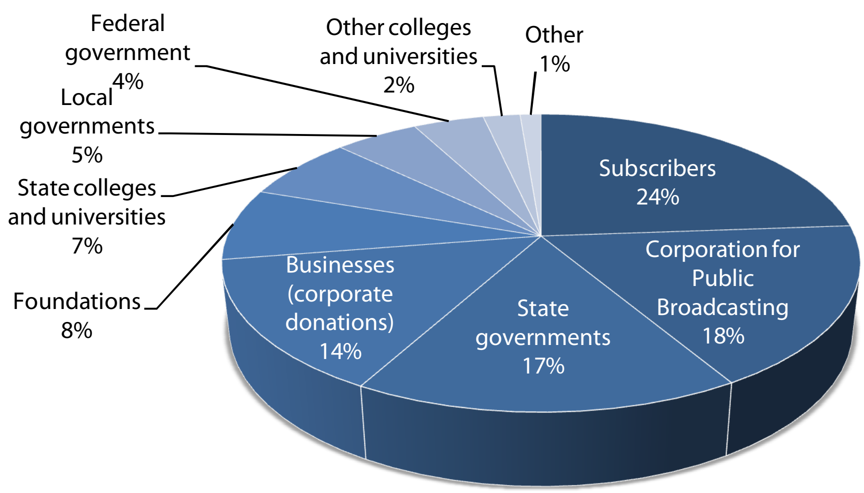
If this model were applied to Canada, it would mean that the Parliamentary vote would fund a central organization to distribute funds to local CBC/Radio-Canada stations, which would somehow be separately mandated as locally controlled non-profits.

Most of the operations of the public broadcasting system in the US take place at the level of the member station. While the overall revenue model is replicated throughout the PBS station system, there are many variations in the relative importance of different sources of funds – market size, location, economic circumstances of its intended audience, state government interest, and the strength of institutional relationships all affect the success of member stations. The largest station is WBGH in Boston with revenues of US $189 million, while other "mid-sized" stations like WRCJ in Detroit (US $19.4 million in fiscal 2009) and KCTS 9 in Seattle (US $19.6 million in fiscal 2010) are far more modest.

The public broadcasting system is vulnerable to the pull-out of major PBS member stations. For example, KCET (Los Angeles) is a major public broadcaster that left the PBS system. PBS can still licence the programming from that station for the national service, but no longer has the membership dues from that station. In terms of production, stations that depart from the system weaken PBS financially. From a service perspective, it leaves holes in the PBS coverage. In fact, the CPB has been urging four other public broadcasters in the Los Angeles area to pool their resources to carry the PBS programming, and thus sustain maintain public broadcasting in that market.

On an aggregated basis for all public broadcasting stations in the US the breakdown by revenue source is presented in Figure 7 below.

Figure 7: Breakdown of aggregated revenue sources for all U.S. public broadcasting (TV) stations (percent of 2009 revenue)



Source: Corporation for Public Broadcasting, *Public Broadcasting Revenue, Fiscal Year 2009*.
Note that these figures represent the aggregate of all PBS member stations and other public broadcasters in the US.

As the above chart indicates, 46% (14% + 24% + 8%) of funding for public broadcasting local TV stations in the US is derived from some form of philanthropic activity. These sources are comprised of subscribers, who are individuals (some of whom live in Canada), corporate donations and sponsorship, and private and public foundations. This ability to generate significant revenue directly and indirectly through donations, in turn, rests on a long history of philanthropy in the US – a history that Canada does not share. Whereas Canadians who gave to charity donated 0.62% of their annual income, Americans gave 1.59% (or 256% more).[3]

Apart from local public and business donations, the collective government subsidies comprise some 44% (state 17% + CPB 18% + other federal 4% + local governments 5%) of the budgets of member stations in the US. Finally, state (and other) colleges and universities contribute a

[3] In 2003 the Fraser Institute, a Canadian think tank, conducted a study comparing charitable giving in Canada and the United States. The study concluded that while roughly the same percentage of Canadians donates to charity as Americans, the extent to which they do so is vastly different.

further 9% of the total budgets. It means that the majority (53%) of the funding received by PBS member stations is actually from government (46%) or quasi-government sources (9%), whereas 46% comes from public, corporate, and foundation donations.

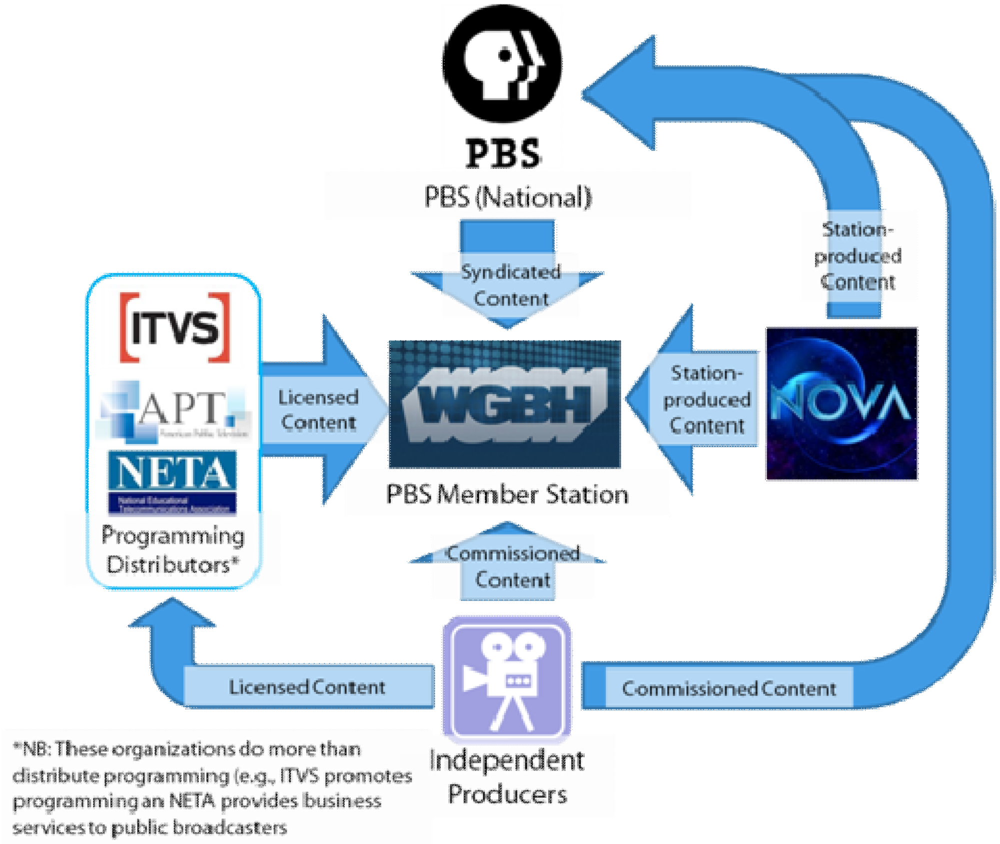
The donations by individuals and by corporations are not without cost, however. There is no authoritative estimate for the cost of raising money for PBS member stations, but they all need to do it; the expenses are considerable and include personnel, production, programming, direct mail, back office operations, and premiums for donors. Meanwhile, there is a decline in the amounts raised in public appeals, and a reduction in the number of people who donate. One definitive study about raising money from individuals for public radio costs indicate that for each dollar raised, it costs 34 cents to do so. While no one could cite an equivalent study for PBS, it was felt that the cost could be up to 50% of the revenue from direct appeals. Even though it is costly, it is still more feasible in the US than Canada. The US enjoys a much higher charitable giving in the US vs. Canada, and Canada would not of course benefit from the longstanding community identification the PBS member station has earned at the local and state level.

Another consequence of the difficulties from direct appeals is that the PBS image can be tarnished by fund raising techniques, e.g. tie-ins with commercial products, poor programming decisions in the fund raising appeals, and lack of editorial integrity. Issues such as these are exacerbated when the effectiveness of public appeals declines.

Any expectation for public broadcasting in Canada that advertising can be replaced in part by public donations should be tempered by the differences in the philanthropy traditions in the two countries, the decline in the efficiency of these approaches in the US, and the adverse consequences on public broadcasting programming itself. It is highly unlikely that similar levels of revenue could be generated by equivalent redeployment of CBC/Radio-Canada into local stations and consequent fundraising

Programming: Historically, PBS has focused its programming efforts in educational programming, arts programming and children's programming – and has been relatively successful in doing so. However, the whole process of financing programming in the PBS system is a fairly complex set of relationships, as depicted in Figure 8 below. It shows the different ways a station can acquire programming – produce/commission programs (limited to the top three PBS members for the most part, or consortia of PBS member stations); license programming from national PBS (which in turn can source some of its programming from the larger member stations); or license content from distributors who acquire rights to shows that fit the PBS requirements (e.g. American Public Television).

Figure 8: Illustration of sources of content for PBS member stations



Only a handful of larger member stations have the capacity to produce in-house or commission production (such as the Nova series in the case of WGBH). The three most important stations from a programming standpoint are WGBH (Boston), WNET (New York), and WETA (Washington). Even these stations rely on independent production companies to do their mainstream shows (e.g. *NewsHour* by MacNeil/Lehrer Productions). Such programming can then be licenced to PBS - which in turn licenses it for free to whatever number of the 350 member stations want the programming.

The vast number of smaller stations do not commission programming for national distribution, so rely more on lower cost programming acquired from distributors. In fact, most PBS member stations produce very little programming themselves. One ex-PBS executive estimated that the "average" PBS station produces about 5 hours of local public affairs programming a week. The smaller stations also rely on programming distributors for cheaper (or free) programming to fill out their schedules. Smaller PBS stations are also talent impoverished as it is not easy to attract highly qualified production executives to locate in the PBS member communities.

Independent producers can be commissioned by member stations or by PBS, although the license fees paid by PBS would not typically cover the overall budget. The producer obtains the remainder of the financing from companies that "underwrite" the show, from foundations, high net worth individuals, government grants, and other sources. Merchandising plays a large role in the financing of production, particularly in the case of kids programming.

What about the national PBS? It has to cobble together funds from the station dues, some money from the CPB, foundations (sometimes – foundations typically help finance local stations or specific programs). Member stations sit on the PBS board, and program concepts can derive from stations, or the national PBS. Larger stations contribute more by way of dues than smaller stations, but small stations have an equal say in the programming produced. Again, it is evidence of the uniquely local approach to the development of public television in the US.

If Canada adapted the US public broadcasting system model for program production, it would require a great deal of adjustment to change the model. Independent producers would somehow need to attract financing from multiple stations and/or their "network" however that would be constructed. CMF guidelines would need to be substantially altered. All these changes would need to be accomplished without the supportive ecology of financing in the US – corporate underwriting, direct appeals to subscribers, state government grants, universities, large foundations, and national endowment funds.

There is another substantial difference in the PBS programming model, and that lies at the heart of the difference in public broadcasting in the US vs. Canada. The PBS programming orientation is public affairs, children's, and documentary – and not fiction, comedy, or sports. CBC/Radio-Canada, of course, covers the latter genres as well as the former. Narrowing the scope of public broadcasting to the PBS program genres would have an adverse impact on the Canadian public broadcasting system mandate to serve and unite all Canadian systems.

In recent years the increasing fragmentation of the US TV market has eroded PBS's uniqueness in this respect. Viewers can now access "PBS-type" programming through many other cable channels in the US (in Canada called specialty-TV services). As a result, PBS now has a very limited audience share and impact on the US market. Its primetime ratings for US networks (Sept. 2009-Sept. 2010) is slightly more than specialty-TV networks like History Channel and slightly less than channels like TNT – but it is still only **1.3%** in a very crowded video marketplace.

Were a similar programming approach undertaken in Canada, it would most likely result in similar competition – given the similar level of market fragmentation. Furthermore, if CBC/Radio-Canada were to commission/produce more education programming it would likely be seen by the provinces as infringing on their jurisdiction.

Conclusion # 4: The PBS operating structure, revenue model, and program production financing could not be readily replicated in Canada. If CBC/Radio-Canada managed to do so, it would likely decline in audience terms to PBS's niche presence in the market.

Being distinctive does not require being ad-free

The mission of most public broadcasters is to be distinctive and an alternative to private broadcasting. Distinctiveness is largely created by scheduling and programming. CBC/Radio-Canada is quite distinctive in the schedule of both the French and English language services relative to their private broadcasting competitors. And Canadians seem to think that

CBC/Radio-Canada is distinctive in its programming.[4] CBC/Radio-Canada could be more distinctive by being ad-free; but there is the potential downside. Relying simply on being ad free is not a sufficient means of demonstrating a broadcaster's distinctiveness. An ad free public broadcaster might rely too much on "no advertising" as its primary mark of being distinctive, rather than concentrating on the distinctiveness of the actual programming.

While the merits of what constitutes a good public broadcasting service can be debated, it must have audience appeal. And that is what the Canadian Broadcasting Act says. Whether or not there are commercials does not affect that objective. In addition, some diversification of revenue through advertising provides more of a bulwark for independence in programming decisions.

Conclusion # 5: Distinctiveness is achieved through scheduling and good programming that makes public broadcasting different from private broadcasting.

Private broadcasters get public support to enable them to meet the objectives of the Broadcasting Act

When the issue that CBC/Radio-Canada competes against the private broadcasters by selling ads is raised, it should be recalled that Canada operates a dual broadcasting system. Both private and public broadcasters are asked to contribute to Canadian programming. The marketplace will not necessarily deliver the volume and type of broadcasting content that fulfils Canada's broadcasting policy.

CBC/Radio-Canada has public and private sources of revenue - advertising, subscriptions from broadcasting distribution undertakings, and government subsidy. So too do Canada's private broadcasters. CBC/Radio-Canada (like public broadcasters around the world) receives public subsidies so that it can address what economists call a "market failure" in broadcasting.[5] Private Canadian broadcasters also benefit from regulation and indirect public subsidies, which go towards helping them to address the market failure in Canadian broadcasting.

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[4] CBC/Radio-Canada and Phoenix Strategic Perspectives Inc., *CBC/Radio-Canada 2010 Opinion Leader Survey: Research Summary*, p. 3.

[5] In a recently published study Nordicity concluded that the direct financial benefit for private broadcasters from the "simultaneous substitution" and section 19 (1) of the Income Tax Act provisions was between **$274 million** and **$335 million** in revenue to English-language private broadcasters in Canada in 2009/10. See: "Value of Public Support for Broadcasters – Simultaneous Substitution and Tax-based Advertising Incentive" by Nordicity for CBC/Radio-Canada.

Conclusion # 6: Private broadcasters have access to public subsidies and regulatory protection to their ad revenue base to help them meet Canadian content requirements. The national public broadcaster has access to advertising revenues to help meet Broadcasting Act objectives. They compete on many levels, but each has a unique contribution to make.

CBC/Radio-Canada radio further dispels the negative perceptions surrounding advertising and public broadcasting

CBC/Radio-Canada's radio services are, of course, ad-free and some would argue make the case for being advertising free for television. After advertising was discontinued in 1974, bold new programming changes were introduced and sufficient funds were made available to enable CBC/Radio-Canada's radio services to succeed and grow – now capturing 13.3% of the total radio audience in Canada.[6]

Being ad free is not the reason for radio's success. Rather, it is due to programming decisions, strong local roots, and annual budgets that are far greater than its competitors in private radio. Whether there is advertising or not, programming works when there is sustained commitment and budget to finance excellence in programming.

Conclusion # 7: CBC Radio's ability to perform well in audience terms is due more to its strong programming strategies and consistent budget support than the absence of on-air advertising. It further demonstrates that audience success and programming choices by public broadcasters are not directly linked to the presence of advertising.

3. Impact on CBC/Radio-Canada and its Ability to Meet its Mandate

If CBC/Radio-Canada cancels all advertising, there would be an immediate hole of **$368 million** in its budget, the gross value of advertising revenue. This amount represents 25% of the total revenues for CBC/Radio-Canada. If the sales costs attributed to that revenue are taken into consideration, the net deficit would still remain large - **$342 million**. Moreover, the reality is that the removal of advertising would start a chain reaction of secondary cost effects that would only exacerbate the financial impact beyond the loss of advertising.

There is a significant programming cost impact

One benefit of advertising is that TV commercials occupy a sizeable amount of airtime, and are provided at no additional cost to the broadcaster. However, under the scenario that TV advertising disappears, it would require replacing by new programming – likely a combination of conventional programming and interstitials or promotion.

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[6] Source: CRTC, *Communications Monitoring Report*, 2011.

There is another major impact, especially for CBC Television. The elimination of advertising is likely to force CBC/Radio-Canada to abandon its commercially valuable sports programming. With no direct revenue to compensate, professional sports programming (hockey, in particular) would likely be dropped because of the high rights and production costs.

Overall, Nordicity estimates that **CBC Television** would have to replace as much as **28%**[7] of its schedule due to the combined loss of advertising minutes and sports programming. On **Télévision de Radio-Canada**, as much as **22%** of the schedule would need to be replaced, largely on account of the lost TV commercials (Télévision de Radio-Canada does very little sports programming).

Indeed, there is a cost saving from exiting sports programming that is estimated at **$159.4 million**. However, there would be a cost to replace such programming from other genres – whether acquired, produced, or commissioned. In total, the loss of advertising would require CBC/Radio-Canada to spend an additional **$349.1 million** on programming simply to fill the airtime freed up by the loss of advertising and sports programming. Thus, the total cost of the airtime replacement programming would effectively cancel out any savings CBC/Radio-Canada would realize from eliminating sports programs for a net additional budget hit of **$189.6 million**.

After accounting for the airtime replacement costs that CBC/Radio-Canada would likely face, we estimate that the net financial impact of removing all advertising from its television and online services would be **$532.8 million**. Thus, the financial impact of loss of advertising would be amplified by the additional programming costs that CBC/Radio-Canada would face.

Table 1: Summary of net financial impact of elimination-of-all-advertising scenario ($M)

	CBC Television	Télévision de Radio-Canada	Specialty television services	Total
Decrease in advertising revenue	221.0	118.0	28.6	367.6
Sales cost savings	14.4	7.8	2.2	24.4
Net increase in airtime replacement costs	95.4	94.2	0.0	189.6
Net financial surplus /(deficit)	**(302.0)**	**(204.4)**	**(26.4)**	**(532.8)**

Source: Nordicity analysis based on data from CBC, CRTC, CAVCO; BBM Canada and CMF.

Allowing advertising in sports would not significantly improve CBC/Radio-Canada prospects

The second scenario examined in this report is the situation should CBC/Radio-Canada decide to eliminate all advertising - except for sports. While sports programming drives audience and advertising revenue, the associated costs for rights and production are commensurately large. There would, in fact, be some financial benefit for CBC/Radio-Canada if it were to maintain ads in sports. By the same approach for the "eliminate all" scenario, we estimate that the shortfall would drop by $150 million to **$381.5 million** (vs. $533 million if all advertising was eliminated). It would appear that CBC/Radio-Canada would be better off financially if it elected

[7] This figure is based on the gross amount of airtime on CBC Television in Scenario A that will require replacement (before taking into account promotional interstitials).

to maintain ads for sports programming, although the financial deficit it would face would still be quite significant – approaching $400 million, or over 20% of its total operating costs.

Conclusion # 8: The elimination of all advertising would have a very significant financial impact on CBC/Radio-Canada. Not only would it lose advertising revenue of $368 million, but it would face some $190 million in additional costs in order to fill the airtime freed-up by the loss of ads and sports programming. In other words, the loss of advertising revenue would actually be compounded by incremental programming costs.

The Canada Media Fund (CMF) compounds the negative budgetary effect

If there is no advertising revenue CBC/Radio-Canada's programming budget would have to absorb a substantial reduction, which would be further compounded by the criteria used to determine CMF funding. In 2011-12, CBC/Radio-Canada's "envelope" in CMF's budget is **$97 million**, meaning that the public broadcaster could tap into almost $100 million of CMF funding for projects commissioned by CBC/Radio-Canada and produced by independent production companies. To put the CMF importance into perspective, CMF-funded TV productions for CBC Television generate **47%** of its audience for the drama/comedy, documentary/factual, children's and variety programming genres.

Without protecting their CMF envelopes, CBC/Radio-Canada would be in danger of failing to maintain its CMF envelope at its current level. If lower programming budgets translated into programming that performed less well in audience terms, the CMF envelope would decline. Thus, there is a spiral effect with respect to CMF programming. CBC/Radio-Canada could lose a significant amount of that important source of program funding for high budget drama, documentary, and children's (and variety) programming.

Budgetary implications for exiting advertising are dramatic

An effective $533 million budget reduction of CBC/Radio-Canada would represent 30% of CBC/Radio-Canada's total operating budget of $1,790 million. This quantification of the impact is even larger when compared to the size of specific budget items. For example, a financial deficit of $533 million represents 43% of the budget for CBC/Radio-Canada's television operations, 63% of its overall television programming expenditures, and is virtually equal to its annual expenditures on independent television production.

Eliminating ad revenue would play havoc with the strategic plan

In 2010, CBC/Radio-Canada announced its five-year strategic plan, including where the corporation wanted to be by 2015. The plan consists of three key thrusts to enhance network programming, regional programming and digital programming. To finance the plan, CBC/Radio-Canada anticipated no additional contribution from the Parliamentary vote, but did include slightly higher-than-average increases from the sale of airtime revenue. Faced with the loss of advertising revenue, CBC/Radio-Canada would need to reconsider the plan.

Conclusion #9: The elimination of advertising revenues could severely hamper the ability to of CBC/Radio-Canada to sustain the quality of its programming – and thereby erode the support of CMF which is critical to the financing of quality Canadian television.

Audience decline would be a tipping point for CBC/Radio-Canada

CBC/Radio-Canada receives about $1 billion annually from Parliament. While on a per capita or per GDP basis this amount is nearly the lowest expenditure of the OECD countries, it still represents a significant amount of money. The question may arise as to whether Canadians are obtaining sufficient "value for money" if the service deteriorates substantially.

If CBC/Radio-Canada removed sports and administered severe cuts in its programming budget, presumably its audience figures would decline, perhaps precipitously. It might approach the 1-2% share of TVO in Ontario, or 2-3% market share of Télé-Québec in Quebec. If it reached anywhere near that point, low audience appeal would surely enter into any calculus of value for money when reviewed by the federal government and Parliament.

Conclusion # 10: Elimination of advertising on CBC/Radio-Canada would jeopardize its ability to meet the objectives of the Broadcasting Act, CRTC expectations, corporate objectives, and current audience levels. Thus, CBC/Radio-Canada might no longer meet any value for money test that Parliament might establish to maintain the annual $1 billion subsidy.

4. Impact of redistribution of CBC/Radio-Canada advertising

While the impact of eliminating advertising from CBC/Radio-Canada would be dramatic, on the other end of the equation the result would be a considerable shake-up for the advertising market as the ad dollars released would represent a windfall for private broadcasters. Interviews of media buying agencies representing 80% of the ad market in the French and English language markets uncovered the following considerations:

Abandoning TV advertising would leave a sizeable gap in the TV advertising market

To put the market impact into perspective, CBC/Radio-Canada's ad revenues are some $368 million in a total TV ad market of $3.3 billion. According to interviews with key Canadian media buyers, CBC/Radio-Canada is deemed a valuable advertising outlet whose absence would be sorely missed. Several reasons are cited because of CBC/Radio-Canada's unique role in the TV advertising market:

- Agencies value CBC Television advertising inventory as being "reasonably priced and providing leverage against the higher-priced private broadcasters";

- CBC/Radio-Canada has a strong local presence in many communities, and represents an effective means for local advertisers to reach local or regional audiences – in smaller markets, losing CBC/Radio-Canada would typically leave one TV alternative;
- CBC Television is a particularly good vehicle for advertisers looking for broad reach into the whole of Canada – only CTV in English Canada is a truly national alternative;
- Because of its substantial presence in the French language market, and because its chief competitor is largely sold out in peak advertising periods, the loss of Télévision de Radio-Canada would force advertisers to scramble to find alternatives.

Generally, **keeping ads on sports** would impact Canada's advertising and ad buying industry in the same way as if all advertising was removed from the public broadcaster. There would be a slight respite for those agencies that buy a national audience through sports programming in that they could continue to buy CBC's Hockey Night in Canada and would not face higher rates on TSN and Sportsnet. Aside from this particular instance, rates, specific buys and advertisers would be negatively affected. Furthermore, there could be internal pressure within CBC/Radio-Canada to increase sports programming, since it would be a revenue generator.

A significant proportion of CBC/Radio-Canada's ad dollars would flow out of TV and some outside of the country

One consequence of the removal of an important broadcaster in the market is advertisers would look toward other marketing vehicles, especially for French language markets. Estimates show that:

- While only about **12%** of CBC Television's current advertising revenue would be redistributed outside Canadian television, they would mainly be to foreign digital platforms, some to border stations, and some retained in Canada in radio, and other marketing and promotion activities;
- An estimated **39%** of current Télévision de Radio-Canada advertising would likely be redistributed to non-TV broadcasting platforms; an additional 8% would go unspent, resulting in a total 48% of current Télévision de Radio-Canada leaving television broadcasting.

Private broadcasters would still gain considerably as the primary beneficiaries of the removal of advertising from CBC/Radio-Canada

CBC/Radio-Canada's exit from TV advertising would obviously benefit its private sector competitors, especially those station groups with conventional and specialty-TV services.

- It is estimated that TV ad rates in English-language markets would rise by 5% to 10% in large markets, particularly in high-demand months; in small markets most media buyers see rates increasing by 10% to 15%.
- Private broadcasters in English language markets could expect another **$207 million** in incremental revenues, representing an 8% increase from what they now earn – split about 2/3 conventional and 1/3 specialty-TV services.
- Private broadcasters in French language markets could aim to receive **$67 million** from the Télévision de Radio Canada exit, representing a 15% increase in their current

airtime revenues – with a relatively greater share taken by specialties (approximately a 45-55% split).

5. Impact on the Broadcasting System and Canadian economy

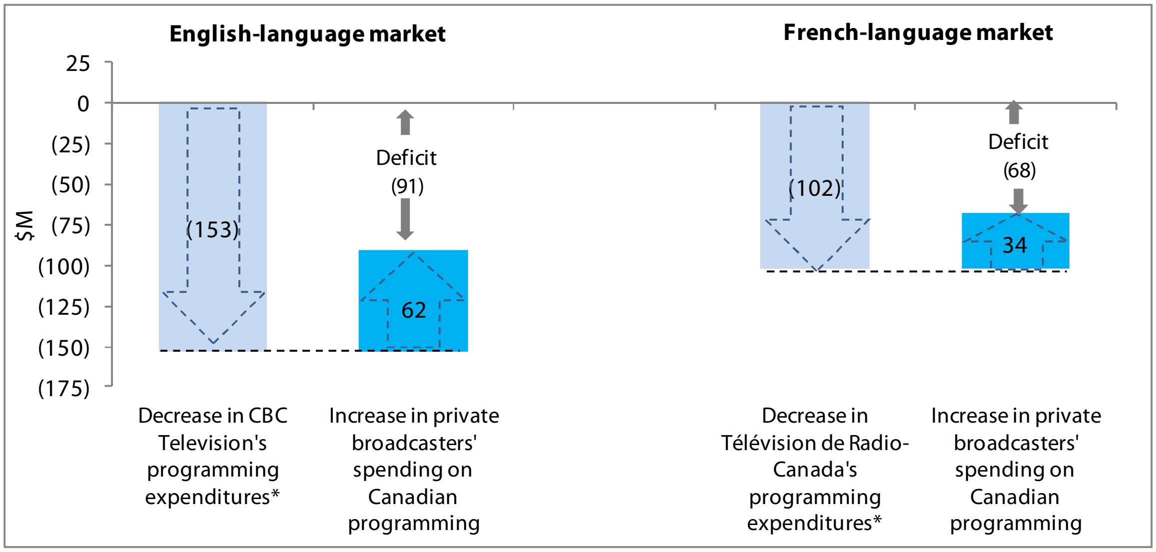
The elimination of advertising on CBC/Radio-Canada would not only impede the public broadcaster from delivering public benefits, it would also lead to an overall net decrease in these public benefits throughout the Canadian broadcasting system. There would be leakage of advertising expenditures from the Canadian broadcasting system. Moreover, private broadcasters invest a lower share of their revenues in Canadian programming than CBC/Radio-Canada. These two outcomes would inevitably result in a significant diminution of public benefits within the Canadian broadcasting system in the form of Canadian programming expenditures (CPE), expenditures on programs of national interest (PNI), and the prominence of distinctly Canadian programming.

With incremental revenues of $275 million, a significant public benefit can be anticipated from private broadcasters – primarily in the additional amount they would spend on Canadian programming. But how much of this increased revenue would Canada's private broadcasters spend on Canadian programming?

- It is estimated that the major private broadcasting groups serving English language markets would spend an additional $62 million on Canadian programming which represents 30 per cent of the additional revenue they would earn.
- The competitiveness of Canadian programming is higher among French language markets; in fact the French language broadcasters spend some 51 cents of every dollar of revenue on Canadian programming. However, there is more projected leakage of ad dollars out of French language television than in English markets as they are expected to turn more to on-line video services. Therefore, at $34 million the estimate for incremental spend on French language programming is lower.

The above figures explain why these amounts are much lower than what CBC/Radio-Canada currently spends with that revenue base on Canadian programming. The leakage factor and the lower proportional spending on Canadian programming add up to a combined net decrease in spend of some **$159 million.** The following Figure 9 depicts leakages amongst the French and English markets separately.

Figure 9: Changes in Canadian programming expenditures



<u>Conclusion # 11:</u> There would be a spending deficit on Canadian programming of $159 million if CBC/Radio-Canada abandoned advertising, and if private broadcasters only spent the minimum they had to on Canadian programming.

Lower budgets would force CBC/Radio-Canada to take budget steps that could lower its quality of programming

The stark situation that would face CBC/Radio-Canada following the elimination of advertising illustrates how substantially the quality of programming acquired, produced or commissioned by CBC/Radio-Canada could be affected. We estimate that CBC/Radio-Canada's reduced programming budget would result in a drop of approximately 40% in average cost per broadcast hour.

Independent production activity in Canada would also suffer

A reduction of CBC/Radio-Canada's programming budget will have an impact on independent production. As in other areas, the resulting increase in expenditures on independent production by private broadcasters is not expected to not pick up the slack.

CBC/Radio-Canada's commissioning activity underpins a large portion of Canada's independent production activity. In 2009-10, CBC/Radio-Canada contributed $189.1 million to Canadian

CBC/Radio-Canada is Canada's largest single contributor to independent production in the conventional television segment - accounting for 54% of total expenditures.

independent production. In fact, CBC/Radio-Canada is Canada's largest single contributor to independent production in the conventional television segment. For example, CBC Television spends more than three times the amount spent by Canada's largest private broadcaster, CTV in the conventional television segment.

- In the **English-language market**, CBC Television's expenditures on independent production are projected to drop by **$46.0 million**;
- In the **French-language market**, the expenditures on independent production would decline by **$38.3 million**;
- Across all television services, we would expect CBC/Radio-Canada to reduce its expenditures on independent production by **$84.3 million**, or nearly one-half of its total independent production expenditures of $189.1 million; and,
- Because of the leverage factor of broadcaster license fees, CBC/Radio-Canada's contribution in 2009-10 triggered some **$576 million** of total TV production by independent producers.

Budgetary restrictions could well lower the quality of programming

CBC/Radio-Canada would likely need to impose budgetary constraints on the commissioning of new production if it lost access to advertising revenue.. It is therefore inevitable that CBC/Radio-Canada would have to make significant reductions to its licence fees across all genres. The diminution of licence fees would be further compounded by the lack of additional funding from the CMF to provide financing leverage. This lack of additional financing contributions to production budgets would likely further drive down production values and quality.

Budgetary restrictions could force a retreat from regional programming

Since independent production lends itself to regional production – i.e., production outside of Montreal and the Greater Toronto Area (GTA) – the reduction in production values could very well be accompanied by a retreat from the regions. In-house production is indifferent to competitive tax credits outside of Ontario and Quebec or CMF funding, and by its very nature, is often produced in-studio. Thus, if CBC/Radio-Canada's production slate were to tilt away from independent production, there would also likely be a loss of regional programming.

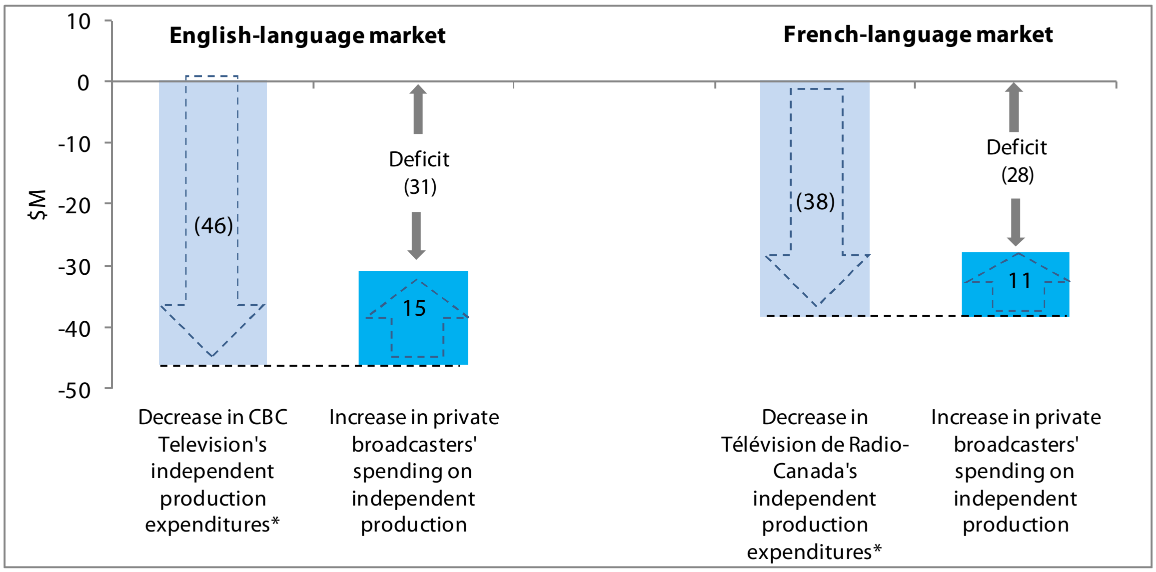
Budgetary restrictions could devastate high risk programming

Some of the most vulnerable – i.e., high economic risk - genres on Canadian television draw a large portion of their production from independent producers. Genres such as drama, documentary and variety rely upon independent producers.

Conclusion # 12: Independent production plays a unique role in helping the Canadian broadcasting system generate programming in under-represented genres, with high production values, and with diversity of regions and points-of-view. Any scaling back of CBC/Radio-Canada's independent production expenditures would put downward pressure on average licence fees, production values and quality. It could also significantly diminish the opportunities for producers in the regions, as well as producers of drama, variety and documentaries.

The loss of advertising revenue on CBC/Radio-Canada would lead to an **$84 million reduction** in its expenditures on independent production. At the same time, private broadcasters' expenditures would only increase by $26 million. That would create a net deficit in expenditures on high risk Canadian production of **$59 million,** as shown in Figure 10 below.

Figure 10: Changes in Canadian broadcasters' expenditures on independent production



Because of the financing leverage that characterizes independent production, this $59 million deficit in broadcaster expenditures would translate into a **$149 million decrease** in the total volume of Canadian independent production.

Conclusion # 13: Economic leakage and the propensity of private broadcasters to spend less per dollar of revenue on independent production mean a significant loss of business for independent producers – a net loss of $59 million, which would otherwise leverage $149 million of Canadian production.

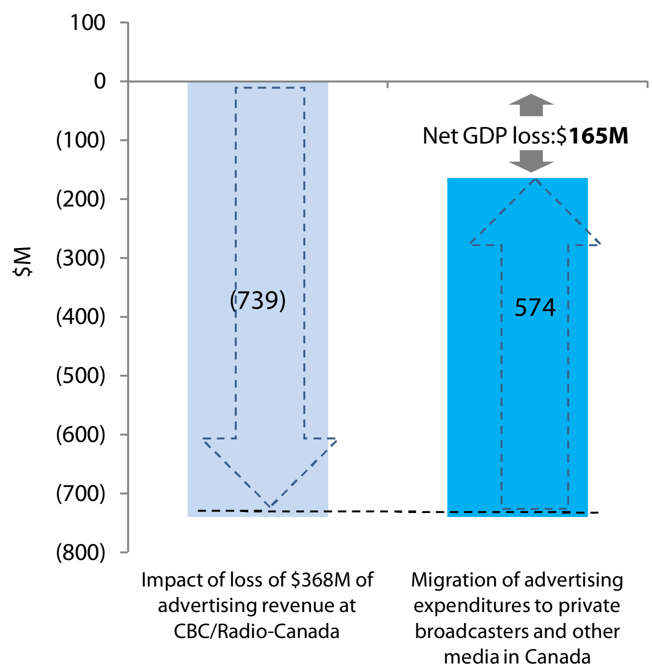
In sum, of the $368 million in advertising revenue lost by CBC/Radio-Canada, $272 million is expected to migrate to private Canadian broadcasters. However, even with these incremental revenues, it is unlikely that the quantity and type of programming produced, commissioned and acquired by private Canadian broadcasters will match that lost from CBC/Radio-Canada.

Conclusion # 14: There would be a reduction in public benefits if private broadcasters spend the new advertising revenues in roughly the same way they do currently.

The diversion of advertising spend away from CBC/Radio-Canada would, in fact, generate net losses to the Canadian economy

The elimination of advertising on CBC/Radio-Canada and the ensuing migration of Canadian advertisers' expenditures to private broadcasters and other media would have a negative effect on the public benefits generated by the Canadian broadcasting system – see Figure 11. In addition, it would have a detrimental effect on the overall Canadian economy.

Figure 11: Impact on gross domestic product (GDP)



Source: Nordicity analysis.

CBC/Radio-Canada contributes significantly to Canadian economic output and helps in supporting jobs. It does so through its direct spending on salaries, acquisition of programming, and spending on other budget categories such as sales and marketing and capital investment. Earlier in 2011, Deloitte & Touche conducted a study for CBC/Radio-Canada that documented that contribution.[8] That analysis was extended to examine the net economic impact if CBC/Radio-Canada withdrew its advertising inventory from the market.

As before, the methodology matches the economic loss to the economic gain arising from the ad spend on other media. It is a net calculation that is characterized by the following negative impacts arising from a different spending profile if CBC/Radio-Canada is to eliminate advertising:

- There is direct leakage out of the Canadian economy altogether, as documented earlier;

[8] Deloitte & Touche LLP, *The Economic Impact of CBC/Radio-Canada*, June 8, 2011.

- There is a much higher proportion of foreign programming acquisition by private broadcasters in English language markets than is CBC Television's practice.

On account of these factors a different multiplier is used to calculate the indirect impacts of the expenditures on the economy. When CBC/Radio-Canada is compared to the scenario where the ad revenue migrates mainly, but not wholly, to private broadcasters, it is estimated that the opportunity cost to the Canadian economy for removing advertising revenues from CBC/Radio-Canada is a loss of **$165 million** in economic output/GDP.

When full time equivalent jobs are calculated, this negative economic impact would result in a net loss of employment of approximately **3,600 jobs** – including an estimated 1,600 in French language markets and 2,000 in English language markets.

Conclusion # 15: Because there is leakage to foreign sources if CBC/Radio-Canada's ad dollars are reallocated to private broadcasters and other outlets – some foreign – it is estimated that the Canadian economy would lose 3,600 jobs and the GDP would shrink by $165 million.

6. Conclusions

Through rigorous analysis of the impacts of eliminating advertising from CBC/Radio-Canada, we have put forward evidence that leads to the following conclusions:

Historical Perspective

- Canadians generally accept advertising on television.
- Most public service broadcasters in Western countries sell advertising as a component of their financing.
- **PBS** is a unique case; upon review it is found to be very different from CBC/Radio-Canada from an operational and governance perspective. Accordingly, it would be very difficult to duplicate in Canada.
- Borrowing from the PBS funding model would not be very productive either. A Canadian PBS would find it very difficult to obtain funds from individuals, corporations, state governments and universities to anywhere the proportionate degree of PBS in the US.
- Finally, the programming acquisition model is completely different for PBS, and runs counter to the Canadian system. In any case it generates a relatively low audience in the US – possibly too low to maintain the current level of government support..
- Canada has a mixed public-private system; commercial broadcasters are the beneficiaries of government policies that stimulate the sale of airtime on private television; however, stifling CBC/Radio-Canada's access to advertising is counter-productive in terms of public benefits in broadcasting.

- International experience shows that some public service broadcasters like BBC and the Australian Broadcasting Corporation (ABC) who do not rely on ad revenues undertake substantial commercial activities. However, the net proceeds that go back to financing public broadcasting operations is far less substantial.
- The recent experiences of France and Spain indicate that PSBs only withdraw from selling ads if that funding is replaced by some form of other public subsidy. Neither types of experience are particularly helpful for CBC/Radio-Canada.

Impact on CBC/Radio-Canada

- The net impact of the elimination of advertising on CBC/Radio-Canada is substantial – a net budget shortfall of **$533 million**, comprised of **$302 million** for CBC Television and **$204 million** for Télévision de Radio-Canada, and **$26 million** for CBC/Radio-Canada specialties.
- If advertising was still permitted on sports, the impact would remain substantial, although reduced to **$382 million (**as opposed to $533 million if all advertising were eliminated).
- If CBC/Radio-Canada spread the shortfall across all departments, it would have some **30%** less to spend on programming on a per hour basis. Program quality would likely be compromised which could lead to a substantial decline in audience tuning that would undermine the value of the Parliamentary subsidy.

Redistribution of CBC/Radio-Canada Advertising Inventory

- The loss of CBC/Radio-Canada as an advertising vehicle would be very badly perceived by advertisers. In English language markets, prices would increase for the other outlets – especially for small markets and for advertisers with mainly reach objectives (since only CTV can substitute CBC Television for those advertisers). Some **$29 million** would leave the broadcasting system, including **$20 million** towards foreign media – mainly digital platforms.
- The French language market would miss Télévision de Radio-Canada even more, since it is a much bigger factor in Quebec, and there are fewer conventional and specialty-television outlets. Rates could rise substantially, and it would trigger a push toward the unregulated digital platforms. Some **$63 million** would leave the broadcasting system, including **$6 million** that would end up on foreign media – mainly digital platforms.

Impact on the Broadcasting System and Canadian Economy

- Private broadcasters would be major beneficiaries of the departure of CBC/Radio-Canada from the market. However, they would not likely make up what CBC/Radio-Canada would be forced to cut given their track record in Canadian programming spend. There would be a deficit in Canadian programming expenditures of some **$91 million** for the English language markets and **$68 million** for the French language markets.
- The overall net economic impact as a consequence of CBC/Radio-Canada moving out of advertising would be **$165 million** in lost GDP, and **3,600 full-time equivalent jobs** in Canada.

- The net propensity to spend less on independent production in Canada by private broadcasters means that there would be an estimated drop in license fees to independent producers of some **$59 million,** and that would mean some $**149 million** less in overall production budgets.

Given these considerations, CBC/Radio-Canada would face severe challenges if a decision to force it to exit advertising was taken. Its programming would be weakened, and its contribution to the economy diminished. There would be a significant reduction of its support of independent producers; and any Canadian content loss would <u>not</u> be made up by private television. The models developed in other countries to raise funds are not realistic in the Canadian context.