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*Mr Carter (!)
page 9 onwards
to the point,
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17/9.*

Dear **[REDACTED]**

Following various telephone calls to your office, we understand that it is not too late to make a submission to the Review that you are currently undertaking of broadcasting policy towards national sporting events. Accordingly, we are sending you the enclosed which, we hope, will be of use to the Review. If you or your office have any comments on the points we raise, we would of course be very pleased to receive them.

Yours sincerely

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Research Student

Sport and the media: the government's role

Professor Julian Le Grand and Bill New
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Introduction

In recent months, policy attention has started to focus on the issue of the availability of sporting events on the broadcast media. This is in part a result of Sky satellite television's aggressive bids for the rights to national sporting events and their similarly aggressive pricing of the sports channels which broadcast them. Partly in response to this, a Review has been instituted by the Department of Culture, Media and Sport of the so-called 'crown jewels' - those sporting events which must be available for broadcast on free-to-air television ('category A' broadcasters in the terms of the Review). The following is a contribution to this Review.

Sky television has in recent years gained exclusive rights to an increasing number of sporting events. These now include English Premier League football, England international football matches, the Ryder Cup golf competition, English rugby internationals and the cricket World Cup. Currently, only a small proportion of the population, about 10 per cent, have access to cable or satellite broadcasts and fewer than this specifically to the sports channels.

On the one hand, critics of these developments argue that the vast proportion of the population are now deprived of sharing in events of national significance. This is 'unfair' and in particular discriminates against those who cannot afford the subscription fees which would allow them to spectate at home. Furthermore, the 'nation' suffers by the restriction placed on people being able to join together to share in a 'national' event, promoting social cohesion.

On the other hand, proponents, including sporting authorities and the satellite television industry ('category B' broadcasters in the terms of the Review), argue that the previous system was paternalistic and did not reflect the latent demand for these sporting events. People have demonstrated their willingness to pay much higher prices for these events than previously, in return for more extensive coverage and a better 'quality' product. This is

reflected in the industry now having money to spend on attracting star players, developing young sportsmen and renovating the capital stock - particularly noticeable in football where satellite television has had the greatest impact.

But concern that certain events of 'national significance' would fall to the satellite broadcasters - Wimbledon, home cricket tests etc. - led the government to act by listing the 'crown jewels'. These events are specified by the Secretary of State under the Broadcasting Act 1996 and can only be changed after due consultation¹:

- * FIFA world cup finals;
- * The Olympics;
- * FA cup final;
- * Scottish FA cup final (only applies to Scotland);
- * Wimbledon tennis (finals week-end only);
- * All cricket tests involving England;
- * The Derby;
- * The Grand National.

This list - and the principles which inform it - are now under review. The principles set out by the government rely heavily on the notion of 'national interest' :

the intellectual defence for having the 'crown jewels' list of events is that these are things which are of relevance to the nation as a whole, where depriving a large swathe of the nation access would deprive them of part of our sense of national identity (Chris Smith, quoted in the Guardian media supplement, pp. 8-9, 1 September 1997)

Specifically, the criteria cited in the discussion document² are the following:

¹ Personal communication, Sean Coster, Department of Culture, Media and Sport.

² Department of Culture, Media and Sport (1997). *Broadcasting events of national significance: criteria for identifying events to be listed.*

- * the event and its outcome has a special national resonance, not simply significance to those who ordinarily follow the sport concerned;
- * it is a pre-eminent and popular event giving it particular potential for encouraging participation in the sport concerned;
- * it is an event which serves to unite the nation; a shared point in the national calendar;
- * it involves the national team in the sport concerned in a major international tournament.

In the following contribution to the review, we will argue that this justification is incomplete, as well as requiring clearer specification. In particular, it fails to acknowledge one particular feature of sporting events which lead to a significant failure in free markets to provide an optimal outcome for the consumer. This feature is the subject of the following section.

Nature of significant sporting events: natural monopolies

The most important feature of sporting events is that they are natural monopolies. This economic term means simply that an industry is the sole supplier of a product, and that this is a direct result of the very nature of the product. There is little or no scope for introducing competition into its supply. In the past, industries which were said to be natural monopolies included the gas, water and telecommunication utilities. Here it was thought that competition was simply impractical: the cost of duplicating pipes and wires to every home would be prohibitively expensive. With developing technology, however, it has been possible to introduce a degree of competition into these industries, particularly telecommunications. More enduring examples of natural monopolies are sites of great natural beauty or historic interest. Here, the 'product' cannot be duplicated, either because it is unique (the Grand Canyon) or because its historic significance has a 'once and only' character (there is only one place where the Battle of Hastings was fought). Such sites are typically controlled in some way by government.

It has not generally been recognised that sporting events also qualify as natural monopolies. Any sporting contest seeks to establish a winner, the best individual or team at a particular

sport or game. These winners exist at a particular time and in a particular geographical area. Within these parameters of time and place there cannot be two 'winners' - this would literally be a nonsense. However, in other geographical areas, similar 'winners' emerge and the desire to see who is the ultimate 'champion' develops, particularly within a nation state, but increasingly at the world level. But in any given geographical area (and within a certain time period, most commonly a year), the possibility of having two winners of the same sporting competition is meaningless.

Take the English (association) football league as an example. The contest here is to establish the best football team in England over one year. There can only be one 'best' team. Therefore, the 'industry' which organises the competition to establish who this might be - currently the Premier League who run the top division of 20 teams - is a natural monopoly supplier of this 'product' (being the competition to establish the champions). Any competitor organisation which wished to enter this market and set up an alternative competition would result in one of two outcomes. It would either run alongside the existing competition, thus diluting the concept of the 'winner'. The likelihood is that the public would consider that the product they wished to buy had effectively been withdrawn, resulting in pressure to re-establish a unified competition. The second possibility is that the new organisation replaces the old one as a kind of business take-over - this is in fact not dissimilar to the process that led to the secession of the old first division teams to form the Premier League in 1991.

Although it is intellectually meaningless to have two winners, it should be noted that this does not prevent new competitor firms in some sporting 'markets' from trying to enter the industry to provide more of the 'same' product. For example, world boxing championship bouts have long been the source of huge riches for the fighters, their managers and agents. This has occurred to such an extent that competitive entry into the market for these champions has taken place. There are now four boxing organisations, each proclaiming a 'world champion' in each weight category in an attempt to gain some of the profits enjoyed by any one single organisation. This has had the effect of diluting the 'value' of each world champion, no longer backed by a monopoly supplier. Attempts to arrange unification bouts - where 'world champions' in each organisation fight each other - are hindered by endless haggling between the participants, usually ending without agreement. The consumer does not gain from this competition, since he or she is offered a sub-standard product (rather than a 'real' champion)

and the numerous championship organisations are still able to wield excessive market power. It is important from this perspective that any government policy should *retain* the monopoly element of sporting fixtures.³

There is another feature of sporting events which relates more closely to the 'national significance' noted in the quote from Chris Smith above, and to at least three of the criteria noted on page 2 of the Department's discussion document². Some popular events, such as the Wimbledon tennis championships, or the Grand National horse race, may produce what economists call 'external' benefits - that is, they contribute to welfare beyond that enjoyed by an individual watching the event. This may occur because of a sense of national togetherness. When the whole nation is encouraged to watch an event - by, for example, ensuring it is free-to-air - social cohesiveness may be enhanced. People who would otherwise not watch can now do so as part of a 'national family', thereby strengthening social bonds and bolstering national unity. This aspect will not be developed in detail in what follows, but is revisited in the recommendation at the end of this paper.

Theory: why government should intervene

Why should government intervene in the activities of monopoly industries? In economic terms, the problem is that such industries tend to restrict the supply of a good, and raise its price, to levels which are not economically efficient. Thus, because a monopolist has a dominance over the market - unlike firms operating in competitive markets, it does not have to take a price as more or less given - it can alter the price of the good by changing the quantity provided. It will seek to set a price which maximises its profits, much as any other firm would do. However, for a monopolist, this will be at a level where it is earning greater profits than are necessary to retain investment of resources in the production of the good. Its position as a monopolist prevents other firms from competing these profits away.

³ Something similar recently occurred in the World Chess Championships, when the two best players in the world refused to play under the existing governing body. The resulting 'world championship' game - featuring other players - was effectively ignored by fans, who followed instead the match between the acknowledged top two players. In football, where a 'competing' event to the FA cup - the old League cup - was introduced, it is instructive to note that it did nothing to compete away the attraction of the older event. It was viewed by fans as simply a separate and less important 'product'.

Furthermore, consumers may be willing to pay more than the cost of producing an extra unit of the good. This, however, does not suit the monopolist because its profits would be reduced (the overall increase in costs is greater than the overall increase in revenue). But as long as the welfare gained by the extra consumer outweighs the profit lost by the monopolist in producing that extra unit, there is a welfare loss⁴. In simple terms, we, the consumers, are not getting as much of the product as we would like, given our preferences and the cost of the good's production.

How does this theoretical discussion of welfare loss in monopolistic industries relate to the situation with sporting events? First we must distinguish two types of monopolistic relationship in the production of sporting events for consumption. The first is between the supplier - the governing organisation or individual club or team - and the individual supporter who might actually *attend* an event. We are not here concerned with this relationship, which does not involve the broadcast media⁵.

The second monopolistic production process is one which has two stages. First, the supplier of the sporting contest - football's Premier League, the Rugby Football Union, or snooker's WPBSA - acts as a monopoly supplier to the broadcasters. In this stage of the production process, the supplier is not in a position to alter substantially the quantity or quality of the product. The nature of the football league contest or the world snooker championship is, broadly speaking, fixed. There is some scope for limiting the extent of the coverage, or in the longer term limiting the wages of the participants and the quality of the venues. But in the short term at least, these factors are not variable. Furthermore, there is only one product to be negotiated at any one time: that is, the 'rights' to cover a single event (or sequence of events which lead to a single champion). The typical course of events is for the supplier to auction these rights to the broadcaster who bids the highest. In terms of the analysis above, the price

⁴ Technically, if the monopolist were able to engage in perfect price discrimination - charge all consumers exactly what they would be willing to pay - then it would produce at the optimal point. However, in practice this is rarely possible.

⁵ This relationship we believe to be one element under consideration by the David Mellor chaired Football Task Force, set up by Tony Banks. Although the analysis of this paper focuses only on the media consumption of sporting events, we believe it could also inform the Mellor task force's work, as monopolistic relationships and pricing also exist between individual clubs and their supporters.

for a given level of production is raised as far as the market will bear. The capital available to the new satellite broadcasters has allowed them to bid up these prices to high levels.

In the second stage of the production process, the broadcaster acts as monopoly supplier to the individual consumer. In this stage, both the quantity/quality and price are highly variable, at least for the subscription-based channels. They are able to vary the price charged to the individual consumer so as to maximise profits. The price they settle on will, according to economic theory, be higher than the economically efficient level - and therefore the 'quantity' of broadcast units supplied to individual subscribers/viewers will be lower. There is thus a welfare loss when compared to the production which would result from a theoretically perfect market. However, as we have seen, competition is impossible without irrevocably altering the nature of the product and diminishing its appeal.

How the current situation has evolved: why is this a problem now?

It could be argued that this situation has existed for as long as television has covered sporting events. They have always been monopolies; why are we only now deciding that government needs to intervene?

The answer lies in the development of the market for broadcasting. In the early days of television, the BBC was the only supplier of programming. To the consumer this was a monopoly relationship, with the government controlling the price (as it does now) via the licence fee. However, for the sporting authorities who controlled the events which were to be broadcast, the BBC was the only *buyer*, what economists call a monopsonist. Thus, the sporting providers were unable to use their market power to bid up the price because they were only able to engage in an auction with one buyer. If they tried to charge too outrageous a price, the BBC could threaten them with refusing to broadcast the event at all - clearly disastrous for the image and popularity of the sport in question. The BBC's monopsony power acted as a counterweight to the monopoly power of the sports authorities, and successfully avoided monopoly pricing.

This situation was not significantly changed by the advent of ITV, for two possible reasons. First, traditional and established ways of operating may well have persuaded many in the

sporting authorities that it would be detrimental to their sport's image if they auctioned off the sport to ITV, who were, in these matters, an unknown quantity. It was better to stick with a trusted partner. Nevertheless, gradually ITV did start to cover some events, notably association football. But it was not in either the BBC's or ITV's interests to compete in an auction for the rights and it is likely that to an extent they operated as a form of cartel, tacitly agreeing not to damage each other's financial position. The FA Cup final, for example, was shown live on both channels for many years. This 'duopsony', alongside the strong element of tradition, continued to restrain the potential for monopoly pricing⁶.

This situation was radically altered by the arrival of the satellite broadcasters with their vast financial reserves and highly competitive instincts, as we have seen. Their actions have effectively ended the duopsony and ITV have themselves become vigorous participants in the competitive auction for rights, wresting control of Formula 1 racing, some snooker and athletics events, and some European football competition. Channels 4 and 5, though with much smaller financial resources, can nevertheless also bid for a limited number of events with some effectiveness.

It should be noted that the old system was not perfect, and almost certainly led to *underpricing* of many events. That is, monopsony/duopsony buying of sporting rights resulted in low prices to the consumer/viewer, but also little finance for the sports themselves. The price paid by the BBC for many of these events was probably well *below* what consumers would have been willing to pay, leading to a lack of investment in the sports which an efficient market would have promoted. ITV's influence was limited too. As long as it could co-operate with the BBC in keeping expenditure for rights low, it could enjoy the large audiences and advertising revenue generated without having to pass on this income to the sports providers themselves.

The satellite subscription payment system, coupled with the competitive auction for rights, led to consumers' willingness to pay to be more directly related to the production of the sport. This resulted, for example, in the increased ability of English clubs to compete in international

⁶ Although it is worth noting that this relationship was showing signs of breaking down during the 1980s before the advent of the satellite broadcasters, as ITV became increasingly aggressive in its attempts to gain the rights to live football matches.

football markets for the best quality players, arguably leading to a huge improvement in the quality of the product for the consumer. This did not only apply to the sporting providers. The satellite broadcasters, too, responded to the free market amongst consumers, reacting to their demands for more extensive coverage of sporting events which no longer had to share air-time with other programming. Sky now has three dedicated sports channels in response to the demands and willingness to pay of the consumer.

These points should not be exaggerated: ultimately football players, for example, are monopoly suppliers of their own talents and increased spending could simply result in inflated players' wages with no increase in quality. However, these comments are made as a warning against simply returning to the *status quo ante*. A balance must be struck between, on the one hand, monopoly power raising prices and restricting supply, and, on the other, stifling government regulation which prevents efficient market signals from operating to indicate where investment and product development is required by the consumer.

Policy options

One implication of the preceding analysis is that the Government should develop the 'crown jewels' policy by extending them to include a much wider selection of sporting events. The eight events (or parts of events) currently established by the Secretary of State cannot claim to be the only ones which constitute natural monopolies. Many others, including the Premier League championship and the Ryder Cup, are equally monopolistic.

However, there are a number of difficulties with such a proposal. In particular, it is not clear how the pricing of these events will develop even under 'crown jewel' regulations. On the one hand, competition between free-to-air broadcasters could inflate prices in a similar way to that occurring now. Whilst the financial power of the satellite broadcasters would not be evident, the monopoly position of the sporting authorities would still allow them to hold an auction amongst the remaining broadcasters. On the other hand, there is a danger that underpricing might continue to result. Free-to-air broadcasters cannot draw on consumers willingness to pay to finance their broadcasts - the licence fee is fixed and advertising revenue is simply based on quantity not intensity of preference. (It is worth noting that the cricket authorities are

already unhappy with their ability to secure additional funding for their sport because of this restriction). Furthermore, terrestrial channels tend to be restricted in the air-time they can devote to certain events, given their obligations to other programming, and may be less responsive to consumer demands to innovate in the presentation of sporting events.

In our view the appropriate response to these difficulties is to institute a regulatory authority, *Offsport*, to regulate the pricing level and structure of the broadcasters who gain rights to events, the conduct of competitive auction for rights, and the establishment of a modified 'crown jewels' policy.

For category B broadcasters, this agency would exist to prevent them from charging monopoly prices to consumers, or insisting on unreasonable 'packages' of channels which effectively raises the price of watching those channels dedicated to sports events. This option has the advantage of potentially allowing continued higher revenues for the sporting authorities than in the pre-satellite era, as well as retaining the innovations which the private sector's competitive instincts and influence can bring to bear on sports presentation.

However, it is likely that regulation would also be necessary for the competitive auction for rights. This is for two reasons. First, category B broadcasters might otherwise be unfairly disadvantaged because price regulation would restrict their ability to bid for events. Second, category A broadcasters pass on costs to the consumer by means other than subscription, which are difficult to regulate. These costs are passed on indirectly, either by excessive charges for advertising time or, in the case of the BBC, by funds being diverted from other programming or requiring excessive increases in the licence fee. Although free-to-air broadcasts ensure *access* (there is no limitation of supply as is the case in classic monopoly situations) the consumer is not necessarily protected from the *consequences* of excessive prices charged by monopoly suppliers of sporting events. In this role, *Offsport* could act as the adjudicator on bids taking into account the level of the bid (the advantages this gives to the sport itself weighed against the need to recoup these costs from the consumer), and the quality of the proposed broadcast programming.

One consequence of this pricing policy is that no sporting events would *necessarily* be secured for category A (free-to-air) broadcasters. However, it may be felt that the external benefits in terms of national cohesion described above, and articulated in the Department's

own set of criteria, are so important that some such guarantee is necessary. An additional element of *Offsport's* work, therefore, would be to establish those events which are considered to display these external benefits in sufficient quantities that they must be broadcast free-to-air. Unlike the rationale on the basis of natural monopoly, the objective here is to encourage mass viewing of certain events by making them free at the point of use, thereby fostering national unity. This would be essentially the existing 'crown jewels' policy but within a new price regulatory framework.

There would thus be three elements of *Offsport's* work:

- * regulation of category B broadcasters' pricing to subscribers;
- * regulation of the competitive bid for rights to broadcast;
- * specification of those 'crown jewel' events which must be broadcast free-to-air.

Apart from the final aspect of *Offsport's* work, there would be no need to specify individual events because the focus of the regulation would be the pricing and bidding activity of the broadcasters themselves. Furthermore, it should be emphasised that the second element of *Offsport's* work - adjudicating on bids - would not involve a judgement on the extent of television access to the sports in question. Access would be an individual consumption decision by the sports fan on the basis of a fair (regulated) pricing regime. Ensuring mass consumption via free-to-air broadcasts would be a decision made specifically with respect to the external benefits of national unity and cohesion.