

**NO 'THIRD WAY' FOR ECONOMIC ORGANIZATION? NETWORKS  
AND QUASI-MARKETS IN BROADCASTING**

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## **Abstract**

We present two linked, longitudinal case studies of the use of quasi markets in UK broadcasting over the past decade: one looks at the regulated outsourcing of programme making to independent producers, the other at the development of an internal market system within the BBC. New network forms are shown to have arisen from the interaction of legal regulation, contracts, and property rights. However, these organizational forms are also seen to be associated with increased transaction costs and with signs of deterioration in programme quality and innovation. We suggest that for such networks to be a viable ‘third way’ between markets and hierarchy, closer attention needs to be given to the issue of institutional design.

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**Keywords:** networks, quasi markets, television production

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## 1. Introduction

For the past decade and a half, British broadcasting has been the subject of a unique institutional experiment in the viability of different forms of economic organization. Two linked reforms were instigated. The first, initiated by legislation, required terrestrial broadcasting companies to outsource a fixed proportion of their programming to external producers; the second, brought about largely by administrative action, created an ‘internal market’ inside the BBC, the principal custodian of public service broadcasting. The reforms were interpreted by many, critics and supporters alike, as a significant step towards the complete marketisation of the sector. However, partly out of respect for the values of public service broadcasting, core features of a market model – universal pay-per-view and the complete unbundling of production from broadcasting – were resisted. The question now facing practitioners and policy-makers is the following: what precisely is the nature of the structure which has emerged from the past seventeen years of change, and can it be relied upon to deliver the creativity and diversity of programme production which are core aims of current broadcasting policy?

New institutional economics provides a concept around which this debate could usefully be structured – the network. Networks represent a kind of organizational ‘third way’, situated ‘between’, or perhaps ‘beyond’, markets and hierarchies (Bradach and Eccles, 1989; Powell, 1990). On this basis, public policy now actively seeks to foster network forms in a number of contexts. One of these is the use of networks to deliver public services in situations – such as broadcasting – where the state no longer has the role of monopoly provider, but where, equally, complete reliance on private-sector market mechanisms is seen as in some way inappropriate or undesirable. Occupying this space is a particular variant of the network form: the quasi-market.

The aim of this paper is to explore the properties of quasi-markets as networks in the institutional setting of the broadcasting sector. The changes which have occurred in Britain since 1990 allow us to study the development of a quasi-market system. We focus on two aspects of this quasi market: the set of complex, structured relations between independent producers and terrestrial broadcasters which has grown up under the regulatory regime for the outsourcing of programme production, and the equally complex internal market which has operated during this time within the BBC. We present evidence, in the form of longitudinal case studies, of the impact at the organizational level of successive waves of institutional reform. We then offer an assessment of the sustainability of the current institutional experiment in broadcasting in Britain. Because reforms similar to those experienced in Britain are under consideration

or in the course of being implemented in other countries, our study has wider implications for the use of quasi-market mechanisms in broadcasting and other fields. It also has significance for the body of theory relating to the quasi-market and other manifestations of the network form. In particular, it queries whether enough attention has been paid to the role of the institutional framework in underpinning network relations.

Our evidence consists of a series of enterprise-based case studies forming, together, a longitudinal, sectoral study which traces developments from the mid-1990s onwards. The justification for using a longitudinal case study approach is that the factors which determine the quality of inter- and intra-organisational relations within television production companies and broadcasting institutions are numerous as well as often being historically specific. The relationship between the nature of the production process in television and the quality of outputs produced is far from straightforward, with complex and sometimes contradictory tendencies in play. The case study method allows, in our view, appropriate regard to be paid to issues of time and place, and extended and repeated interviewing enables tensions between competing tendencies to be effectively captured. In the original phase of our research we carried out over thirty in-depth interviews in the period between 1996 and 1999 covering eighteen organisations in the UK media industries. In our more recent research, in the year and a half to July 2004 we conducted a further round of twenty in-depth semi-structured interviews with producers, commissioners, channel and business affairs executives, trade associations, unions, independent consultants and regulators. In some cases, we were able to revisit firms and individuals to whom we had spoken in the first wave of interviewing. While the case study approach has its limits, on balance we believe that it does make it possible to capture important organisational and sectoral trajectories and thereby usefully complement more quantitative approaches (see, for example, Dex, *et al.*, 2000) towards understanding structural change in the media industries.

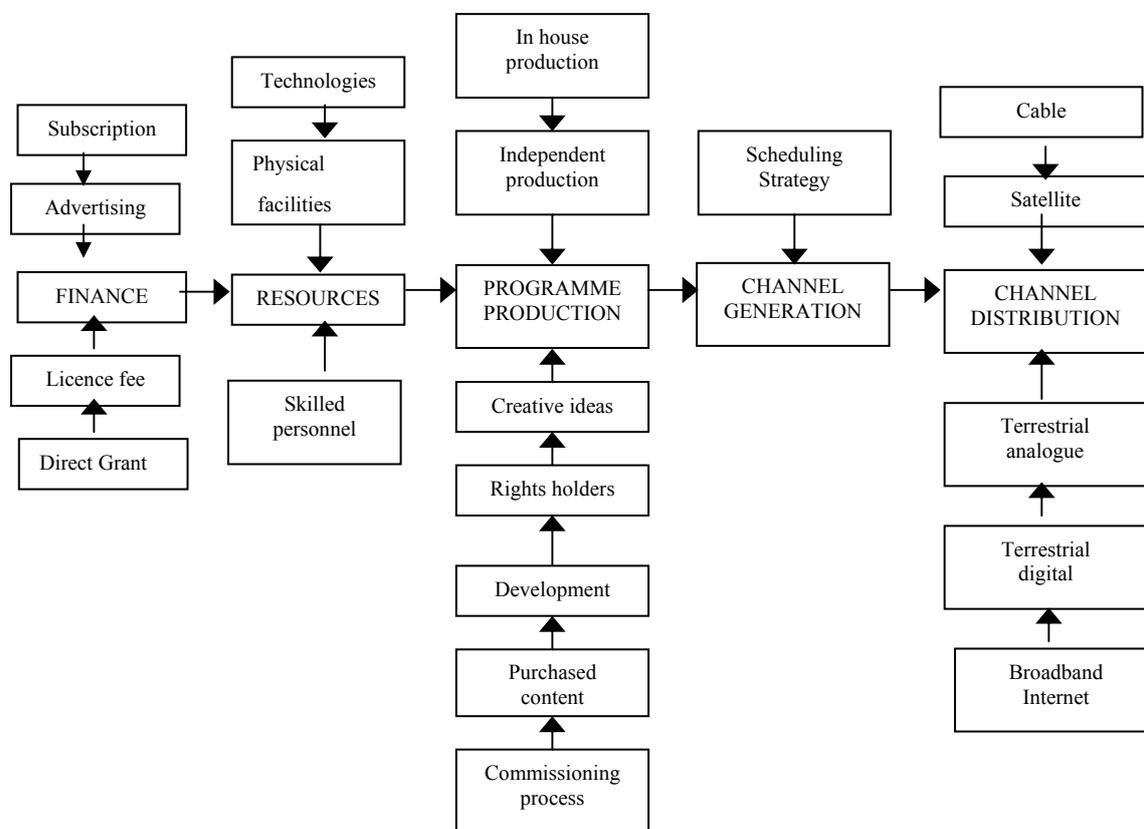
We begin our analysis in section 2 below by describing the structure of UK terrestrial broadcasting and the relevance in this context of the concepts of networks and quasi-markets. The scene is then set for the analysis, in sections 3 and 4 respectively, of the experience of the independent production sector and the BBC. Section 5 consists of an assessment of the evidence and section 6 concludes.

## 2. Networks and quasi-markets in UK broadcasting

Within the UK the vast majority of domestically originated programming is still either produced within or commissioned from just four organizations.: the British Broadcasting Corporation (BBC); ITV plc; Channel Four Television Corporation; and Channel Five Broadcasting Ltd. The BBC is a publicly owned corporation which is funded by the licence fee, essentially a flat-rate tax which is levied on all households using a television. ITV is a network of 15 different regional licences plus a breakfast TV licence, predominantly owned by a single company, ITV plc. Channel 4 is a public-sector corporation funded by advertising that has been broadcasting since 1982. Channel 5 is a private-sector corporation, currently owned by the Bertelsmann group. Each of these organizations relies on a mixture of in-house (or in the case of Channel 5, in-group) production and external programme supply, with the exception of Channel 4 which is entirely reliant on the independent production sector and material purchased from international markets.

The television broadcasting and programme production process can be divided into a series of relatively discrete stages (Barrowclough, 1998; see Figure 1).

**Figure 1: The broadcasting production process**



Stage 1, *finance*, relates to the sources of funds required to begin and maintain the activity of programme production and channel transmission. In the UK context, there are four general types of funding: advertising, subscription or pay-per-view, direct grant, and the licence fee which supports the BBC. Stage 2, *resources*, relates to the provision of the physical facilities, technologies and skilled personnel required for programme production (including studios, editing suites, camera crews, and sound engineers). Stage 3, *programme production* itself, involves combining diverse physical facilities and technical skills with creative ideas and resources (including agreement from specific rights holders) in order to generate programme material. Programme material may be produced in-house, as a vertically integrated activity within a television broadcasting organisation, in which case facilities owned by the organisation will be used and technical personnel and creative talent contracted to that organisation relied upon. Alternatively programming may be bought in from outside. Already-produced content may be purchased, typically from overseas, in particular from the large US market, or ‘independent producers’ can be commissioned to provide new programming.

In the case of independent production, programme material is commissioned by the broadcaster through a process that typically follows a specific sequence: the *proposal*, whereby the independent producer submits an idea for a programme to a broadcaster; the *development*, which relates to the concretization of particular aspects of the proposal, such as budget and allocation of intellectual property rights; the *approval*, which involves the submission of the programme proposal to the broadcaster and the confirmation of the commission by the commissioning editor, and the *contract*, whereby the production agreement is finalised and key terms, such as rights, price, production fee and net profit share are made explicit (see ITC 2002, appendix 5). Independent production companies can vary considerably in size, and when producing television content may themselves rely upon independent facilities houses. Stage 4, *channel generation*, encompasses combining the completed programmes with other material to form a coherent schedule. This involves not simply the allocation of a date and time for transmission but also the development of a scheduling strategy, that is, a rationale for the nature of the portfolio of programming offered on a particular channel and the placement of particular types of programmes in specific slots. This strategy will then feed back into commissioning processes and purchasing decisions and will also need to be effectively communicated to potential audiences. Stage 5, *channel distribution*, relates both to the technical task of transmitting channels and also to the reception of the programmes by those who will finally consume them. Channel distributors bundle channels together into packages and retail these packages to the final consumer.

The current structure of UK broadcasting is the result of considerable institutional, organisational and technological change over the past decade and a half. Broadcasting organisations were subjected to varying degrees of vertical disintegration: in effect, the (partial) separation of stages 2-4 of the broadcasting and programme production process outlined above. Following the recommendations of the Peacock Report (Peacock, 1986), the BBC and ITV were required to contract out 25% of their programme making by volume to independent producers by the Broadcasting Act 1990. The 1990s also saw significant changes within the BBC. The first stage, known as Producer Choice, was introduced in April 1993. It essentially took the form of a purchaser-provider split at the level of the relationship between programme makers and suppliers of production resources. The purpose was two-fold: to enable the BBC's management to obtain information on the indirect, overhead costs of its programmes, in particular accommodation and capital depreciation, and to benchmark the costs of internal resource provision against those of external providers, so making it possible to carry out market testing. The second stage involved the introduction of a number of separate internal units or 'directorates' in the autumn of 1996. Programme makers were allocated to the Production directorate and commissioners to the Broadcast directorate. An internal commissioning system for television production was then put in place, to operate in addition to the 25% external quota.

How far does the structure of UK broadcasting justify the description implied by the terms 'network' and 'quasi-market'? The concept of the network is of particular interest here precisely because it holds out the promise of a third way for economic organisation, 'an alternative to both hierarchies and markets, with some of the advantages of each, but without some of their disadvantages' (Starkey et al., 2000: 299). According to this perspective, networks are characterised by a particular, beneficent combination of competition and cooperation (Sako, 1989). Thus competition, based on the externalisation of production, helps to reduce the fixed employment costs of hierarchical forms of organisation, and to mitigate the rigidities of bureaucratic management structures. At the same time, close cooperation between supplier and customer firms provides a basis for the maintenance of quality in production and for technological and organizational innovation, of the kind which markets based on spot contracting and atomistic competition may not offer (Windeler and Sydow, 2001; Sydow and Staber, 2002; Dyer and Singh, 1998).

It is, however, by no means a straightforward task to identify the conditions under which this type of cooperation is likely to take place. It has been suggested that 'institutional embeddedness' of the kind most likely to nurture sustainable network relations 'means more than the mere presence of

institutions that set reliable rules and provide material and informational resources', it also 'implies extensive interaction and a common orientation among interdependent actors' (Sydow and Staber, 2002: 220). To that extent, the emergence of successful networks is an evolutionary process, the nature of which cannot be wholly mapped out in advance. But in the case of British television production which we are considering here, institutional reform has been a conscious process, to a large degree planned and imposed from above through the use of legal-regulatory and bureaucratic mechanisms. The prominent role of conscious institutional design in the reshaping of the sector makes it appropriate to refer here to the concept of the quasi-market.

At the core of the quasi-market idea is the use of institutional mechanisms to mimic what are understood to be the workings of the *private* market, but within the framework of the delivery of *public* services, that is to say, services which are financed from general taxation or a hypothecated tax (such as the licence fee), and which are in principle made universally available by the state as an incident of citizenship. Because they involve vertical disintegration of production and the displacement of organizational relations by contractual (or more precisely, inter-organisational) ones, quasi-markets contain many of the elements of inter-firm networks. However, they also possess distinctive features of their own, suggesting that they are best thought of as a *variant* of the network form.

Quasi-market reforms were first introduced in Britain in the late 1980s and early 1990s, and now extensively affect education (West and Pennel, 2002), the National Health Service (for overviews see Powell, 2003 and Dixon, Le Grand and Smith, 2003) and the delivery of certain local authority services (Vincent-Jones, 2000). The 'market' aspect of the quasi-market structure is embodied in the replacement of monopoly state provision by competition between rival, independent suppliers, a process which requires legal intervention to end state monopolies and continuing regulation to maintain the competitive process (Prosser, 1997). However, a version of marketisation can also occur through the initiation of purchaser-provider splits within public sector entities, where bureaucratic control plays a more important role than legal regulation.

Quasi-markets differ from more general manifestations of the network form in three essential respects (see Bartlett and Le Grand, 1993, and the discussion of McMaster, 2002). Firstly, within quasi-markets, both for-profit and non-profit organisations can compete for the relevant public contracts. In the broadcasting case, as we shall see below, this has taken the form of independent producers, which are commercial enterprises, competing for commissions both among themselves, and also with entities set up for this purpose within the BBC. Non-

profit organizations which are located entirely within the formal ambit of the public sector are not subject to the threat of insolvency which in principle acts as a discipline on private-sector firms and a mechanism for the promotion of economic efficiency. While it may be possible to replicate some of the effects of insolvency law within the public sector, for example through merging loss-making entities into more successful ones, this, in turn, requires the development of specific administrative mechanisms and devices.

Secondly, the purchasing power of consumers in a quasi-market is centralised in a single purchasing agency, or is allocated to users in the form of vouchers rather than cash. The effect is that there are either few or no 'natural' market prices; instead, tariffs or schedules are set through administrative means, or through negotiation. Again, this has implications for the way in which prices operate as signals for the distribution of resources. As we shall see below, although contracts between the broadcasting organizations and independent suppliers take the form of legally binding arrangements in an open market setting, their 'cost-plus' character, meaning that programme costs are met in advance by the broadcaster and a production fee is paid to the producer on completion, limited, until recently, the possibility of prices playing a market-clearing role.

Thirdly, and relatedly, the final users in a quasi-market are represented by surrogate agencies. This is the case where purchasing decisions are made by doctors on behalf of their patients, and by schools on behalf of parents and children. In the broadcasting context, it is the difference between a system based on pay-per-view, in which consumers register their tastes directly, and one in which decisions on programming are in effect taken by broadcasting organizations on their behalf, via the commissioning process.

The characterization of the broadcasting reforms in terms of the theory of networks and quasi-markets has important implications for our understanding of the goals of regulation in this area. On one interpretation of both network theory and its more specific application in the quasi-market context, the introduction of competition into the programme making process, through the removal of barriers to entry for independent producers and the setting of quotas for outsourced production, would, in itself, provide a stimulus to innovation. Yet network theory also indicates that there are potential costs to vertical disintegration and organizational fragmentation. One of the capabilities which had been tied up with the vertically integrated forms of organisation which formerly dominated the industry was the trust and loyalty of employees who had a confident expectation of job security, in return for which they were willing to transfer part of the value of tacit knowledge and expertise to the

organisation and hence to the viewing public. Quasi-market theorists are, in general, sceptical of the idea that the highly stable and protected character of public service employment, in and of itself, reduces the scope for opportunistic action, let alone generates a surplus from which society as a whole benefits (Le Grand, 2003). However, there are grounds for acknowledging the role played by the organizational culture of the BBC and by the notion of public service broadcasting in promoting, over many years, a context for innovative programme-making. Tom Burns's classic longitudinal studies of the BBC, carried out in the 1960s and 1970s stressed the degree to which BBC staff during this period 'seemed to be devoting themselves - and consciously so - to individual ends and values which were consistent with those of public service broadcasting without being necessarily derived from them', thereby creating what a personnel manager of that earlier era called 'an increment you don't pay for' (Burns, 1994: 91). Georgina Born's more recent and equally comprehensive anthropological study of the BBC points to 'the existence of common professional ethics and standards... supported by common institutional cultures, internal training and limited competition' in the vertically-integrated BBC, 'unifying dynamics that were undermined as a consequence of deregulation' (Born, 2004: 151). The nature of the issues involved here can be understood with reference to this comment on the 1990s reforms, made to the authors of the present paper by an employee representative: 'when the independent quota came in, and outsourcing of cleaning, catering and security began, most employees, far from saying "what an opportunity", were fighting to hold on to their jobs,' with the result that 'it was like working for any other broadcasting organization; it didn't matter to the staff that it was the BBC any more' (interview notes, 2003).

Network theory suggests that the development of resources operating at the sectoral or inter-organisational level is one possible response to vertical disintegration (Starkey et al., 2000; Lampel and Shamsie, 2003), and this argument has been taken up in the policy debate within the sector. Thus the Independent Television Commission (the former sector regulator), in its 2002 review, argued for importance of 'production capabilities' (ITC, 2002: para. 12) which would serve to enhance the capacity for innovative programme making of the sector as a whole. What could have been a straightforward narrative of market liberalisation was thereby qualified by a perception of the importance of 'collective competition goods' (Crouch and Voelzkow, 2004) and other shared industry-level resources of the kind emphasised by institutional and evolutionary theories of the firm. There was a recognition that the success of the independent sector depended upon a range of factors in addition to the intensity of competition: these included the types of contracting arrangements offered by broadcasters, the possibilities which were available for inter-firm

collaboration, and the maintenance of a skilled workforce, but also the role of public intervention in preserving the large home market for qualifying programmes which was supported by the BBC licence fee and the regulatory commitment to public service broadcasting. At the same time, there was a growing view within the sector to the effect that resources developed within particular organizational structures and boundaries could only with some difficulty be re-created at an inter-organisational level. A report by the think tank the Work Foundation, carried out for the BBCI in 2005, argued that ‘freedom, autonomy, good role models, resources (including time), encouragement, freedom from criticism, and norms in which innovation is prized and failure is not regarded as fatal’ were the drivers of creativity in programme production, and that these were ‘by-products of the organisation’s social character’ (Work Foundation, 2005: 17).

Thus the theory of networks and quasi-markets points to the need for an institutional framework or architecture which is supportive of the forms of cooperation on which creativity and innovation depend. But are there, in practice, viable alternatives to complete marketisation, on the one hand, and the simple preservation of the status quo, on the other? We now turn to an examination of our case study evidence on this point.

### **3. The development of the independent production sector**

#### ***3.1 Elements of the ‘architecture’ supporting the independent sector: the quota, terms of trade, broadcast rights and the form of production contracts***

The independent sector did not come into being with the market-led reforms of the 1990s; the initial impetus behind its growth was the creation of Channel 4 in 1982 which, as we noted earlier, was an ‘editorial’ channel with no in-house production facilities of its own. However, the statutory 25% production quota which was introduced in 1990 has been the major stimulus to the independent sector’s growth. Since the quota was intended to ensure, among other things, that vertically integrated organisations, combining production and broadcasting, could more effectively benchmark the efficiency of their programme making capabilities against outside suppliers, it stimulated additional rounds of organisational changes which further encouraged outsourcing. The arrival of Channel 5 provided additional impetus. In 2002, the review of programme supply conducted by the ITC concluded that ‘there remains for the time being an important role for an independent production quota in the UK’ on the grounds that ‘the quota has created access to the main networks for a large

number of new producers, and without it, there is a risk that the main broadcasters would once more favour in-house suppliers' (ITC, 2002: para. 32).

Thus it was in very large part thanks to the quota that by 2005 there were over 800 television programme production companies in the UK (Mediatique, 2005), the vast majority of which qualified for quota-related contracts on the grounds that they were 'independent' in the sense of being legally and organizationally autonomous of the main terrestrial broadcasters. Among the non-independent producers were the production arms of the BBC, the regional licence holders in the ITV network (who did not produce exclusively for the ITV) and a number of other producers with close links to terrestrial broadcasting companies in the form of cross-shareholdings.

The quota was, however, not the only influence on the growth of the independent sector. A second pivotal issue concerned the 'terms of trade' governing contracts between the independents and the broadcasters. The expression 'terms of trade' covers 'the broadcaster's benchmark, framework and guide for the negotiation of production deals with independent producers'; it embraces 'the commissioning procedure, guidelines on development and approvals, along with the broadcaster's starting point on key issues such as rights, production fee, net revenue share, distribution etc.' (ITC, 2002: Appendix 5, para. 2).

Until the early 2000s the terms of trade between broadcasters and independents varied substantially across the sector. The main divergence was between models offering a 'full funding' or 'cost-plus' contract, under which the broadcaster paid in advance the full costs of production plus a fee for the producer, and a 'licensing' option under which production costs were borne by the supplier. Under full funding, the broadcaster acquired all rights in relation to the programme, that is, not just the *primary right* to broadcast it in the UK, but all *secondary rights* relating to its rebroadcast on other channels and further exploitation in the UK or overseas, and *tertiary rights* relating to residual copyright and merchandising. The licensing variant, by contrast, allowed the producer to retain most secondary and tertiary rights, with the broadcaster licensed to make a limited number of showings over a fixed period of time, sometimes with the option of an extension.

At one end of the spectrum were the ITV Terms of Trade, which provided that the ITV Network Centre, the body through which (among other things) agreements with independents were made, acquired only the right to UK terrestrial showings for a limited period, and which, in return, required the supplier to meet all production costs up front and to carry the risk of any

shortfall between the agreed fee and actual costs. The Network Centre had no funds of its own for programme development, so that a licensing model of this kind was its only viable option; however, the ITV Terms of Trade went further than this in seeking to protect the rights of independent producers, guaranteeing them equal access to the commissioning process with in-house ITV producers, and applying the same selection, commissioning and contracting procedures across the board.

By contrast, the BBC, Channel 4 and Channel 5 all operated some version of the fully-funded model, but with variations in the degree to which producers were allowed to retain certain rights. 'Format rights', or 'the rights to the idea, concept or other distinctive features of the programme, including remake rights and sequel rights', which are not normally protected by copyright law, were assumed by Channel 4 as part of the deal for funding, whereas the BBC and Channel 5 allowed them to remain with the programme maker. In other cases, the possibility of negotiation over the terms of the deal was explicitly acknowledged; thus Channel 4 maintained that it was prepared to negotiate on an individual basis with each independent producer it dealt with (ITC 2002, Appendix 5: para. 36).

The ITC review of programme supply, conducted in 2002 (ITC, 2002), came out strongly in support of the ITV model for terms of trade, arguing in favour of 'a presumption... that producers retain rights in their programmes unless explicitly sold to broadcasters and other parties'. In addition, the ITC recommended that there should be clear separation, within agreements, of primary, secondary and tertiary rights; that the terrestrial broadcasters should publish indicative tariffs for primary rights, so that producers would be aware in advance of the scale of funding available in return for the acquisition of such rights; and that a clear demarcation should be drawn between negotiations with distributors over the content of secondary and tertiary rights and negotiations with broadcasters over primary rights. The ITC proposed that these principles should be incorporated into codes of practice, published by the broadcasters, which it would be the responsibility of its successor body, Ofcom to enforce. These proposals were then given effect in the Communications Act 2003, which empowered Ofcom to issue guidance notes for the relevant codes of practice. The Ofcom guidance, also based largely on the earlier ITC Review, was published in early 2004 and the BBC<sup>1</sup> and Channel 4<sup>2</sup> shortly afterwards published new codes of practice incorporating, in essence, the Ofcom recommendations.

The basis for the ITC's conclusion was, in part, the perception that the BBC had used its market power 'to squeeze price and profit margins on primary rights', but even if this argument from abuse of a dominant position had not been available, the ITC would still have opted for the licensing model as a means of enhancing the sustainability of the independent sector: 'unless changes are made to the framework within which commissions are negotiated, then it is unlikely that a strong independent sector, able to build long-term value and capable of attracting significant external finance, will emerge', in particular since the inability of independents to retain secondary and tertiary rights 'reduces their attractiveness to external investors' (ITC, 2002: Appendix 5, para. 21).

The ITC's approach chimed in with the views of the large and more ambitious independents who saw their priority as orientating their operations toward more competitively organized markets for television content. These were independents which saw themselves as sustainable enterprises capable of competing outside the 'protected' regime instituted by the quota. In the mid to late 1990s it was argued that 'because the independent producer doesn't have the capital to develop his business... independent production in this country is nothing more than a cottage industry' (Gutteridge, 1995: 7). One indicator of the precarious position of many television producers was their dependence upon commissions from one broadcaster and the limitation of their expertise to one genre of programming. In 1997 a survey of UK television production found that 58% of officially independent production companies only produced for one channel during the four-year period under scrutiny and 84% did not produce for more than two channels. The same survey found that 78 % only produced in one genre and 94 % did not produce in more than two genres (European Institute for the Media, 1999).

From that period onwards there was a growing division in the sector between a small group of successful and growing businesses, engaging in take-over and merger activity, some attracting venture capital and increasingly adopting an international orientation, and a larger group of smaller independents known in the trade as 'lifestyle companies' because 'winning one or two commissions a year was enough to finance many a lifestyle business' (Mediatique, 2005: 8). In our most recent round of interviews, some respondents spoke of a generational shift which the sector had been going through, with the result that many of the original 'cottage industry' producers were going out of business. The changes introduced by the Communications Act 2003 were expected to accelerate this change. As the larger independents built up stocks of programmes in which they retained secondary and tertiary rights, they would use these assets to attract venture capital and other forms of external finance. For some in the industry,

this was a major change: ‘it’s never been a business sector before’ (industry representative, interview notes, 2003). By 2005, four independent companies had achieved stock exchange listings,<sup>3</sup> and four others<sup>4</sup> had received private equity backing, with the expectation of a flotation at a future point (Mediatique, 2005).

However, the sector was not of one view on the merits of this development. For the smaller independents, the cost-plus deal which had long been typical within Channel 4, whereby programme costs were met by the channel and a production fee was paid on completion, carried advantages, in terms of a guaranteed income, over the ITV model where the company did not receive payments to cover costs until the programme was delivered. In addition, broadcasters (in particular Channel 4) argued that to pursue the rights-based model at all costs would be to fail to recognise the creative contribution of their own commissioners (see for discussion Preston, 2003: 18). Channel 4’s code of practice explicitly acknowledges this, as it states that when the broadcaster develops a programme format or treatment internally before briefing the producer, it reserves the right to depart from the licensing model in recognition of the broadcaster’s role in the creation of the underlying intellectual property in the programme.

### ***3.2 Output deals, repeat trading, creativity and risk***

Related to the role played by commissioners was the use of output deals. As a particular type of governance structure for network forms and, more specifically, for quasi-market relations, output deals can be used to foster creativity and risk taking, and to manage the uncertainty inherent in project-based contracting. We learned from our most recent round of interviews that Channel 4 used just 30 suppliers to provide it with 70% of its originally commissioned material. Reputation and experience were seen to be of vital assistance to commissioners who are looking to establish a reliable source of supply. It was also acknowledged to be in the interest of commissioners to build up particular relationships through repeat trading. As a Channel 4 commissioning editor put it to us:

‘the output deals change the nature of the relationship with the company. The producer does not feel like he is selling. If there is an element of security in the deal, there is an element of collaboration. The proportion of commissioning deals on the basis of collaborative relations is about 10%, but can become higher’ (interview notes, 2003).

A BBC manager said to us:

‘the development of long term relationships has distinct advantages specifically in terms of quality. It is the combination of the delivery of quality product at reasonable cost’ (interview notes, 2003).

In 2003, when announcing a series of output deals with independent documentary makers, Channel 4’s head of documentaries explained:

‘The key thing is, how do we get our conversations to be more grown up rather than being slightly overselling sales person and suspicious reluctant buyer, which characterises a lot of the dealings. I want to have relationships with producers where we both look for the right things.’ (*Broadcast*, 13 June 2003).

This trend towards output deals might have brought financial stability to producers, but for critics of the practice, it weakened competition, thus contributing to consolidation within the independent production sector. Moreover, for the growing segment of independents with the capacity to trade in the international market for broadcast rights, output deals were not viewed positively, as they could imply giving up or at least sharing control over intellectual property rights.

For many in the sector, the development of mechanisms for the sharing of risk between producers and commissioners was at least as important as the intensification of competition in terms of fostering creativity. There was a perception that independent producers had come to fore in the late 1990s and early 2000s in producing innovative ‘cross-genre’ programming spanning the traditional divide, for example, between documentaries and entertainment. The prime example cited was *Wife Swap*, described by its makers as a ‘reality show unlike any other. Two wives take the ultimate challenge and exchange families for two weeks, each day returning from their ordinary day job to their new household, husband and children’.<sup>5</sup> This was an illustration of the use of a new format to present issues of social concern which fell within the traditional remit of public service broadcasting: ‘programmes are not simply entertainment, you are meant to learn something from them’ (interview notes, independent producer interviewed by the authors, 2003)

However, beyond this small segment of highly successful independents, most companies were operating on exceptionally tight margins, in a position of financial fragility. For these companies, output deals were scarcely known, and

few had the economies of scale to benefit financially from the transfer of intellectual property rights to producers brought about by the change to the terms of trade in 2003. In their case, the intensification of competition since the late 1990s meant that ‘risk taking has diminished a lot... the indy is not allowed to fail, because there’s a market and if you’re unsuccessful, someone else will do the job’ (interview notes, industry expert interviewed by the authors, 2004).

#### **4. The BBC internal market**

While the independent sector was undergoing the changes just outlined, the reforms initiated by John Birt in the mid-1990s – Producer Choice and the implementation of purchaser-provider splits – were having unexpected and unwelcome effects on staff morale, innovation and efficiency. While a greater awareness and sensitivity to issues of cost and efficiency were engendered by the introduction of internal trading, the form of the internal market brought new problems of its own. The resource-based directorates set up after 1996 were expected to compete with external facilities providers yet, initially, were not themselves able to bid for outside work on any significant scale. They were also expected to help cover heavy corporate overheads which made it difficult for them to match the charges of the smaller independent providers. Moreover, the charging structure which was implemented was rigid and took little account of high volume use. The limitations of the Producer Choice initiative were recognised by BBC executives themselves (see Wyatt, 2003: 276)

The implementation of Producer Choice led to debates within the corporation concerning which kinds of activities could benefit from market type co-ordination and which were too important to be left to this form of organisation. So, for example, Producer Choice was initially extended to the supply of research and development effort within the BBC. However it was quickly recognised that given the rapidly changing technical environment of broadcasting this was an area of such strategic significance that internal market provision was simply too risky an option (see Childs, 1997 for details).

The 1996 split between broadcast and production was also, in time, seen as generating tensions which limited its ability to deliver improvements (see Born, 2002, 2004). BBC Broadcast received the license fee income, while BBC Production had no autonomous income. Production also had no official claim on rights, which were held and negotiated by BBC Worldwide with rights revenues returning to BBC Broadcast. Just as with the resource departments before them, in-house producers perceived that they were being treated unfairly and that the internal market was being structured in such a way that they could

not compete effectively. Since the production directorate was not allowed to sell its programmes to outside commissioners, while the broadcast directorate could commission from the independent sector, production units were in a weak bargaining position

A former BBC broadcast manager told us in 2003:

‘There was much to be said for the structural separation which John Birt introduced: organisational structure has had quite an influence. It led to specialisation in production and the development of core managerial skills; on the broadcast side, it led to a better understanding of what the audience wanted, and greater efficiency through market testing. However, in practice, the split was taken to an unproductive extreme. The commissioners behaved as if they were buying on a spot market. In time they came to learn that they should be developing long-term relationships with particular suppliers. But at the time, there was a serious loss of morale in the BBC’ (authors’ interview notes, 2003)

The then head of BBC Broadcast has since acknowledged that ‘[t]he chief problem with the reorganisation was that once in existence, BBC broadcast was seen to be bigger and more powerful than anyone expected, creating an imbalance in the BBC. The result of this was that other parts of the organisation tried to claw back what they could. This wasted much energy and time on all sides’ (Wyatt, 2003: 298). Some internal producers also claimed that the split between broadcast and production inhibited the creative process involved in programme making (see Abramsky, 2002). The discontent of in-house producers was partly responsible for the decision of the BBC management in 1997 to guarantee its in-house production directorate 60% of the annual programme expenditure of BBC1 and BBC2. This self-regulated quota reduced the area of competition between in-house producers and independents: competition between inside producers and independents was reduced to only 15% of the market, given the compulsory quota of 25%.

Thus while the implementation of the split between production and broadcast in the BBC raised internal conflicts of interest, the responses which the BBC made to overcome these tensions called forth complaints from independent producers concerned that they could see access to potential commissions being once more curtailed. Although Producer Choice and the extended internal market within the BBC did have the merit of allowing for greater awareness of the costs involved in television production and for enhanced accountability, they also had

the side effects of increased bureaucracy and high co-ordination costs, and were seen as inhibiting innovation.

With the appointment of Greg Dyke as Director-General in 2000 the BBC was subject once more to a wave of organisational reform. The new reforms were in part a response to the perceived limitations of the earlier structural changes. However, whereas the 1996 reforms were responding to the problems of Producer Choice by taking the logic of the internal market further, the 'One BBC' reforms introduced by Dyke could in certain respects be seen as abandoning that logic.

The objectives of 'One BBC' were four-fold: more effective control of overheads; the simplification of the internal market system; the dismantling of the production/broadcast split in certain areas; and the increase of focus on audiences, creativity and collaborative work (Dyke, 2002). Reforms to the internal market were seen as necessary not only in order to reduce high coordination and transaction costs, but also because of the low motivation of human resources which it had entailed and its adverse effects on innovation and creativity. The new structure introduced under 'One BBC' involved the abolition of the Broadcast directorate and its related support structure. This was replaced by four divisions: Television, Radio, New Media and Nations and Regions. At the same time, the Production Directorate was broken up. Thus the idea that the functions of commissioners and programme makers could be separated out and a market-like interface inserted between them was all but given up.

For critics of the Birt reforms, the changes made by Dyke were a necessary corrective:

'Dyke was seen as rolling back Birt. He was more committed to programme making... Dyke took the opposite view to Birt: why outsource if you could do it better in house? Dyke recognized that morale was at an all time low when he took over. When he left staff morale was quite high. Dyke recognised that a lot of the internal market was nonsense; extra layers of bureaucracy and regulation. He was a big picture man, not a detail man, and that was his downfall' (interview notes, employee representative, interviewed by the authors, 2004)

A very different perspective came from those who saw Dyke's BBC as encroaching on the legitimate sphere of the independent sector:

'Birt ran the BBC at low peak capacity. Dyke ran it at top peak. Lots of people were employed, but not to make programmes. The licence fee payers of the next generation will not give the BBC the benefit of the doubt as at present. Under Dyke, the BBC over expanded, and now faces death by a thousand cuts' (interview notes, industry representative, interviewed by the authors, 2004)

This remark proved to be prescient. In 2004 Dyke's successor as Director-General, Mark Thompson, announced a restructuring programme which anticipated the loss of several thousand jobs. In addition, the BBC, under pressure to make greater use of the independent sector, announced that in addition to strictly observing the 25% quota (something which it had failed to do in both 2001 and 2002), it would open up a further 25% of its programming spend to competition between independents and its in-house producers from the autumn 2005 commissioning round. This so-called 'window of creative competition' (or WOCC) was expected to lead to 'an increase in the volume of work for the independent sector' with 'a dramatic impact on revenue growth over the next few years (Mediatique, 2005: 13), while also posing yet another 'profound organizational challenge to the BBC' (Work Foundation, 2005: 43).

## **5. Assessment**

Three interpretations may be suggested as ways of understanding the evolution of British broadcasting since the reforms which began in the early 1990s. According to the first, what we are witnessing is the gradual withdrawal of broadcasting services from the public sphere, a process which will end sooner or later in full marketisation. Pay-per-view and the complete unbundling of production from broadcasting have simply been postponed. The pre-reform structure of the BBC, with the absence of choice and competition, enabled producers to set their own agenda for programme content and quality:

'British broadcasting was effectively run by producer elites, while the economic rewards went disproportionately to the workforce. This unusual arrangement arose from the twin features of monopoly funding and a Reithian ethos - television should be good for you. The definition of what was good for you was left to the programme departments of the BBC and ITV companies, self-perpetuating oligarchies which shared a common value system,

supported by managements and regulators who themselves started their careers in the broadcasting organisations' (Cox, 1997: 22).

In this perspective, the reform programme of the 1990s was the harbinger of the further disintegration of the BBC, which will be inevitable as the independent sector grows in size and influence. This point of view sees the way forward in terms of reforms aimed at enhancing contestability in the sector. Plans to make licence-fee funding fully contestable, although rejected in the review of the BBC's Charter which was completed in 2006, remain on the wider policy agenda.<sup>6</sup>

The second interpretation shares the same prognosis as the first, but is much more pessimistic about its implications. This sees an integrated BBC as the only effective means for guaranteeing the mix of objectives contained in the notion of public service (or public value) broadcasting, including the preservation of quality and innovation in production. Under the pre-reform structure, with limited competition, notions of product quality were largely generated from within the production process. The BBC operated on the basis of a common value system which sustained production capabilities of a certain kind. These are to be understood above all in terms of the shared knowledge, autonomy and long-term view taken of the risks of failure which the BBC offered its producers. In this view, the advent of Producer Choice, the producer-broadcaster split and the regulatory encouragement of the independent sector are seen as fatally undermining this organisational heritage. Even at the point of the partial reversal of purchaser-provider splits in 1997, 'the damage had been done' (Born, 2004: 177). The institutional conditions that had once allowed public service objectives to be met have been undermined, with the consequence that the sector's output has become increasingly uniform, non-challenging and non-informative (see Ursell, 2003). Organisational and financial pressures have also been seen as responsible for an increase in factually inaccurate and misleading programme making, which in turn has exposed both the BBC and some of the more commercially-orientated independents to new forms of reputational risk.<sup>7</sup>

The third interpretation sees the past, and the future, differently. This holds that the reforms of the past decade and a half have proved a success in maintaining a creative and diverse programming base: 'there has been an acceleration of choice besides the maintenance and even improvement of quality' (Work Foundation, 2005: 3). A 'third way' is possible: competition from the independent sector has improved the performance of the BBC while allowing for the emergence of new programme formats which are consistent with the public service goal, while also satisfying the market-driven imperative to satisfy consumer wants. The broadcasting reforms have left the sector as a whole with

‘strong production capabilities’, in large part because of the role played by the quota in ‘[opening] up the programme supply market to many hundreds of independent producers, responsible for adding to the creative and innovative programming available to viewers’ (ITC, 2002: para. 12).

Can we therefore conclude that a viable ‘third way’ for economic organization has emerged, a true alternative to the market-hierarchy dichotomy? On the evidence available to date, that conclusion would be premature. There are signs that the present equilibrium is not stable. The ITC review of programme supply concluded in 2002 that:

‘the independent production sector remains fragile – producers lack the scale to diversify their risk, and lack the rights base which would allow them to attract external finance – only a few independents have been able to grow sizeable and sustainable businesses at home; and fewer still have made inroads in the international marketplace’ (ITC, 2002: para. 13).

Worse still, the quota, while ‘a success in its original terms’, was becoming part of the sector’s problems:

‘it addresses only some of the issues that are required for a healthy programme supply market, and has its own disadvantages as well as advantages. Some broadcasters use it as a ceiling not a floor, and many have said that it risks creating a “welfare culture” of small independents who depend on the quota, rather than their own competitive strengths, for their continuing existence’ (para. 18).

The solution advanced by the ITC was one based on the further intensification of competition: by limiting perceived abuses of market power by the BBC, moving to the ITV’s terms of trade, and attempting to disembed the commissioning processes, the independent sector would be released from the forces holding it back. The expectation was that as old-style ‘cottage industry’ firms were sidelined, the survivors, now able to assert control over secondary and tertiary rights, would be better equipped to attract external capital.

But there is a rival narrative running through the recent experience of the television production sector. The model of cost-plus financing, while making it difficult for some of the smaller independents to grow, also protected them from the downside risks of cost shortfalls which are a common feature of television production and which only the larger suppliers have the scale and reserves to deal with. A fully level playing field for the independents would probably require the formal unbundling of the broadcasting and production functions of the BBC; but as the ITC was compelled to recognise, ‘structural separation of

the BBC's broadcasting and production businesses might have the effect of creating a more level playing field between the BBC's own producers and independents, but would likely impose significant costs on the Corporation' (ITC, 2002: para. 31).

The changes which came in the wake of the 2002 review have already had an impact; the sector, which had been 'fundamentally weak from a business point of view' (Mediatique, 2005: 8), began to attract external financial capital on a significant scale following the redrawing of the terms of trade in the independents' favour. But private equity and stock market interest come at a price. The sector is dividing into a small but commercially-orientated group of larger independents, and a long tail of 'lifestyle' businesses. One possibility is that 'the big integrated companies, supported by City money but required to deliver predictable growth, are likely to produce more homogenised programming in their quest to deliver year-on-year profit progression from multiple revenue streams' (Mediatique, 2005: 3). In the past, the private company form taken by most independent producers concealed extremely tight margins and 'lumpy' or variable financial performance over time, as individual programmes and formats came and went; a stock exchange listing makes such concealment impossible. Thus while a financially stable core of independents with a strong export orientation would be 'a national asset in economic and industrial terms', there is 'likely to be an increasing tension between this ambition and [the independent sector's] role as a committed supplier of creative, high public value television to the BBC' (Work Foundation, 2005: 38-9). Innovation in programming is more likely to come in future from the 'long tail' of lifestyle businesses, but, because of diseconomies of scale, these companies are also the least likely to survive a further intensification of competitive pressures (Mediatique, 2005: 3). For the BBC, meanwhile, the increased contestability implied by the 'window of creative competition' makes it more difficult for it to plan ahead and to resist the poaching of its staff, while the loss of secondary and tertiary rights to the independents threatens to undermine its financial base. As a result, 'the BBC risks a serious hollowing-out as a creative organization by a rapidly growing and newly empowered independent sector' (Work Foundation, 2005: 7).

The prospects of a 'third way' for broadcasting are therefore extremely uncertain. It would be plausible to believe, on the experience of the British case, that the process of moving away from vertically-integrated forms of organization, supported by secure public financing under conditions of limited competition, can only lead in the end to the full instantiation of private-sector market relations. That is the direction in which the independent sector now appears to be heading. The BBC, on the other hand, partially reversed its

purchaser-provider splits and engineered a degree of vertical reintegration in the early 2000s. This period of relative stability for the BBC, however, has proved to be short-lived.<sup>8</sup> The realignment of the terms of trade which began in 2003 is now seeing the growth of an independent sector which is more financially secure but with a reduced capacity for innovation, while putting the future of the BBC further in doubt. Thus the mixed public-private arrangement which has operated for the past seventeen years, notwithstanding its success in many respects, may turn out to be unsustainable.

## **6. Conclusion**

In this paper we have reviewed the impact of legal and institutional changes in British broadcasting over the past seventeen years which saw the introduction and extension of competitive forces and the establishment of a complex system of mixed public and private provision. For proponents of reform, market liberalisation involved the establishment of consumer sovereignty and the consequent disempowerment of a ‘producer elite’ which was seen as having imposed its own tastes on the viewing population. For critics, the disorganisation of previously well established productive relations has undermined institutional capacity and engendered a ‘race to the bottom’ in terms of the quality of the end product. We have presented evidence which offers tentative support for a third way for economic organisation, beyond the traditional dichotomy between market and hierarchy. Liberalisation did not lead either to enhanced consumer sovereignty or to atomistic competition between programme suppliers. Instead, features recognizable from the network mode of economic organization emerged: a supportive environment for creativity and diversity in programme making was established through contractual and other mechanisms for the sharing of costs and risks and the transmission of knowledge and values supporting long-term cooperation. Innovations led, for the most part, by the independent sector saw the emergence of new genre types for factual and documentary programming, using more ‘popular’ cross-genre formats, but which producers and commissioners alike have maintained are faithful to the public service broadcasting ideal.

However, we have also seen that the equilibrium in which the industry currently finds itself, if such it is, is extremely unstable. Institutional changes aimed at further removing barriers to entry, intensifying competition and strengthening the financial position and commercial orientation of the independent sector have the potential to weaken the BBC and to undermine the innovative capacity of the sector as a whole. It is far from clear that the institutional architecture of

this sector of the creative industries is adequate to the task of securing its sustainability.

What are the implications of this for our understanding of the properties of networks and quasi-markets? Our study need not be read as implying that the benefits of network forms of economic organization are incapable of being realized, but our findings do suggest that successful and sustainable networks are the exception, not the rule. The conditions under which networks thrive are only rarely encountered, and may prove hard to maintain. There are organizational forces at work which tend to undermine network relations. It is difficult to recreate at an inter-organisational level the kind of environments which support autonomy and innovation in the production process within organizations. Arrangements for knowledge-sharing and the transmission of cultural values underpinning cooperation across autonomous and legally separate entities are, by their nature, fragile and transient.

These problems have been compounded by weak institutional design, as exemplified by the introduction of the quasi-market model into the BBC. The fundamental problem with the idea of the quasi-market is the difficulty in formulating an institutional framework which is adequate to the goal of combining market mechanisms with a public-service policy agenda. In contrast to the dynamic and evolutionary character of norms stressed by network theory, many quasi-markets have set up rule-systems which are complex and rigid. The BBC's experience, in particular, is testimony to the damaging and unanticipated effects which ill-designed quasi-market systems can induce.

But ill-conceived regulation is also capable of undermining network forms more generally. Our analysis suggests that competition policy, while it is necessary in order to remove barriers to access and to support new entrants, has the potential to destabilize long-term inter-organisational arrangements. The preferred transactional model within competition law is one based on arms-length dealing and spot contracting; it therefore sits uneasily with the goal of providing an architecture or framework which is supportive of collaboration across legal and organizational boundaries. As long as competition policy is simply directed towards the ever greater intensification of inter-firm rivalry, the promise of the network form is unlikely to be realized. In place of the unreflective application of competition law rules, broadcasting policy should acknowledge, firstly, that organisational forms which do not conform to the model of atomistic competition should not, for that reason alone, be condemned; secondly, that production capabilities can often best be preserved within organisational units; and thirdly, that terms of trade need to be sensitive to the wide variety of contractual arrangements through which inter-

organisational collaboration can be sustained, and to avoid a one-size-fits all approach. More generally, our work highlights the need of (?) a clearer focus within network studies on the issue of institutional design.

## Notes

<sup>1</sup> See <http://www.bbc.co.uk/commissioning/tv/business/code.shtml> (last viewed October 2007).

<sup>2</sup> See: [http://www.channel4.com/corporate/4producers/resources/guidelines\\_codeofpractice.pdf](http://www.channel4.com/corporate/4producers/resources/guidelines_codeofpractice.pdf). (last viewed April 2006).

<sup>3</sup> The Television Corporation plc, makers of a range of programmes in the documentary, entertainment and sports formats; Ten Alps Communications plc, a media organisation with several operating companies producing documentary and docu-drama programmes, and an interest in the Teachers TV channel set up with funding from the Department for Education and Skills; Shed Productions plc, makers of popular dramas, mainly for the ITV network; and RDF Media Group plc, pioneers of the ‘factual entertainment’ format (including *Wife Swap*: see section 4.2, below).

<sup>4</sup> All3Media Ltd. (formed from a management buy-in of the Chrysalis Television Group in 2003, after which it acquired a number of other production companies in the areas of drama and entertainment); HatTrick Holdings Ltd. (one of the most successful and enduring independents, makers of comedy and entertainment programmes and one of the first to be able to retain the secondary rights in its programmes through negotiation with the broadcasters); Shine Ltd. (maker of a range of documentary, features and entertainment programmes, founded by Elisabeth Murdoch in 2001); and Zenith Entertainment Ltd. (maker of popular drama and entertainment programmes).

<sup>5</sup> See: <http://www.rdfmedia.com/reality/WifeSwap.asp> (last viewed April 2006).

<sup>6</sup> This suggestion was contained in a report on the BBC by a number of broadcasting experts and practitioners for the Conservative Party in 2004 (Elstein et al. (2004)); the review of the Charter in 2006 concluded that the case for making licence-fee funding available beyond the BBC was not made out, but should be reviewed as part of the next Charter review (DCMS, 2006: para. 11.1.4).

<sup>7</sup> The ‘CrownGate’ affair of 2007, which arose when a BBC press launch showed misleading footage of the Queen ‘walking out of a formal photography sitting’, was found to have arisen in part because the programme maker RDF re-edited the footage in order to impress ‘co-investors at a sales convention’, and because the BBC, in addition to failing to spot the error in time, had ‘devolved too much of the relationship with Buckingham Palace to the independent producer’ (Wyatt, 2007: 3-4).

<sup>8</sup> In the period after our interviews were conducted (2003-4), the financial and regulatory pressures on the BBC further intensified, with several rounds of redundancies being announced, the most recent of which, in the autumn of 2007, was expected to lead (among other things) to a significant reduction in the BBC’s in-house production capacity.

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