Channel 4 and the British Television Industry: 1982–2013 (Case A)

Case

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Abstract

This is part of a case series. This business strategy case aims at illustrating issues of strategic positioning in dynamic and fast moving environments. It allows participants to cover all levels of industry analysis, from macro-environment to competitive environment (industry) and strategic group. It also allows participants to reflect on the values, mission and strategic orientation of a single corporation through time. Channel 4 is a UK-based television broadcaster with both public service responsibilities and commercial imperatives. The third largest player in the UK television industry, its competitive advantage stems from its unique brand and production values, a desirable audience profile and its reputation for creative risk-taking. Yet, Channel 4 faces a turbulent environment characterized by industry consolidation and convergence, and a shift in viewing behavior toward digital content delivered through the Internet onto computers, laptops, tablets, and mobile phones. Potentially disruptive technologies, the advent of new content production and consumption patterns, new media and an emerging new set of competitors, changes in government policy and a marketplace heading towards deregulation all open up opportunities and challenges for Channel 4 as it celebrates its first thirty years on air. The case is suitable for use in the context of an MBA or Undergraduate Business Strategy course or module.

Case

When David Abraham joined Channel 4 (C4) in May 2010, industry observers were aware of the challenges that he faced in turning around the performance of the company, which along with other commercial broadcasters, struggled with a decline in the advertising market during the recession. Three years later, the new CEO had proven himself. The broadcaster reported that revenues increased from £830m in 2009 to £941m in 2011, overall profit after taxes soared from just £300,000 in 2009 to £34.5m in 2011. In August 2011, C4's *The Inbetweeners Movie* also set a record for the most successful opening weekend for a UK comedy film, and its DVD released in December became the third fastest-selling British home media release of the year. In 2009, his predecessor Andy Duncan had announced that, despite his best efforts, since no government subsidies were made available to meet the funding gap, the broadcaster would have to cut its content budget by at least 10%. Instead, under new leadership, C4 content spending increased to a historic high of £592 million in 2011. In 2012, C4 was the official broadcaster for the *London 2012 Paralympic Games*, and continued to push the boundaries of television programming with such controversial documentaries as *Bin Laden: Shoot to Kill* and *Drugs Live: The Ecstasy Trial*, and edgy US imports such as *Homeland*.

And yet, the stakes for Channel 4's future growth and success remain high. The company faces stiff competition from other UK broadcasters for fresh content that viewers will watch and advertisers will pay for, with a programming budget totalling less than half of competitors' BBC and ITV spend of over £1 billion in programming in 2012. C4 often takes risks with new programmes, both commissioned and acquired. Yet, C4 tends to lose bidding wars to other networks after the commercial success of its US imports is proven. A clear example is the US show "*Glee*", which was first introduced by C4, who were eventually outbid by Sky after the programme's viewership soared. While the company fends off domestic competitors, C4 also faces a shift in viewing behaviour. The proliferation of digital content delivered through the Internet onto computers, laptops, tablets, and mobile phones marks a potential shift in the way the public views programming. Potentially disruptive technologies, the advent of new content production and consumption patterns, new media and an emerging new set of competitors, changes in government policy and a marketplace heading towards deregulation all open up opportunities and challenges. Developing and implementing a strategy for an organisation as unique as Channel 4 in this intricate competitive and institutional environment is a complex, yet exciting proposition.

The UK Television Industry in 2013

The UK television industry is among the most creative in the world. Exports of British television programmes (finished programming, digital rights and format sales) rose by 9% in 2011 to £1.48bn in revenue.[1] In the last few years, the face of the UK TV industry has also changed beyond recognition: from four channels thirty-one years ago to over a thousand today, from a single analogue delivery platform to multiple digital platforms, from passive entertainment to interactive services, free-to-air to pay-TV,[2] and a multitude of new players in the market.

This period of change is far from over: technology continues to evolve at lightning speed and the full impact of the changes already underway for consumers and the industry have not yet been fully felt or understood. Some clear trends, however, are emerging.

- The traditional value chain of television is being eroded through channel proliferation and the competitive threat presented by new media players (Exhibit A). The shape of the industry is changing fundamentally with shifting boundaries and roles, changes in revenue models, changes in industry structure and ownership, and the emergence of new competitors (Exhibit B).
- The entertainment, computing and telecommunications industries are converging. Whilst the rate and extent of convergence are slower than anticipated, the value systems operating within these industries are increasingly overlapping: "*The time is not far off when you will be answering your television, watching your computer, and programming your phone.*" (Raymond Smith, former Chairman/CEO, Bell Atlantic)

Technology

New technology has affected the way that viewers consume TV and fundamentally changed the way that the industry delivers its products. The most significant technological change has been the introduction of digital TV leading to a dramatic increase in the number of channels available (Exhibit A). Almost overnight, multichannel television has hugely increased competition for audience share and although the public service broadcasters (PSBs) remain dominant, audiences are fragmenting and deserting to other channels (Exhibit B). In 2013, the UK leads the world in digital services. The country completed its switch over from analogue to digital initiated in late 2012. Digital take-up has been rapid so far, from 86.7% of homes with digital TV on their primary set by the end of 2007[3] to 100% in 2012[4].

Other key technological changes include:

- *Delivery platforms*: Digital TV is now available on different types of technological platforms: satellite, cable and Digital Terrestrial Television (DTT). Satellite is provided by Sky and Freesat (a subscription-free joint-venture (JV) between BBC and ITV. Viewers can also get Freesat through Sky). Virgin dominates the cable market. DTT refers to services such as Freeview (jointly run by five equal shareholders: BBC, ITV, Channel 4, Sky and Arqiva), which can be delivered by a set-top box or integrated digital television (idTV), and pay-DTT (e.g. BT Vision), which require a service provider set-top box. Internet Protocol Television (IPTV) is delivered by such telecommunications companies as Tiscali. Satellite and cable give the viewer access to free-to-air digital channels and enable access to encrypted channels on a subscription basis. DTT consists of a one-off payment for a set-top box or an idTV that then gives the viewer access to free-to-air digital channels, but does not have decryption technology. By Q1, 2011, almost all British homes had taken up multichannel digital (satellite 44.2%, DTT 39.3%, cable 13.1%) and 52.5%–54% had pay TV (pay satellite 36.7%, pay DTT 1.3%, pay cable 13.1%) and the switchover from analogue to digital was complete in 2012.[5] The boundaries of media companies are also blurring; companies such as Sky and Virgin Media, who are largely known

as pay TV providers, also offer phone and broadband and compete against more traditional telecoms companies such as BT and TalkTalk with 'triple play' offers.

- *Interactivity*: The majority of viewers are already familiar with interacting with their television sets to select programmes. Interactive television (iTV) takes this to a new level by allowing viewers to access additional information about the programme they are watching, select different camera views of a sports event, play games, or access the Internet and send e-mails. The range of interactive services available is ultimately determined by the choice of service provider and receiver equipment. VoD also allows service providers to generate additional revenue through on-demand streaming of shows, movies, and other content.
- *Broadband* (Exhibit A): In the very competitive UK broadband market, over 500 service providers and resellers of cable and DSL Internet compete for custom. By 2011, nearly 3 in 4 homes (74%) in the UK had a broadband Internet connection, with just 3% of homes relying on a narrowband dial-up Internet connection.[6] The average (blended) speed of access in May 2011 was 7.6 Mbit/s, although actual speeds experienced may be lower, varying due to the quality and length of line from premises to exchange and the number of simultaneous users. In 2006, households with a mobile connection (93%) had exceeded households with a fixed connection (90%) for the first time and by 2011 nearly 1 in 3 mobile users accessed the internet on their phones. BT has also undergone investments of £1.5bn in fibre optic cables aimed at bringing most UK homes in reach of an ultra-fast broadband service.[7] Ofcom's media literacy research has found that UK adults with Internet access claimed to spend an average of 15.1 hours online each week, rising to 19.6 hours amongst 25-34 year-olds. Men spend more time online than their female counterparts across all age groups; while "silver surfers" over 55 years of age are accounting for at least 6.9 hours each week of total time spent on the Internet. More importantly, 18% have watched TV online, 11% have listened to radio online, 26% have watched video clips, and 22% have downloaded music. Sending emails is still the top internet priority for most people (93%), followed by general surfing (89%), and social networking (64%).[8] Video streaming over the Internet has significantly gained in momentum, as illustrated by the popularity of the video-sharing platform YouTube which Google acquired in the first half of 2007. Broadcasters such as the BBC and Channel 4 make programmes available online through sites such as YouTube, as well as via their own sites. Channel 4 was the first UK channel to launch an on-demand service (4oD), offering free 30-day catch up and archive content as well as films to rent. The BBC subsequently launched iPlayer, which allows UK licence fee subscribers[9] free access to BBC television content via the Internet. With viewers having access to an increasing number of connected devices, these on-demand services are now available on a wide range of other platforms across online, mobile and TV including games consoles, connected TVs, and iOS and Android devices. With the growing availability of high bandwidth mobile networks (first 3G and now 4G), the distribution of TV content via mobile phones also has significant growth potential. Mobile and tablet "apps" are also creating new channels through which users can experience TV content. BBC, ITV, and C4 have all launched their own on-demand apps. While these are currently free (but ad-funded for ITV and C4), the massive commercial success of mobile applications – estimated to hit $46bn by 2016 – suggest a key growth area for the future.[10] Moving forward, the availability of high bandwidth networks is likely to have a significant impact on the nature of video content distribution, from user-produced amateur clips to professional TV programmes.
- *Personal content management devices* include Electronic Programme Guides (EPGs), Personal Video Recorders (PVRs) and Video on Demand (VoD). EPGs, the personal content management device with the highest adoption rate, have a profound impact on viewers' ability to locate and select channels and services; they have now moved beyond being simple information sources to becoming interactive and personalisable schedulers. Early research into PVRs suggests that in 2012, nearly 10% of all TV viewing in the UK was timeshifted.[11] Timeshifting allows audiences to skip through ad-

verts, undertake much less browsing and plan their viewing more closely. As discussed above, VoD is increasing in popularity (4oD reported 427 million views[12] and BBC iPlayer 1.94 billion views in 2011)[13] and has obvious benefits for viewers, but again takes audiences away from live viewing on mainstream channels. These advances in viewing technology have increased the degree of control that audiences have over their viewing experience.

- *Cross media and cross platform development*: Television companies are increasingly operating across a range of media and platforms to support television broadcasting including Internet, SMS messaging, radio, music, and published media. This development allows TV companies to diversify their revenue base into media and services for which consumers are used to paying a fee. C4 cannot pursue such commercial ventures for financial purposes only, but to drive revenue to fund its core public service channel and PSB activities (Exhibit F).
- *Big Data*: defined as very large data sets in terms of volume, variety, and velocity that render traditional methods of data processing inadequate,[14] Big Data may alter the balance of power between broadcasters and advertisers in the near future, as the former learn to exploit it to help the latter better target their campaigns.

It is impossible to predict what significant further advances in technology will occur over the next decade. However, factors such as the price, quality (such as realised broadband speed) and ease of use of new technology, business confidence, regulation, and the general economic climate are all likely to influence how use of the available technology evolves and which applications become dominant. Their impact on the industry is as yet unknown: "*The worry that multimedia and on-line services will cannibalise TV is the old argument that film would kill radio, then TV would kill film, then home video would kill network TV and so on. None of this has happened."* (Pat Mitchell, TBS Productions). Yet platform proliferation and audience fragmentation have been happening for years and their effects are now quite real.

Audience

Despite increased competition from other media, TV viewing levels have remained relatively unchanged over the past few years at between 3.5 and 4 hours per person daily. Yet, with the increasing availability of on-demand content elsewhere, these viewing levels are under threat. Since the late 1990s there has been a substantial increase in the number of commercial radio stations, magazines, Internet sites, news supplements and alternative media sources without an accompanying increase in the time people spend consuming media. None of these sources, however, has cannibalised the time spent watching TV to a significant extent. In all age groups, TV remains the key media platform in UK society (95%), although this dominance is now being challenged by the mobile phone (82%) with PCs and laptops not far behind (72%).[15] Social networks, in particular Facebook and Twitter, have a huge reach (1 billion and 140 million viewers respectively)[16] across genders and age groups. With more choices available, patterns of consumption are changing, particularly amongst the young who consume less television in comparison to other media and age groups. This trend has particular implications for Channel 4 in retaining its 16 to 34 year-old target audience and capturing advertising revenue. As this group ages, this pattern will spread throughout the population and will have a profound impact on the take-up of substitute media and platforms. C4's Sales House, including Box and UKTV, accounted for 28% of the UK television advertising market in 2011, compared to 47% for ITV and 16% for Sky.[17]

Over the last few years, the TV sector has also witnessed increasing fragmentation of its audiences as a result of the rapid growth of multichannel television. More choice for consumers has meant greater competition for audiences (Exhibit C). Some programmes, for instance Event TV such as major sporting events and

innovative formats such as The Voice, The X Factor and Big Brother, which are designed to encourage live viewing and real-time viewer participation (e.g., through social networks and voting), continue to pull in big audiences. Of the new digital channel launches, the specialist entertainment channels have been the most successful at gaining audience share. New media and other leisure and entertainment activities share audiences across a greater number of delivery channels, competing for audience time and attention. Gaming has become a popular niche activity amongst adults, whilst the Internet, DVDs, VoD and PVRs are providing new forms of in-home visual entertainment.

An optimistic view of industry development would suggest that the proliferation of choice would see the emergence of a wide range of programming appealing to varied audiences, with quality being the key to gaining audience share. In this scenario, the role of PSBs is unclear. A less utopian view would suggest that programming will drift towards the lowest common denominator and populist formats in a bid to gain a sizeable audience. This is arguably the situation that has emerged in the US, where multichannel TV has been available for a much longer period. In this scenario, the role of PSBs in maintaining high standards and catering for a range of tastes remains vital.

Trends in TV funding

In broad terms, total advertising revenue and subscriptions are increasing. However, the economic downturn is hitting TV advertising revenue hard at the same time as the costs of production rise and competition for content and audiences increases. Commercial broadcasters are diversifying across platforms and services to maintain brand presence and to maximize audience reach and commercial revenue in a digital world (Exhibit E). Generally, they are also paying more attention to their cost base, seeking to minimise overheads, fully exploit programme assets (subject to rights ownership) and develop low cost, popular formats such as docusoap and reality TV. With increasing competition for advertising revenue from other media, the future of TV advertising is now blurred. The massive growth in Net Advertising Revenue (NAR) in the mid to late 1990s was fuelled in part by the dot.com boom. Industry observers are now speculating that the recent drop in advertising revenue represents a fundamental readjustment. In 2004 television advertising revenue began a tentative recovery – which gave way, again, to a significant drop in 2006, a further drop during the recession in 2008–2009, and slow growth to £3.3bn in the UK in 2012.[18]

Whatever its long term evolution, advertising expenditure will continue to be susceptible to economic trends and follow the general economic cycle. Alternative sources of revenue include:

- *Subscriptions* for channel packages have been the main area of revenue growth in recent years.
- *Rights*: all those involved in content creation and distribution are looking to increase revenue through multimedia and international rights sales, and the exploitation of ancillary rights such as merchandising and the sale of related branded goods. This is a particularly lucrative area for children's properties with global mega-brands such as *Bob the Builder*. In the case of PSBs, strict terms of trade govern the ownership of all intellectual property rights associated with a production.
- *VoD*: UK internet advertising totalled £4.78bn in 2011, representing 28% of the total advertising spend in the UK. It is still driving the UK market in 2012, with an expected 35% of total advertising expenditure.[19] Commercial broadcasters in particular are deriving much of their digital revenues from online ads (within VoD streams) or pay-per-view TV or movie content (the recent launch of ITV's online pay player is an example).
- *Sponsorship*: an alternative proposition to traditional TV advertisement, sponsorship of particular programmes has grown in popularity as TV companies experiment with more innovative ways of delivering advertising messages. Advertiser-funded TV programming (AFP), where a programme is created

around a brand and the advertiser is closely involved in the creative and production processes, is also gaining ground. For instance, C4 worked closely with energy company E.ON on *Home of the Future*, and with fashion retailer New Look on *Style the Nation*.

Whilst it is critical that new revenue channels are explored, TV advertising is likely to remain a dominant source of revenue for commercial broadcasters for the foreseeable future. However, the share of total NAR received by each player will decrease as audiences continue to fragment and the number of competitors increases.

Regulation and government policy

The UK has one of the richest TV markets in the world. At £11.3bn in annual revenues in 2010, the UK is the wealthiest TV industry in Europe, following only the US (£94bn) and Japan (£28.6bn) globally. In per-capita revenue terms, the UK is second only to the US.[20] Yet, it is also a highly regulated and government-controlled industry (see details of legislative interventions in Exhibit I). One intervention in particular, the Communications Act of 2003, was the most radical piece of legislation so far and had wide-ranging and profound implications for the broadcasting industry. This legislation made significant progress towards industry deregulation and the promotion of greater competition through the creation of a free market. The key points of the Act were:

- Transferral of functions to a single powerful regulator – the Office of Communications (Ofcom) – replacing the earlier five regulators (Independent Television Commission; Radio Authority; Office of Telecommunications; Broadcasting Standards Commission and Radiocommunications Agency)
- Introduction of a new, more coherent structure for commercial broadcasting regulation in the digital age, allowing greater freedom for public service broadcasters to regulate themselves, and protecting the rights of both consumers and citizens
- Reform of the rules on media ownership toward significant deregulation to promote competition and investment, with a few core rules retained to protect diversity and plurality
- Making provision for Ofcom to introduce spectrum trading, leading to speedier access for new services and more efficient use

The Act presented a number of challenges for the industry, not least establishing a relationship with the new regulator, Ofcom. In a clear break from the past, Ofcom was set up primarily as an economic market regulator with wide-ranging powers and interests. The creation of a free market for spectrum and the relaxation of licensing restrictions reduced barriers to entry. The government's desire to move to a market-based system for spectrum management should have also allowed spectrum markets to respond flexibly and quickly to need, rather than waiting for spectrum planners to react to changing demands. To this day, however, control of distribution sits with the dominant platform providers rather than the government and spectrum access is still limited and controlled.

Liberalisation of the media ownership laws also had a profound impact on industry structure. Without intervention, the TV industry would naturally consolidate due to the economic pressure to achieve the economies of scale and scope associated with production and broadcasting. The additional pressure to optimise asset utilisation (programme content and rights) across multiple distribution channels also supports consolidation. Trends towards vertical and horizontal consolidation thus emerged. They were supported by limited access to spectrum and the existence of only a small number of gateways or networks. The removal of prohibitions on concentrated media ownership, cross media ownership and international ownership of UK media assets accelerated this trend. Industry observers have therefore argued in favour of tough economic regulation to protect consumers and competitors from abuse by dominant players.

Finally, the Act preserved the role of PSB for the foreseeable future, continuing the oversight and funding arrangements for the BBC and the ownership status of C4. This included maintaining protection for the independent production sector.

PACT, the UK trade association that represents and promotes the commercial interests of independent content producers, lobbied successfully to incorporate into the 2003 Communications Act new quotas on all PSBs in the UK to commission at least 25% of their output from the UK independent production sector. Under current regulation, C4 cannot produce its own programmes and must acquire or commission 100% of its programming. Although C4 remains committed to supporting and developing the UK's independent production sector, this places some constraints on the Channel.[21] The 2010 Digital Economy Act meant some changes to C4's remit, enshrining in legislation new requirements such as commitment to film, and delivery of the remit across all services, not just the main Channel 4 channel (Exhibit I).

Commitment to public service broadcasting will always be subject to prevailing political will, and media as a whole is generally more susceptible to political change than most other industries given its intrinsic power of communication to the masses. The UK political climate is currently dominated by centrist politics. A significant shift either to the left or right could have real consequences for the industry in terms of regulation and attitudes to market intervention, public ownership and funding of media assets.

The History of Channel 4

Birth of a channel: Jeremy Isaacs, 1981–1987

C4 went on air for the first time at 4:45 pm on 2nd November 1982 with the quiz game "*Countdown*", a show that remains a key element of the afternoon schedule in 2012. This achievement followed months of detailed preparations by the newly formed management and staff, and years of deliberations by government and the industry about the creation of a fourth television channel. With only two terrestrial broadcasters, BBC and ITV, competing for viewer's attention on three channels only, BBC1, BBC2 and ITV, the launch of C4 was a huge event for the British viewing public. As such, it attracted much attention and comment (Exhibit G).

The UK television industry in 1982 had changed little in the last 20 years. The BBC, funded by the licence fee, operated two television channels. BBC1 was targeted at mass-market audiences, whereas BBC2 appealed to more diverse and niche audiences and broadcast most of the BBC's educational output. ITV, the commercial broadcaster that represented a network of 15 regional companies, operated a single channel also targeted at mass audiences. Despite the differences in funding streams, both organisations were designated as PSBs and operated in a tightly controlled and highly regulated environment. A fourth channel had been technically possible since 1969. Years of debate followed, as various propositions were put forward for use of the available spectrum.

Within this context, the 1981 Broadcasting Act, which brought C4 into being, designated a very specific audience and market remit for this fourth channel. C4 was required to provide a distinctive and different offering from existing broadcasters in terms of its creative direction and audience appeal. The Act had defined the new channel's main tasks as:[22]

- To win an audience additional to that of ITV;
- To meet audience requirements different from those of ITV;

- To develop and broadcast programmes of an educational nature as a significant proportion of total programming;
- To achieve this with programming that provides a distinctive character for the Channel in terms of source and content.

Equally, C4 was intended by the government to intervene in the existing industry and stimulate competition as a complement to ITV in two specific ways:

- *Competition in the television advertising market*: prior to the creation of C4, ITV was the only player in the UK TV advertising market and operated as a single entity when it came to negotiating with the advertising industry. The creation of a competitor was seen as essential to promoting an efficient TV advertising industry.
- *Creation of a viable independent production sector*: prior to the creation of C4, the independent production sector was almost non-existent in the UK. The BBC and ITV produced almost 100% of their programming in-house, and the lack of an independent sector was perceived as a gap in the UK creative industries.

Together these two factors dictated the form, financing, and operating model of the new Channel to create a globally unique hybrid organisation:

- *Form*: C4 was established as a separate company, supervised by the Independent Broadcasting Authority (IBA). The company was state owned, had no shareholders and was supervised by a board consisting of a Chair, a Deputy Chair and eleven non-executive members.
- *Financing*: C4 was funded by subscriptions paid to the IBA by the ITV companies in return for which ITV sold advertising airtime on C4. The amount was set annually and was in approximate proportion to ITV and C4's shares of total industry advertising revenue. This afforded a degree of protection and predictability to C4 revenue and allowed the Channel to focus on the creative and programming elements of its remit, rather than commercial advertising sales activities.
- *Operating model*: whilst operating as a third broadcaster, C4 was prohibited from producing its own programmes and required to commission or acquire programmes from the ITV companies, international programme suppliers and the nascent UK independent production sector.

The Channel's first Chief Executive, Jeremy Isaacs, brought the call for distinctiveness and difference to the heart of the Channel's operations without delay. The original commissioning team was an unconventional line-up of people from a range of media backgrounds. Isaacs intentionally sought to create a new, creatively diverse culture that would not follow the traditional norms of the other broadcasters. Free from the funding constraints that preoccupy most leaders during a start-up phase, Isaacs was clear that his responsibilities lay in creating a strong identity for the Channel, building the Channel's audience and establishing C4 as a creative and challenging force on the UK media scene. Isaacs set his team the challenge of innovating and taking risks, pushing the boundaries of conventional programming, and serving audiences that were neglected by the mass appeal of the other broadcasters.

This approach frequently caused controversy and heated debate about decency and other broadcasting standards that had been unchallenged for years. In these early years opinions about C4 were often polarised: despite the secure funding environment, the success of the Channel was far from guaranteed. Yet, controversies ensured that C4 was often in the public eye, building a distinctive brand and creating profile and attention that belied its relatively small size. The C4 brand quickly became associated with ground-breaking and high quality niche programming, for which it won many awards (Exhibit G).

Audiences too were warming to the alternative offered by C4. Whilst the BBC and ITV's remit was to serve

most of the people most of the time, C4's aim was to serve some of the people some of the time – but in doing so to reach a wide range of audiences whose needs were unmet elsewhere. After one year of broadcasting and far exceeding expectations, the Channel had secured a 4.4% share of the total TV audience and 9% share of the total commercial viewing audience (Exhibit H). By the end of Isaac's tenure in 1987 these had risen to 8.5% and 14.8% respectively. The profile of the audience was already showing a prevalence of young (16–34), upmarket (ABC1) viewers. C4 maintained over the years this highly sought-after viewer demographics (Exhibit H), which also became a key factor in future plans for the commercial independence of the Channel. In discussions with the board, Isaacs established an ultimate audience target of 10%, which soon became the driving force for successive management teams. Alongside creative success Isaacs and his team were making great strides in stimulating growth in the UK independent production sector with year on year increase in the number of suppliers and total spend. This strong emphasis on programming allowed Isaacs to keep C4's cost base in tight control.

By 1987, Isaacs's strong personal vision, creative drive, and leadership had set the Channel on the path to success. Audiences were growing steadily, he had developed excellent relationships with suppliers and the rest of the industry and a good rapport with government and regulators. Most importantly he had created a new TV Channel that was hugely respected and was firmly established as an essential part of UK TV output. Five years after C4 came on air, Isaacs decided that it was time to move on.

Growth: minority channel to mainstream challenger, Michael Grade, 1987–1997

Jeremy Isaacs handed over to Michael Grade a thriving organisation. However, C4 was still dwarfed in terms of resources, audience, and output by BBC and ITV. With the first signs of major technological change starting to appear, Grade needed to make sure that C4 was well positioned to respond to emerging opportunities and to lobby to ensure its needs were recognised in any forthcoming legislative changes. The key preoccupations of Grade's era were to preserve the unique remit, status and independence of the Channel in the face of legislative and industry change and to build a professional, independent, commercial Channel of scale. His personal challenge was to take C4 from its status as a successful minority broadcaster to a viable, independent Channel with a loyal and distinctive audience.

Political challenges and commercial independence

By 1987 C4 was already starting to over deliver in terms of audience share relative to the subscription it received from ITV companies. With an annual subscription of £135.9m (10.8% of total industry NAR) in 1987, C4 was not only paying its way earlier than expected, but was effectively putting cash into the hands of the ITV companies. Whilst C4 was clear that its future success depended on maintaining good relations with ITV, not least due to the amount of programming acquired from this source, this inequality formed the foundation of much of C4's lobbying for greater commercial independence.

Technological change was just starting to impact the wider industry. The possibility of multichannel television, as had already emerged in the US, was likely to become a reality in the UK within the next decade. Accordingly, competitors were already positioning themselves to take advantage of possible opportunities. In 1985 the Thatcher government had commissioned the Peacock report to explore the future prospects for the UK TV industry in this context. This wide ranging and hugely influential report raised a number of issues that had previously been thought to be untouchable, such as the future of the BBC licence fee. The C4 Board and management team began a lobbying campaign to ensure that C4's needs were not overlooked in any forthcoming changes and that the essential elements which had allowed C4 to thrive were not discarded.

The Peacock Report recommended that C4 should be able to sell its own advertising, a proposal that was strongly endorsed by the Channel. Less welcome was the suggestion that C4 should no longer be a subsidiary of the IBA, although it would retain a regulated programming remit. As the Peacock report progressed into a White Paper and into draft legislation, the spectre of privatisation was repeatedly raised and successfully vanquished. When the 1990 Broadcasting Act was finally passed, C4 had retained creative independence and an unchanged programme remit as well as its status as a self-governing statutory corporation secure under the protection of a new regulator – the ITC.

C4 was generally content with its position and the overall shape of the industry, and would even sell its own advertising independently of ITV from 1992. Even so, the financing of the Channel remained controlled. Under a mechanism known as "the Funding Formula" C4 was required to pay to ITV half of its annual qualifying revenue in excess of 14% of the total industry qualifying revenue.[23] In return, ITV guaranteed to fund C4 up to 2% of the same figure should C4's generated revenue be under 14%. In theory this arrangement offered a safety net to C4 should its advertising revenue be insufficient to support its operations. It also served to placate the ITV companies who had been forced to accept competition in the previously monopolistic TV advertising market and had grown used to supplementing their income through the sale of C4 airtime. In reality, however, it became a financial drain on C4 almost as soon as it was implemented. In 1993 C4 paid £38.2m (14% of the 1993 programme budget) to ITV. Over the next six years C4 paid almost £410m to ITV and argued that this money should have been spent on public service programming. Despite fierce lobbying from C4, the Funding Formula was not removed until the Labour government came to power in 1997.

By 1992 the government revisited media ownership rules established in the 1990 Broadcasting Act to allow mergers between the regional ITV companies. Over the next few years aggressive consolidation within the ITV companies left Carlton and Granada as the two dominant players. The other significant change emerging from the 1990 Act was the decision to create a fifth terrestrial channel to be run on a commercial basis, increasing competition for advertising, production and audiences. Whilst Five (formerly Channel 5) would not launch until 1997, this decision, combined with the relentless emergence of multichannel television and the rise of BSkyB, made it clear that the UK television industry was becoming more competitive and that audiences would inevitably fragment.

The 1990s were therefore typified by instability and change: increasing competition, technological innovation, and trying to predict which technologies would emerge as dominant in the long term. After a shaky episode linked to a general economic depression in the early 1990s, the television advertising industry experienced a period of unprecedented growth and prosperity. In 1992, the renewal of the ITV company licenses caused a spike in demand for top TV managers. In the related scramble the C4 Board was forced to pay significant salary increases to retain Grade and his team. They were compensated by their performance in dealing with external changes and in continuing to grow and consolidate the Channel's position.

Building an independent, commercial Channel of scale

Whilst complex political policy and a dynamic market environment dominated Grade's external agenda he was equally vigilant in building C4's audience and developing the C4 brand. Imposing a stronger commercial focus and a professional approach to operations were vital in moving C4 from being a marginal TV broadcaster to becoming a scale player in the industry.

The decision in 1990 to allow C4 to sell its own advertising from 1992 onwards gave Grade and his team a two-year window to develop new expertise and a more commercial culture. Stewart Butterfield was appoint-

ed from the advertising industry to head up the first advertising sales team. The team quickly identified C4's audience profile as the Channel's key strength in the advertising sales market. Whilst not being able to offer “weight” (i.e. large, mass-market audiences), C4 had real strengths when it came to “shape”. Indeed, C4 was able to offer advertisers a guaranteed 16 to 34 year old ABC1 audience at peak viewing times and very specific audience profiles for niche programming. This ability to target audiences so directly greatly appealed to marketers and advertisers wanting to communicate specific product messages. C4's advertising sales operation was an unprecedented success from the outset. Still, the Channel was unable to reap its direct benefits until the Funding Formula was lifted in 1997.

Grade understood that building C4's audience was the key to maintaining commercial stability and would provide a powerful lobbying tool in the fight to maintain independence. He therefore continued Isaacs' creative lead by bringing together an exceptional commissioning team who developed strong relationships with the independent production sector. Whilst the overall creative direction and programming remit were unchanged, C4 needed to set up a process of continual renewal to keep on developing high quality, high profile, innovative television (Exhibits H and I). During this period the Channel achieved artistic acclaim and commercial success in film, with Channel Four Films providing funding for *Trainspotting*, *Shallow Grave*, *The Madness of King George*, and *Four Weddings and a Funeral*. Grade was quick to recognise the power and potential of the C4 brand, and was the first Chief Executive in British television to apply traditional marketing techniques to build and manage this key asset. C4 was also the first TV channel to use a range of media to advertise its own programming and attract audiences. As a result, in the autumn of 1990, C4 breached the critical 10% threshold for three consecutive weeks. By 1992, the Channel's 10th birthday, C4 broke through for the full year. In 1993 it had overtaken BBC2, its key competitor for the young, upmarket audience.

Throughout this period of growth and prosperity Grade continued to keep tight control of the Channel's costs in order to invest in programming. The Channel bought high quality US comedy and light entertainment. These programme acquisitions were relatively inexpensive at the time. They were popular with C4's core audience and quickly became an essential component of the schedule.

In his drive for revenue generation and cost control, Grade developed a more professional approach to other commercial activities such as programme rights exploitation, international sales and film production. Grade's leadership came to an end in 1997. C4 was now on air 19 hours a day, 7 days a week with a stable audience share in excess of the 10% target. The corporation had recently moved into award-winning new premises in central London and continued to be critically acclaimed by the industry and audiences alike.

Maturity: Renewal and Reinvention, Michael Jackson, 1997-2001

Michael Jackson was a former Director of Television and Controller of BBC1. He joined C4 at a time of optimism and prosperity. As Isaacs had before him, Grade handed over to him a Channel in outstanding shape. Thanks to the end of the Funding Formula and exceptional growth in advertising revenue fuelled by the beginning of the dot.com boom, C4 was wealthier and more popular than at any time in its history. It had finally achieved the virtuous circle of balanced audiences, advertising revenue and programme investment. Michael Jackson's appointment to the dual roles of Chief Executive and Director of Programmes, however, was not without its challenges. Jackson recognised that whilst years of stability at the top had been good for the organisation, the editorial priorities and creative direction needed refreshing. With the emergence of the Internet, digital technology and a developed cable and satellite infrastructure, the multichannel revolution that had been long promised was now finally arriving. Also, C4 still had limited resources and remained first and foremost a PSB. As such, it could not afford the expensive experiments that some of its competitors were

undertaking.

Whilst focusing initially on shoring up the main Channel, Jackson quickly moved on to considering wider diversification and commercial development. With its remit as guardian of a non-profit making organisation, the C4 Board had a history of cautious and prudent decision making. Preservation and reinforcement of C4's public service obligations were paramount. C4 was consequently much more cautious than some of its competitors about pursuing dot.com opportunities. When the dot.com bubble burst, C4's losses on dot.com experiments were almost non-existent. In the meantime, competitors like BSkyB and the BBC had lost several hundred million pounds each on failed business ventures. Equally, C4 recognised that if it wanted to retain its reputation as innovative and daring it needed to find a way of participating in this new, technologically sophisticated world that would sit happily with its public service remit and make the most of the core brand and Channel. The award-winning C4 website was praised by early-adopters and presented a good example of how C4 integrated new media in a low cost, low risk way. This allowed the Channel to observe changes in the marketplace whilst developing a more ambitious digital strategy to respond to imminent audience fragmentation.

Alongside the development of digital plans, Jackson was also keen to consolidate and expand the commercial activities initiated by Isaacs and Grade. Jackson ramped up the international sales and rights exploitation businesses. The Channel formed key alliances with MacMillan and Universal Music to develop programme-related books and music products. 4Learning, C4's education programming and services, had always been a key element of the Channel's public service remit. With increasing use of the Internet for education purposes and a clear commitment by the government to expand the use of technology in schools, 4Learning looked at ways in which it could participate profitably in the digital revolution and take advantage of the public sector funding pumped into this area. C4's new premises also included under-utilised state of the art studio and post-production facilities. Hiring of equipment and expertise to production companies and corporations soon became another area of expansion.

During this period of optimistic and entrepreneurial growth, business opportunities sprung up and were exploited in a fairly ad hoc manner.[24] This was in keeping with the general mood of the industry in the late 1990s, which was typified by relative wealth due to the booming advertising industry, a scramble to take advantage of new technology opportunities, the desire to respond to new media and Internet threats and the fear of impending audience fragmentation. C4's excellent track record to date may also have contributed to a mood of confidence and infallibility. The Channel's more aggressive expansion into commercial ventures attracted criticism from observers. Some viewed commercial diversification as an unwelcome distraction from the core business of a PSB and as taking funds away from investments in programming. Others considered that the Channel's plans were not ambitious or robust enough and criticized C4 for not paying enough attention to building up its commercial presence in a changing industry environment. During this period of growth and change, balancing C4's commercial and public service elements was a constant challenge.

Two major initiatives in terms of levels of investment dominated this era: the development of FilmFour Limited into a vertically integrated production company and Attheraces, a complex and ambitious JV. The huge ambitions and subsequent problems with both endeavours have played a significant role in shaping the Channel's later approach to commercial development.

FilmFour Limited

C4 had always been involved in supporting British film making. One of Isaacs' earliest innovations was to fulfil a significant amount of the Channel's drama quota through film. For many years C4 had dedicated a specific budget to invest in British film making, supporting innovative, art-house, minority movies that tied in with the Channel's overall creative and brand profile. This was a low-cost, low risk approach to film production. C4

was simply one of a number of backers with relatively low levels of investment; in return the Channel generally secured the UK TV broadcasting rights together with some additional revenue and exploitation rights. Whilst specifically targeting fringe film making, FilmFour enjoyed significant critical and commercial success in the early to mid-1990s and was at the centre of a renaissance in the British film industry. In 1994, C4 Films accounted for 17 Oscar nominations – only surpassed by Warner Bros. Film was seen as one of the jewels in C4's crown and appeared an obvious candidate for expansion.

Moving away from a pure investment model, FilmFour Limited (FFL) was set up in 1998 on a vertically integrated producer/distributor model with ambitions to rival the US studios. FFL abandoned its track record of success in independent film making to pursue more mainstream scripts in an attempt to appeal to mass global audiences. The resultant output, including films like *Lucky Break* (2001) and *Death to Smoochy* (2002), were critical and commercial flops. They failed to appeal to FilmFour's loyal audience and were not a coherent fit with the usual film content on C4 and Film4. FFL also failed to break into the US distribution market and to secure a deal with a major US player. After only two years of operation, FFL reported a £3m loss – with the actual loss to the corporation at more than four times this level.

Attheraces

In 2000, the Jockey Club decided to renegotiate UK horseracing rights for a ten-year period. Attheraces (ATR), a JV between C4, Sky, and Arena Leisure, was set up to secure and exploit the global media rights to UK horseracing. The concept was to develop a gambling channel based on horseracing on C4's digital spectrum and to use Sky's expertise in iTV and web gambling products to earn additional revenue. Arena was to provide the IT infrastructure and additional financial guarantees.

From the outset the JV encountered problems. Although viewing figures for the Channel were good, delivery of the web-based betting products and iTV capability were severely delayed. The management team lacked experience in gambling development and failed to make progress in selling international rights. Losses quickly mounted and the agreed financial commitments from Sky and C4 were approaching their limits. Moreover, an Office of Fair Trading (OFT) enquiry questioned whether the Race Course Association had the authority to sell the TV rights to ATR on a collective basis in the first place. Internally, C4 top managers were also questioning the fit between the largely downmarket, older audience of horseracing and C4's overall profile. What had been hailed initially as a successful venture due to the overall reduction in the cost of horseracing to C4 was quickly becoming a problem.

4Ventures

In January 2001, the various streams of C4's commercial activity were eventually brought together into a separately identifiable business entity through the creation of 4Ventures. 4Ventures, which consisted of ten separate businesses of differing scale and fortunes (including FilmFour Ltd and Attheraces), reflected C4's determination to grow a successful commercial arm.[25] Investment into 4Ventures peaked in 2001 at 9% of group turnover. Despite a turnover in 2001 of £156m, the varied commercial fortunes of the constituent businesses meant that 4Ventures recorded an overall loss of £65m. Combined with the beginnings of an economic slowdown, this counter-performance was cause for concern.

In July 2001 Michael Jackson unexpectedly announced his intention to move on to pursue a career in the US. Despite his comparatively short tenure, Jackson left his mark on the Channel. He steered the organization

during a crucial period of increasing industry complexity and change to reposition it for success in a multiplatform, multichannel digital future. With E4 emerging as a clear rival to Sky 1 for digital viewers and C4's total overall audience share holding firm at 10%, the strategy to launch digital offerings had helped maintain C4's position. But as the search for the Channel's fourth Chief Executive began, conditions in the industry were about to become substantially tougher.

Late maturity: searching for growth, Mark Thompson, 2001–2004

The terrorist attacks in the US on 11th September 2001 hastened the emerging economic recession. Marketing budgets and advertising spend were particularly hard hit and C4 had to find £20m in overhead savings. Mark Thompson, who was appointed as Chief Executive in late 2001, had joined Channel 4 following a successful career at the BBC where he held the post of Director of Television from 1998. When he took up his C4 post, another £10m in savings was required to see C4 through to the end of the financial year. C4's overheads, in particular staff costs, had crept up in recent years.

Thompson set clear immediate priorities: cut costs, bring 4Ventures on track and renew the main Channel by continuing to invest in the programme budget. He led a complete overhaul of the Channel's cost base and reorganised to promote efficiency. Most notably, 4Ventures was restructured into four business units:

- *4Channels*: incorporating all C4's digital channels (including E4 and Film4) and responsible for future channel development
- *4Rights*: bringing together the former C4 International and Consumer Products divisions into one unit responsible for C4 rights activities within the UK and overseas
- *4Learning*: continuing to oversee the Channel's education programming, products and services but with a clear remit to develop a more commercial edge
- *4Services*: bringing together a range of internal service units (4Creative, 124 Facilities, 4interactive) aimed at developing external revenue sources[26]

In July 2002, Thompson closed the vertically integrated FFL business. Yet, in a return to its successful original film model, C4 retained a ring-fenced £10m per year for investment in new British film-making. ATR was a more difficult problem to resolve due to the long-term contractual arrangements involved with the JV. However, in April 2004, the OFT ruled that the original collective sale had breached competition law. This gave C4 the opportunity to sell its 33% stake in ATR to BSkyB in May 2004.

Thompson's drive was largely successful. Overhead costs were cut by a sustainable 20% and the Channel entered 2003 with the largest programme budget in its history to date. Underpinning these activities, however, was the pressing need to create a clear strategic direction and vision for the future of the corporation. With economic recession and some of the predicted impacts of audience fragmentation, multichannel competition and industry regulation starting to take effect, investments in commercial ventures had to demonstrate an ability to deliver returns. Whilst the main channel remained cash rich, C4 needed to grow new sources of revenue. With audience share starting to decline, it was likely that the programme budget would soon need topping up from other sources.

A new deal: Andy Duncan, 2004–2009

Andy Duncan was appointed Chief Executive of C4 on July 19, 2004 one month after Mark Thompson resigned to replace Greg Dyke as the Director General of the BBC. A marketing expert, Duncan contributed to Unilever's success in household brands such as *PG Tips* and *I Can't Believe It's Not Butter*, before moving to the BBC as Director of Marketing and Communications in 2001, then as Director of Marketing, Communications and Audiences from 2003 onward. Duncan was the first C4 Chief Executive with a marketing, rather than a broadcasting, background. The start of Duncan's tenure coincided with the first airing of *The Simpsons* on C4 in November 2004, after C4 had secured the terrestrial rights to show all future and past episodes of the US animated series. This was a major blow to the BBC, which had previously held these rights. Duncan also took digital channels E4 and Film4 free to air in 2005 and 2006 respectively, and created More4 as a digital free to air channel in 2005.

Duncan set as his primary goal the establishment of a “New Deal” that would profoundly alter the future funding of Channel 4 and secure more sustainable financial foundations for the Channel. Together with a reshuffled management team, he embarked on convincing Ofcom that C4's financial situation was unsustainable in a digital multi-channel and multi-platform era, and that public money would be well invested given the Channel's continuing societal value both on- and off-screen. By 2009, it was apparent that public funds would not be available to C4 and that the company would have to find its own solution to its funding shortfall. In November 2009, Andy Duncan resigned as CEO and Anne Bulford, C4's Finance Director, took over as interim CEO.

A fresh start: David Abraham, 2010–present

In January 2010, the Board of Channel 4 announced that David Abraham would be the Channel's new Chief Executive. Abraham began his career in advertising and co-founded a successful agency in the 1990s. He later held senior executive positions at the Discovery Channel in the UK and the USA. In 2007, he became Chief Executive of UKTV and embarked on a highly successful rebranding of the network's channels. Despite his history in media, many industry observers were surprised that the Channel 4 Board chose a new CEO with no experience working for a publicly owned network.

David Abraham moved quickly to make his imprint on Channel 4. He reversed the “New Deal” strategy of his predecessor and embarked on a self-sustaining strategy to increase advertising revenue to fund the company's growth. Abraham was helped by a surge in advertising spending in 2010 after a couple years of decline in advertising spend due to the recession. In addition to re-focusing C4's commercial strategy back on advertising, Abraham also embarked on a series of other changes.

First, he streamlined the management of the Channel, by shrinking the size of the management and middle-management teams. He reduced the number of department heads from 45 to 25 and cut his own direct reports by half. He also hired a new sales director, Jonathan Allan, who was previously the managing director of a £1 billion-a-year media buying agency. Faced with a sharp drop in overall viewership share of the core Channel 4, from 9.6% in 2006 to 7% in 2010, he set the target of 7% as a minimum benchmark for the network.

Second, Abraham breathed new life into the creative side of the company. Abraham organized his schedule to spend his mornings with the creative team and his afternoons with the strategy and commercial teams. He also hired a new Chief Creative Officer, Jay Hunt, from the BBC and gave her additional funds to fulfil the goal of being competitive every hour of the day. The Channel was entering a period of ‘creative renewal’ following the 2009 decision to cancel Big Brother, which freed up 200 hours of programming. This presented both an opportunity to commission a larger number of new programmes, and a challenge in replacing Big Brother's accompanying advertising revenue. In addition, the linear and online content teams were brought together for

the first time, with all content teams now reporting to Jay Hunt.

Finally, Abraham accelerated the company's digital and online content strategy, with a dual focus on increasing the reach of 4oD by expanding the distribution of the player on new platforms, and using data to create a deeper relationship with viewers. The latter involves understanding what C4's viewers like and what they do, and using this data to deliver new, innovative products to advertisers. This Big Data strategy was being led by the newly created position of Director of Audience Technologies and Insight. As of October 2013, over 9 million viewers had registered their details via channel4.com or ioS.

In July 2012, Channel 4, in partnership with BBC, ITV, Five, Arqiva, BT and TalkTalk, launched YouView. YouView is a service providing free DTT and PVR functionality, and when plugged into a broadband line, access to on-demand TV services and other content such as NowTV.[27] 4Seven, a new catch-up channel set up to: "schedule the main channel content that is creating noise – amongst social media, bloggers, commentators and of course via contact our viewers have directly with us – and incorporate this buzz into the look and feel of the channel"[28] was also successfully launched on 4th July 2012, with an initial provision of 20 hours of programming content per day.

2013 and Beyond: Future Prospects

The emergence of digital technologies and the rise of multichannel pay-TV have opened a new competitive era for UK TV. Players with vertically integrated, multiplatform business models such as the BBC and Sky are increasingly dominant. Competition for audience share is at unprecedented levels and the traditional industry value chain is under threat from a range of new media entrants. Competition is emerging from multiple sources, including broadband, telecom providers, ISPs and Internet new entrants which specifically set out to redefine traditional TV delivery models and viewers' experiences. On the supply side, the proliferation of channels has caused an increase in competition for high quality, popular programming and the cost of US programme rights and popular independent producer formats is likely to increase. Emerging content production and consumption patterns, most notably within online social networks, also offer new leisure alternatives to traditional television.

In Channel 4's favour are continuing high levels of investment in programming and high potential for diversification. Indeed, C4 continues to spend more on programming per market share than any other broadcaster and has a proportionally lower percentage of derivative revenue. As David Abraham reflected on the important strategic decisions ahead of the corporation within this complex and shifting environment, his assistant informed him that Adheesh Bhagat and Srinivas Radhakrishnan, two recent MBA graduates he had invited to discuss Channel 4's strategy, had just arrived. He smiled and called them in.

Notes and References

1. http://www.ukti.gov.uk/uktihome/aboutukti/item/386201.html

2. Exhibit J provides a glossary of key terms and acronyms used in the case.

3. http://stakeholders.ofcom.org.uk/market-data-research/other/tv-research/dtv/dtv-site/

4. Interview with Channel 4's Director of Strategy, August 2012.

5. Interview with Channel 4's Director of Strategy, August 2012.

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8. http://stakeholders.ofcom.org.uk/binaries/research/media-literacy/media-use-attitudes/adults-media-use-2012.pdf

9. The licence fee is levied on all UK households owning a television in order to fund the BBC. The level is set by the government and collected by the BBC as their primary source of income.

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17. Interview with Channel 4's Strategy Manager, October 2012.

18. http://www.guardian.co.uk/media/2012/jun/19/zenithoptimedia-tv-ad-revenue

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20. http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr11/icmr/ICMR2011.pdf

21. Yet, pre-negotiated terms of trade restrict price negotiations between PSBs and independent content producers.

22. Channel 4 Report and Accounts, 1983.

23. Qualifying revenue was ITV & C4 advertising revenue, sponsorship, subscription, and barter income.

24. Interviews with the 4Ventures management team, July 2003.

25. C4's public service remit requires however that any commercial activity can be undertaken only to the extent that it cross-subsidises the main PSB activities of the Channel (Exhibit G).

26. In 2005, 4Learning and 4Services were transferred to other operating units. As of 2012, only 4Channels and 4Rights still exist as independent business units.

27. http://www.dailymail.co.uk/sciencetech/article-2168734/Lord-Sugar-launches-YouView-offering-BBC-ITVChannel-4-Five-catch-services.html

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