

Outdoor advertising

An OFT market study

February 2011

OFT1304

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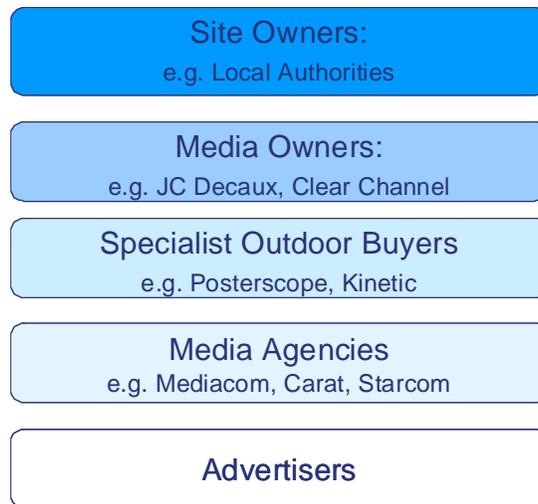
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1 EXECUTIVE SUMMARY

Background

- 1.1 Outdoor advertising has been the fastest growing traditional advertising medium over the past decade. Spend on outdoor advertising reached £976m in 2007, a little over five per cent of total advertising expenditure. Outdoor spend declined to £939m in 2008 before falling back sharply to £782m in 2009, in line with other advertising expenditure. Outdoor spend has since recovered significantly, with estimated spend of £880m in 2010.
- 1.2 In addition to roadside billboards, outdoor advertising comes in a variety of display formats at various types of location such as bus shelters, underground and railway stations, airports, shopping malls and supermarkets.
- 1.3 Outdoor advertising is provided via a long supply chain. An advertiser typically uses a media agency to plan and buy its advertising campaign, and the agency uses a specialist outdoor buyer for the outdoor advertising component of the campaign. The specialist outdoor buyer then purchases space from media owners who in turn have contracts with site owners to lease the sites on which to place posters.



- 1.4 This market study was prompted by high concentration at certain levels of this supply chain, in particular at the levels of media owners and specialist outdoor buyers. Concerns had also been raised with us about the contractual linkages and payments between the levels in the supply chain and the conduct of some of the players in the industry.

Key Findings

- 1.5 At the outdoor media owner level the sector is highly concentrated nationally. Three large media owners (CBS Outdoor, Clear Channel, JCDecaux) represent around 80 per cent of the supply of outdoor advertising space. A fourth smaller media owner (Primesight) represents up to 10 per cent. The media owners are differentiated by the nature of the locations and formats they supply. For example, CBS Outdoor supplies the vast majority of advertising on and in buses and has the contract for London Underground, whereas Clear Channel has a large proportion of local authority contracts for street furniture such as bus shelters, with associated advertising rights.
- 1.6 During the market study concerns were expressed, especially by smaller media owners, that there were significant barriers to entry and expansion faced by small and new entrant media

owners. In part, these obstacles derive from rebate agreements between media owners and the specialist buyers. Some smaller media owners complained that the retrospective nature of these agreements meant that it was very difficult for them to offer rebates that would match the marginal incentive of specialist buyers to place volume with large media owners.

- 1.7 In addition, barriers to entry and expansion may stem from contracts between large media owners and some site owners, especially local authorities. Street furniture contracts tend to be of long duration, in some cases exceeding 20 years, and many contain restrictions on the use of other sites within the local area covered by the agreement. The OFT is therefore concerned that these contracts may be locking up existing sites and limiting the opportunities for new and smaller media owners to provide outdoor advertising space on alternative competing sites.
- 1.8 Local authority contracts cover sites which accommodate about 25 per cent of outdoor panels and about 20 per cent of outdoor advertising revenue. The majority of local authority sites carry small format advertising, for example bus shelters with six-sheet panels. Local authority contracts represent around 80 per cent of small format sites. Between them Clear Channel and JCDecaux have virtually all local authority contracts for such small format sites.
- 1.9 We found that many local authority contracts for small format advertising rights were agreed in the 1990s without a tender process, and appear to represent poor value for local authorities. Site rents appear low relative to the advertising revenue that installations on the sites may generate. There also appears to be limited competition for new contracts. To date, relatively few contracts have been put out to tender at renewal due to a combination of the length of contracts, tacit renewal clauses and local authority procurement practices. Where contracts have been put out to tender, the incumbent media owner appears to have won the new contract in the large

majority of cases. Local authorities have expressed concerns over the level of competition in bidding processes where contracts have been put out to tender.

The OFT is concerned that certain agreements between media owners and local authorities may be limiting competition at the media owner level and is currently assessing street furniture contracts for their compatibility with UK and/or EU competition law.

Foreclosure of small media owners

- 1.10 The OFT has considered whether the effect of rebate agreements between media owners and specialist buyers may be harmful to small media owners. These agreements are such that a specialist buyer may have a very strong incentive to divert marginal spend to large owners even when a small owner offers a lower price. Small media owners have complained that they find it especially hard to attract the interest of specialist buyers.
- 1.11 Whilst recognising these concerns with the rebate agreements, we note that these agreements have the effect of attracting marginal spend away from other large media owners as well as from small media owners. As such, they may simply reflect strong competition between media owners for volume from specialist buyers.

Competition between media buyers for advertisers

- 1.12 An advertiser will typically contract with a media agency for planning and buying across media channels. For outdoor, media agencies generally use a specialist outdoor buyer. Some large advertisers deal directly with a specialist outdoor buyer for the outdoor element of their campaigns. Relatively few, mainly smaller, local advertisers, buy direct from media owners.
- 1.13 The specialist buyer level is highly concentrated. Two buyers, Kinetic and Posterscope, represent over 75 per cent of outdoor

buying. A third smaller buyer, IPM, represents under 10 per cent. Most of the remainder is accounted for by advertisers and media agencies buying direct from media owners. Despite the concentration at the specialist buyer level there appears to be a reasonable degree of competition between them.

- 1.14 Although each of these buyers is part of a larger media buying agency group, they also compete to acquire the business of non-group media agencies and larger advertisers that may want a direct relationship with a buyer. Advertisers face two components to the cost of outdoor advertising, the prices paid per panel and the commissions paid to both media agency and specialist buyer net of any rebates passed back to the advertiser.
- 1.15 In the context of competing for an advertiser's business, a buyer may agree with an agency to offer guaranteed discounts or may guarantee to beat certain price benchmarks. Aside from these guarantees, buyers appear to have little direct incentive to achieve low panel prices in their fortnightly negotiations with media owners, since higher prices may mean the buyer will receive higher commission and rebates. Competition on delivering lower prices per panel may therefore not be strong.
- 1.16 We have found that the specialist buyers pass back a large proportion, and in some cases all, of the rebate they receive from media owners to media agencies. As we explain below, however, this does not necessarily get passed to advertisers and thus may not be enough to ensure that advertisers get a good deal.

A good deal for advertisers?

- 1.17 The rebate agreements and consequent payments between media owners and the specialist outdoor buyers raise concerns about the incentives of media agencies and the specialist buyers to deliver a good deal to advertisers.

- 1.18 Typically neither media agencies nor the specialist buyers are agents of the advertisers according to contract law, so neither owes a fiduciary duty to the advertiser. Buyers are buying on behalf of advertisers but receive a substantial part of their remuneration from payments from media owners. Indeed on average these payments exceed the commission paid to specialist buyers by advertisers. This appears to present a conflict of interest.
- 1.19 The potential concerns for advertisers are threefold:
- to the extent that such rebate payments are not passed through to advertisers they may be paying higher prices for outdoor advertising buying services
 - buyers appear poorly incentivised to negotiate lower prices on behalf of advertisers
 - the rebate agreements and payments may distort the campaigns offered to advertisers.
- 1.20 On the first point, unless contracts with advertisers require that rebates be passed on, neither specialist buyers nor media agencies are obliged to do so under contract law. While most (especially smaller) advertisers do not receive rebates directly, large advertisers may contractually require pass on of a proportional share from agencies. All advertisers may receive some benefit indirectly from the rebates through lower commission rates charged by media agencies.
- 1.21 Nevertheless, the specialist buyer may stand to benefit from higher (not lower) prices from media owners, and has less incentive to negotiate hard on price or find cheaper space. Since specialist buyers usually receive a commission as a proportion of advertiser gross spend, and rebate payments are similarly related to spend, the specialist buyer has an incentive to maximise the spend on the campaign rather than to lower the price per panel.

- 1.22 Since campaigns are not standardised and therefore prices hard for advertisers to compare, it is difficult for the advertiser to monitor the buyer's prices to ensure it is getting a good deal. We found striking variations in prices achieved for apparently comparable packages of sites. We note that a significant proportion of campaigns are not audited.
- 1.23 As a result of the rebate payments, media agencies as well as buyers have an incentive to encourage advertisers to direct expenditure towards outdoor rather than other media channels, possibly distorting advertising campaigns. We understand that while outdoor accounts for about five per cent of total advertising spend it can represent up to half of rebate income for media agencies and agency groups.
- 1.24 As well as distorting campaigns towards outdoor relative to other forms of advertising, the rebate agreements may give buyers an incentive to concentrate spend within individual campaigns towards certain large media owners. Campaigns that miss cheaper, better located, more innovative and/or higher quality sites offered by other including smaller media owners would be correspondingly less effective.

Competition is capable of providing advertisers with a good deal in this market but the incentive structure for the specialist buyers does not appear to guarantee this.

Advertisers should provide appropriate contractual incentives and/or put in place monitoring to increase the probability of media agencies and specialist buyers acting in their best interests.

Next steps

- 1.25 During the course of the market study we obtained a large number of contracts between certain media owners and site owners. Currently, we are assessing certain street furniture contracts for their compatibility with UK and/or EU competition law.

- 1.26 We remain concerned that competition for new contracts put out for tender by local authorities may be weak and may result in contracts that are poor value for the taxpayer. Chapter 6 makes a number of recommendations to local authorities as to how they may protect themselves and mitigate the effects of this weak competition.
- 1.27 While the majority of rebates may pass through to advertisers, some advertisers may not be getting the best deals for their campaigns. However most advertisers are in a position to take steps to ensure they get a good deal, for example by seeking greater transparency and taking rebates into account when negotiating contracts. Specific recommendations on the steps available to advertisers are given in Chapter 6.
- 1.28 Finally, in the course of the market study the OFT considered whether a market investigation reference of the outdoor advertising sector to the Competition Commission would be appropriate. While the OFT considered that there may be features of the market that may restrict, prevent or distort competition in the market the OFT has provisionally decided that it would not be appropriate to exercise its discretion and refer the market to the Competition Commission. Our analysis is set out in Chapter 6. We are consulting on our provisional decision and responses should be emailed to outdooradvertising@oft.gsi.gov.uk by 5pm Friday 18 March 2011. Alternatively, they can be sent to:

Outdoor Advertising Market Study (Floor 2C)
Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London EC4Y 8JX

Thank you

1.29 As part of this study we consulted with parties at all levels of the supply chain, including advertisers, media agencies, specialist buyers, media owners, local authorities and other site owners, media auditors and advisers to the industry. We met smaller firms as well as with the major players at the specialist buyer and media owner levels. We requested and received written responses from individuals and companies on issues of relevance to the study. We are grateful for the contributions of all the above and their willingness to assist the OFT's team.

2 INTRODUCTION

Summary

- 2.1 Outdoor advertising in the UK was worth £782m in 2009, representing 5.4 per cent of all advertising. Outdoor advertising has been the fastest growing traditional advertising medium over the past decade.
- 2.2 The Outdoor sector has a complex multi-level structure with site owners, media owners, specialist buyers, media agencies and advertisers. Specialist buyers act on behalf of media agencies and their advertiser clients to buy from media owners. Eighty-five per cent of all Outdoor expenditure flows through specialist buyers. Both the specialist buyer and media owner levels are highly concentrated.
- 2.3 In the short term, the supply of outdoor space is essentially fixed. The specialist buyers negotiate with media owners on the price of future space on a campaign-by-campaign basis. The specialist buyers are not brokers – the price they achieve is the price that advertisers pay.
- 2.4 Both media agencies and the specialist buyers are paid fees or commission by advertisers. The commission paid to specialist buyers is generally an industry-standard five per cent of gross billings. In addition to the fees they receive from advertisers, specialist buyers are paid substantial volume rebates by media owners. These rebates appear proportionally larger than those in other advertising sectors.
- 2.5 While the largest advertisers may require that all rebates received by media agencies, or received by specialist buyers if contracting directly, be passed on to them, most advertisers do not negotiate this. Indeed, the majority of advertisers may not be aware of the rebates.

- 2.6 We launched this market study into the outdoor advertising sector in May 2010 to consider whether there are any distortions to competition or barriers to entry within the sector.
- 2.7 The study was prompted by high levels of concentration at certain layers of the supply chain, in particular at the layers of outdoor media owners and specialist buyers. In addition, concerns had been raised with us about contractual linkages and payments between different layers of the supply chain and the conduct of some of the players in the sector.

What is outdoor advertising?

- 2.8 Outdoor advertising, also known as out of home advertising, reaches consumers on the move or consumers in particular environments. Outdoor advertising opportunities are diverse, ranging from very large high impact banners, special builds and large format billboards at the sides of roads through to advertising on bus shelters, in stations, trains, taxis and buses, leisure centres, and in shopping malls and supermarkets.
- 2.9 Outdoor advertising ('Outdoor') is typically used as one component of a wider advertising campaign that may include television, print, radio, internet and other advertising. Outdoor is often a relatively small part of the overall campaign budget and may complement, for example, a larger television advertising campaign. Outdoor may be used to reach a mass audience quickly or to target specific audience groups in discrete geographic locations.
- 2.10 The Outdoor sector consists broadly of three sectors¹

¹ See the Outdoor Media Centre (formerly the Outdoor Advertising Association) website www.outdoormediacentre.org.uk

- roadside, such as billboards, bus shelters and phone kiosks
- transport, which covers rail, airports, buses and taxis
- leisure, point of sale (POS) and retail environments, which include supermarkets, shopping and leisure centres, bars and petrol stations

2.11 Outdoor comes in a variety of formats, including:

- phone box posters (0.7x1.6m)
- four-sheet (1.0x1.5m) panels in train stations, bus depots and shopping malls
- six-sheet (1.2x1.8m) panels on bus shelters and free standing units on high streets and in pedestrian areas
- 48-sheet (6.1x3.1m) panels on main roads
- 96-sheet (12.2x3.5m) panels in city centres and on main roads

2.12 The choice of environments and formats depends on the audience targeted by a campaign. Innovation in outdoor advertising has led to the rise of new formats such as digital installations. Digital displays including plasma screens account for a growing proportion of the market, increasing from under two per cent in 2003 to more than 10 per cent in 2010.

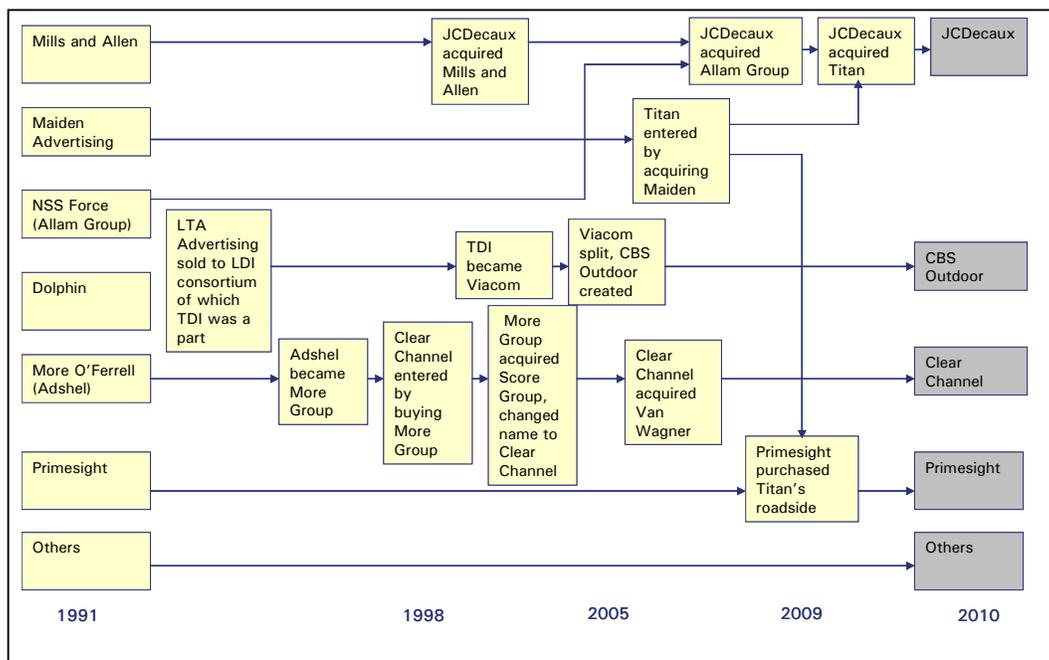
History of outdoor advertising

2.13 Poster advertising long predates the development of a sophisticated advertising industry. Originally local in nature, the growth of road transport saw the development of poster contractors offering panels over a wider area. The advent of commercial television spurred consolidation of the sector and the formation of industry associations to promote Outdoor as a medium.

- 2.14 In the early 1970s a selling agency called British Posters Limited was organised to represent the interests of its media owner members. British Posters acted as a sales consortium marketing packages of panels made available by its members to media agencies and advertisers.
- 2.15 In 1981 the Monopolies and Mergers Commission published its 'Report on the Supply in the United Kingdom of Roadside Advertising Services'² (the MMC report). The MMC report found that complex and scale monopolies of British Posters and its members had restricted competition and had led to higher prices. The MMC recommended that British Posters should be closed.
- 2.16 Following the subsequent dissolution of British Posters in 1982, a number of specialist buyers were started by ex-employees. Specialist buyers are not common in other types of advertising. In Outdoor, however, an advertiser wishing to launch a national campaign required the services of a specialist to buy from a very large number of media owners. An important role of the specialist buyers was to ensure that advertising campaigns had in fact been posted. Today, the principal functions of the specialist buyers are to plan Outdoor campaigns and negotiate with media owners.
- 2.17 Both the media owner and specialist buyer levels of the sector have consolidated significantly, principally through mergers. Figure 2.1 below illustrates how consolidation has led to the main media owners of today.

² MMC - HC (1980 – 81) 365 available at www.official-documents.gov.uk/document/hc8081/hc03/0365/0365.pdf

Figure 2.1: Consolidation of outdoor media owners



Note that names within parentheses indicate ownership. For example, NSS Force (Allam Group) means that NSS Force is owned by the Allam Group.

2.18 As a result of the mergers outlined in Figure 2.1 a small number of media owners now account for the majority of the market. The top three media owners CBS Outdoor, Clear Channel and JCDecaux currently have a combined share of around 80 per cent and the fourth largest owner Primesight has a share of up to 10 per cent.

2.19 The OFT has previously investigated and cleared two of these mergers. In 2002, the OFT investigated the proposed acquisition by Clear Channel UK Limited of Score Outdoor Limited and decided not to refer to the Competition Commission.³ In 2010, the OFT investigated and cleared the

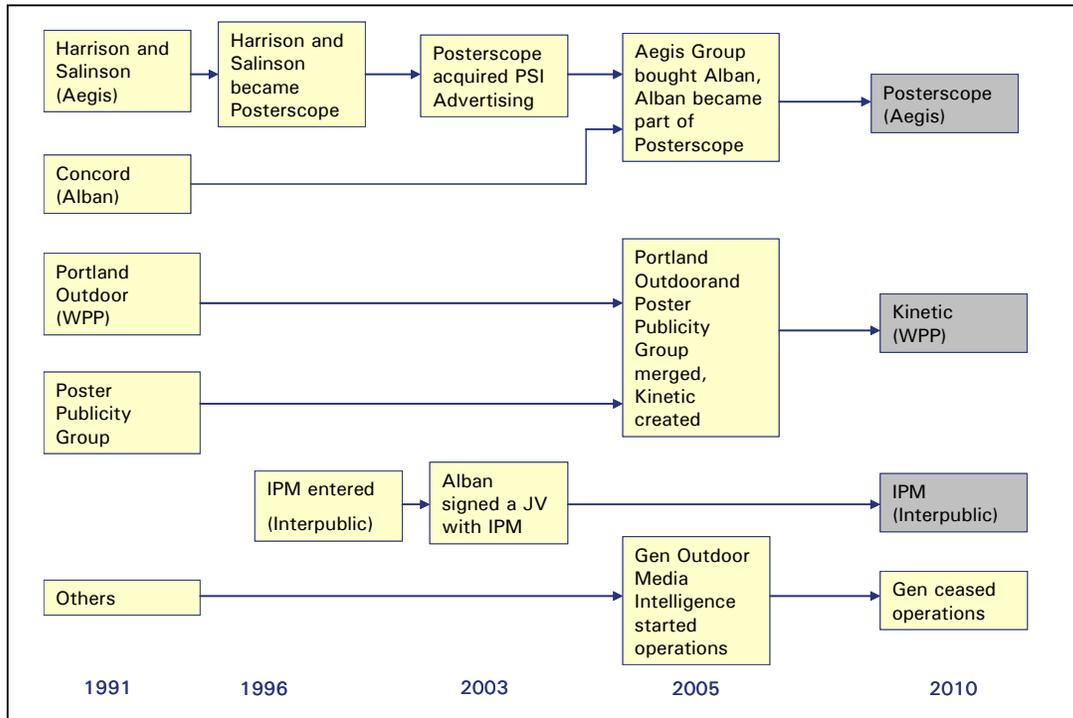
³ For further details, see

www.of.gov.uk/OFTwork/mergers/mergers_fta/mergers_fta_advice/clear-channel-uk

completed acquisition by JCDecaux Limited of Titan Outdoor Advertising Limited.⁴

2.20 The specialist buyer level has similarly consolidated, and is now highly concentrated. Figure 2.2 below shows how this has happened.

Figure 2.2: Consolidation of specialist buyers



Note that names within parentheses indicate ownership. For example, Kinetic (WPP) means that Kinetic is owned by the WPP Group.

2.21 In 2005, the OFT cleared the most significant combination at the specialist buyer level, the proposed merger between Poster Publicity Group Ltd and WPP Group plc, which created Kinetic.⁵ Since this merger, all of the major specialist buyers

⁴ Full text of the decision is available at: www.of.gov.uk/shared_of/mergers_ea02/2010/JCDecaux.pdf

⁵ Full text of the decision is available at: www.of.gov.uk/shared_of/mergers_ea02/2005/wpp.pdf

have been vertically integrated with a media agency network. Posterscope is owned by Aegis, Kinetic by WPP, and the third smaller specialist buyer IPM by Interpublic. Agencies belonging to other agency networks typically use either Posterscope or Kinetic for the Outdoor component of their clients' campaigns.

- 2.22 The two main specialist buyers Kinetic and Posterscope currently have a combined share of over 75 per cent of the market. The third smaller specialist buyer IPM has a share of [0 – 10]⁶ per cent.

Size of the Outdoor sector

- 2.23 Spend on Outdoor reached a peak of £976m in 2007, having grown steadily since the dissolution of British Posters. In line with other forms of advertising, it declined to £939m in 2008 before falling back sharply to £782m in 2009. Outdoor recovered in the first half of 2010, with spend up 16 per cent over the equivalent period in 2009.

⁶ The range given in parentheses is to protect commercially sensitive information.

Table 2.1: Advertising expenditure (gross) by medium (£m)

Year	2008*		2009**		Growth rate 2008-2009 (per cent)
Medium	Gross expenditure (£m)	Share (per cent)	Gross expenditure (£m)	Share (per cent)	
TV	3,820	22.1%	3,800	26.2%	-0.5%
Newspapers and magazines	4,860	28.1%	4,290	29.6%	-34.1%
Directories	810	4.7%			
Business and professional	840	4.8%			
Internet	3,350	19.3%	3,510	24.2%	4.7%
Direct Mail	2,040	11.8%	1,550	10.7%	-24.0%
Outdoor	940	5.4%	780	5.4%	-17.0%
Radio	450	2.6%	410	2.8%	-8.9%
Cinema	210	1.2%	160	1.1%	-23.8%
Total	17,320	100%	14,500	100%	-16.3%

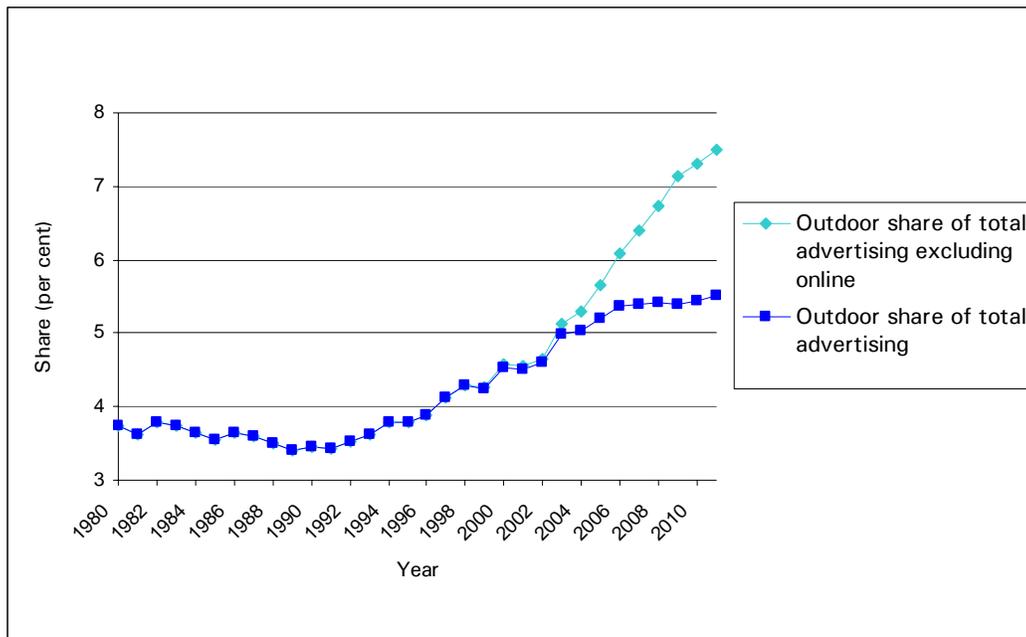
* Source: Advertising Statistics Yearbook 2009

** Source: Advertising Association www.adassoc.org.uk/aa/index.cfm/adstats/

Note that gross expenditure has been rounded to multiples of £10m

2.24 The value of spend on Outdoor has more than trebled in real terms over the past 20 years. Until the late 1990s, Outdoor's share of total advertising was below four per cent, but has increased since then.

Figure 2.3: Outdoor's Share of Total Advertising Expenditure



Source: Advertising Statistics Yearbook, 2009

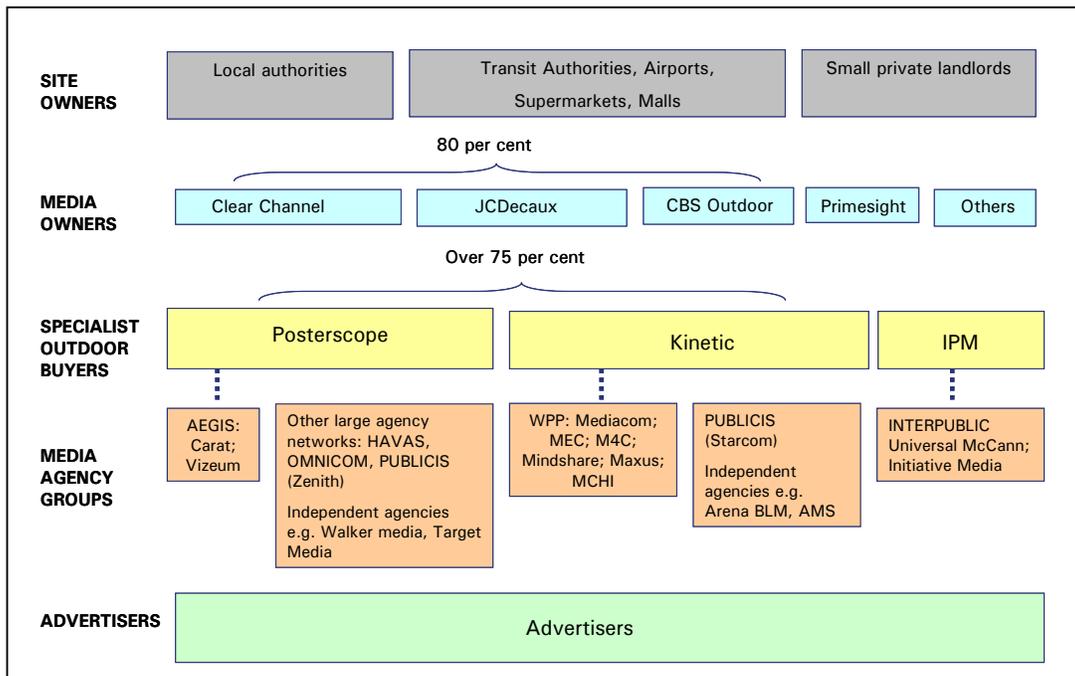
Structure of the Outdoor sector

2.25 The Outdoor sector is complex and has a multi-level structure with firms operating at five different levels, illustrated in Figure 2.4 below:

- **Advertisers** are businesses that buy advertising and are the customers in the Outdoor sector.
- **Media agencies** are distinct from creative agencies. Media agencies are contracted by advertisers to research, plan and buy advertising campaigns. They prepare a strategy for allocating the campaign budget to various media channels, which is subsequently approved by advertisers. There are a very large number of media agencies, including several independents. Most large media agencies, such as Mediacom and Carat, are multinational and part of advertising groups (here WPP and Aegis respectively).

- **Specialist buyers** plan and buy the Outdoor component of advertising campaigns on behalf of advertisers. Specialist buyers advise on the optimal types and locations of billboards required. Once a plan has been agreed, they negotiate and buy media space from the media owners. The three major specialist buyers are part of media agency networks. These ownership linkages are indicated by dotted lines in Figure 2.4.
- **Outdoor media owners** sell outdoor advertising space. Media owners contract with site owners for the right to use sites for outdoor advertising. Once there are contractual arrangements in place and planning permission has been obtained, media owners can install advertising panels on sites.
- **Outdoor site owners** are the landlords that own sites used for outdoor advertising. They have contracts with media owners and receive rents from them. Site owners may be local authorities, as well as private landlords such as transport companies and supermarkets.

Figure 2.4: Main players in outdoor advertising



Outdoor Sectors

2.26 The industry recognizes three broad sectors in Outdoor. These are, in order of size:

- Roadside (around £380m revenue). Roadside includes everything from phone kiosks, six sheets for example on bus shelters, 48 sheets, 96 sheets, and special builds and banners. Roadside is considered a very effective way of reaching mass audiences. Roadside can be further subdivided into large format roadside (£160m) and small format roadside (£220m).
- Transport (around £310m revenue). Transport covers railway and underground systems, airports, buses, taxis, and so on. Some of the contracts for sites are very large, for example the London Underground contract or the Network Rail contracts. Transport can offer longer consumer 'dwell time' opportunities.

- Retail/POS/leisure (around £90m revenue). This sector covers advertising at and in supermarkets, petrol stations, shopping malls, health and leisure centres, and night clubs. It may be used to support price or other promotions targeting consumers in 'shopping mode'.

How advertisers appoint media agencies and specialist buyers

- 2.27 In general, advertisers choose media agencies through competitive tendering. In choosing an agency, advertisers may narrow their selection by asking agencies to fill out requests for information, holding initial interviews to assess fit, and inviting pitches. Commissions and fees are negotiated. The media agency is responsible for planning and buying across all different types of media, not just Outdoor.
- 2.28 Contracts come up for renewal on a regular basis, for example every two to three years. While this gives the advertiser the option of switching agency, in practice many advertisers choose to renew or to renegotiate terms and renew. Relationships between advertiser and agency are frequently sustained for five to 10 years or more.
- 2.29 Most large media agencies subcontract the Outdoor component of campaigns to a specialist buyer. Each media agency will have a relationship with a particular specialist buyer. Agencies within groups that own a specialist buyer will generally use that specialist buyer unless the advertiser specifically requests otherwise. Agencies within groups that do not own a specialist buyer, as well as independent agencies, typically have a working relationship with either Posterscope or Kinetic.

How outdoor advertising space is bought

- 2.30 The following steps outline how Outdoor space is bought:
- The media agency designs a campaign for the advertiser and proposes an allocation of the campaign budget across

different types of media including Outdoor. The campaign strategy and plan is reviewed and subsequently approved by the advertiser.

- A buying brief for the Outdoor component of the campaign is agreed between the media agency and the advertiser for the specialist buyer, based on coverage and frequency objectives. The brief specifies parameters for the types and locations of media to be used. It may be revised on an ongoing basis depending on how the relative prices of different Outdoor media change over time.
- The specialist buyer plans the campaign, selecting specific Outdoor sites or packages of sites from particular media owners. Media owners provide indicative prices to the specialist buyer based on expected future availability during the campaign dates (media owners practice a form of yield management)⁷. Outdoor space is typically provided in 14-day cycles, and one or a number of 14-day periods may be requested depending on the duration of the campaign.
- The specialist buyer and media owner negotiate provisional prices for specific sites across the specified periods, following which the space will be 'optioned' thereby reserving it for a limited time.
- The specialist buyer will seek the advertiser's approval before confirming the booking, at which point the price is agreed. Specialist buyers may in addition secure either at or subsequent to confirmation additional value in terms of free space or quality upgrades for particular advertisers.

⁷ Yield management is a pricing strategy with the objective of maximising revenue for a future period of capacity constrained supply whereby prices are adjusted over time taking into account remaining capacity and anticipated future demand.

- The campaign runs on the agreed sites for the agreed fortnightly periods.
- The advertiser pays for advertising space.⁸ The media agency is paid an agency commission and the specialist buyer is paid a specialist agency commission (SAC).
- The advertiser may ask an auditor to audit the campaign. The auditor compares the prices achieved to prices in its pool, adjusting for differences in the quality of media, and also evaluates the composition of the campaign.
- Finally, at the end of the year, the specialist buyer is paid volume rebates by media owners for the total expenditure it has placed with each over the course of the year. The expenditure placed with each is across all the advertisers that the specialist buyer has represented and is not specific to the advertiser in question.

2.31 There may be some exceptions to the process of Outdoor buying outlined above. For instance, some large advertisers may contract directly with specialist buyers.⁹ Other advertisers may buy directly from media owners, as may some of the smaller media agencies. Such business is typically local or regional in nature. We estimate that around 12 per cent of the leading four media owners' revenue comes directly from advertisers and media agencies. In addition, specialist buyers may negotiate discounts based on volume for larger advertisers across all their campaigns over the year.

⁸ The media owner generally invoices the media agency (the invoice may be sent care of the specialist buyer) and the media agency then invoices the advertiser.

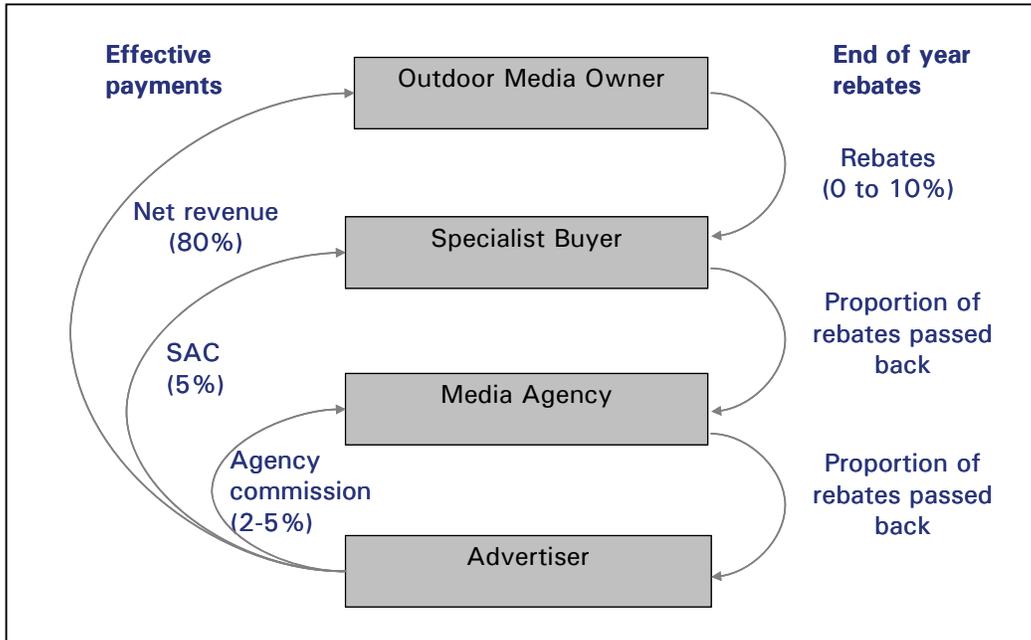
⁹ The top three specialist buyers' direct business with advertiser clients accounts for around 15 per cent of the combined total expenditure that they represent.

How prices are negotiated

- 2.32 Price setting in Outdoor is complex. Specialist buyers buy from media owners for individual campaigns according to the frequency and coverage objectives of each particular campaign, rather than buying advertising space in bulk for advertisers or agencies. In most cases, prices are individually negotiated and agreed for each campaign separately, though as mentioned above some large advertisers do negotiate across all their campaigns over a year to achieve lower prices. The specialist buyers may use the fact that they are negotiating for a number of campaigns at once to secure lower prices or additional value such as free space for advertisers.
- 2.33 The very large majority of Outdoor media bookings run on a traditional 14-day cycle, although the market is becoming more flexible to take advantage of digital displays. Media owners have a limited supply of space and price dynamically according to their remaining capacity and expectations of demand for any future 14-day period. Prices change continuously and the large media owners provide regular (weekly) updates to specialist buyers on availability for the next few periods. Some also provide indicative prices or price offers.
- 2.34 Prices depend on how far in advance the space is booked. We have been told that advertisers buying space well in advance are in general able to buy space at lower prices. However, advertisers may also benefit from lower prices if they wait until near the start date of a display period and there happens to be spare capacity of the type of Outdoor media they wish to purchase. The latter strategy is risky as there is no guarantee that good quality advertising space will be available.

Payment flows

Figure 2.5: Payment flows in Outdoor



2.35 Figure 2.5 above provides a simplified illustration of the payment flows in Outdoor. There are two distinct kinds of commission – the agency commission, which is paid to media agencies and is typically between two and five per cent; and the Specialist Agency Commission (SAC), which is paid to specialist buyers and is typically five per cent. Commissions are expressed as a percentage of gross billings which include by convention a 15 per cent agency commission, much higher than the commission typically paid.¹⁰

¹⁰ This is why the payments to the right in the figure do not sum to 100 per cent. Historically the standard 15 per cent agency commission would be paid to a single agency responsible for the creative as well as the media planning and buying. These functions are now handled by a creative agency and a media agency respectively. The media agency receives substantially less than 15 per cent, and may charge as little as between two to five per cent.

- 2.36 Agency commissions are calculated as a percentage of gross revenue. Net revenue received by the media owner is 80 per cent of gross revenue.
- 2.37 This is the typical payment structure but there may be minor variations. For example, some advertisers or media agencies may buy direct from media owners. In a minority of cases, the SAC may vary from five per cent and the media agency commission may be outside the two to five per cent range.
- 2.38 In addition to the SAC, the specialist buyers receive end of year volume rebates from each of the media owners. Rebates are calculated as a percentage of the total annual spend of a specialist buyer with a particular Outdoor media owner.
- 2.39 The majority of rebates are paid according to a tiered structure and apply retrospectively ('rollback' rebates). The specialist buyer is paid a percentage rebate, where the percentage is determined by the level of expenditure in increasing tiers. When the next tier is reached, the additional percentage rebate applies to all expenditure rather than just to the incremental expenditure beyond the tier. For example there may be a five per cent rebate for total expenditure up to £20m and a higher rate of 10 per cent for expenditure exceeding £20m and the higher rate applies to the entire expenditure once £20m has been spent, not just to spend in excess of £20m.
- 2.40 Volume rebates are generally negotiated annually between specialist buyers and media owners and apply for the course of a calendar year. Rarely, the thresholds for tiers as well as volume rebate rates may be adjusted during the year. This happened in 2009, when Outdoor spend as with other advertising spend was much lower than forecast at the beginning of the year.
- 2.41 The structures of rebate agreements and the amounts paid in rebates are considered commercially sensitive by specialist buyers and media owners. We understand that this information

is not commonly known to advertisers or even beyond senior executives within the organisations.

- 2.42 The very large majority of rebates earned by specialist buyers pass through to media agencies, as a result of a separate level of rebate agreements between specialist buyers and media agencies. Media agencies in turn pass on a proportion of rebates they receive from specialist buyers to advertisers.

Structure of this report

- 2.43 Chapter 3 covers competition between media owners, where we consider how sites are acquired, profile the main media owners, consider potential barriers to entry for media owners, analyse the impact of rebate agreements and describe some features of local authority contracts with media owners.
- 2.44 Chapter 4 looks at competition between specialist buyers and between media agencies. In this chapter, we consider the market power of specialist buyers, discuss how the specialist buyers compete, assess the extent to which rebates are passed through, and consider how media agencies compete and the role of potential competition.
- 2.45 Chapter 5 deals with agency issues resulting from rebate payments. We consider why advertisers choose media agencies and specialist buyers, how agency issues arise, the contractual position of media agencies and specialist buyers, the lack of incentives for buyers to negotiate low prices, and the potential for campaigns to be distorted as a result of rebate payments.
- 2.46 Chapter 6 sets out next steps and recommendations arising from our market study. We provide guidance for advertisers on how they may achieve greater transparency and mitigate potential distortions to their campaigns. We provide guidance for local authorities on ensuring a competitive tender process and contracts that represent good value for them. At the end

of the chapter we invite views on our proposed decision that a reference to the Competition Commission would not be appropriate at this time.

3 COMPETITION BETWEEN MEDIA OWNERS

Summary

- 3.1 Despite high concentration at the media owner level, there appears to be competition between the large media owners for the business of specialist buyers. The evidence suggests that buyers have considerable discretion over where to place marginal spend. Competition between the large owners is reflected in the substantial volume rebates they pay to the buyers.
- 3.2 To provide a stronger incentive to specialist buyers, the large media owners typically structure rebate agreements to offer higher percentages for higher volume, applied retrospectively to all the volume placed with the owner over the course of the year. These rollback agreements may make it difficult for some smaller and new entrant media owners to compete for business, despite offering comparable or even higher quality advertising space. This is because a smaller media owner may need to offer a very high percentage rebate to match the marginal incentive of the rollback rebates.
- 3.3 We recognise the possible impact of rollback rebates on smaller media owners. Nevertheless, rebates reflect strong competition between the large media owners and, to the extent that they pass through to advertisers, reduce the price that advertisers pay. Further, smaller media owners with highly innovative or attractive Outdoor space appear able to win business from the specialist buyers.
- 3.4 A further barrier to entry and expansion may derive from long duration and potentially restrictive contracts for local authority sites. Clear Channel and JCDecaux have between them the very large majority of such contracts. These may have the effect of locking up sites that other media owners might want to use. The contracts may also contain clauses that restrict the local authority from contracting with other media owners for new sites in the local authority area.

3.5 We begin this chapter with a brief description of the structure of the market at the media owner level and set out potential barriers to entry and expansion. Two potential barriers stand out. The first arises from the rebate agreements between large media owners and the specialist buyers. The second relates to long duration and potentially restrictive contracts for sites between some media owners and local authorities. We assessed these two potential barriers during the course of the study and cover them in some detail through the remainder of the chapter.

Site owners and media owners

3.6 Less than 20 per cent of sites are owned outright by media owners. Most are leased or (in the case of local authorities) may be sites on which street furniture is installed under contract, with associated advertising rights. Site owners in the UK can be categorised broadly as follows:

- local or regional authorities
- transport authorities
- small private site owners, such as local shops and property owners
- large private site owners, such as supermarkets, shopping centres and airports.

3.7 Media owners compete for the right to use sites on which Outdoor equipment can be installed. Visible sites with high traffic are more desirable. Before installing equipment, media owners must obtain planning permission from the relevant local authority.

3.8 Contracts for large portfolios of sites are generally awarded by tender, for example a contract to provide Outdoor equipment in a large local authority area. Permission to use small private

landlord sites is generally bilaterally negotiated, for example the right to install a billboard on the wall of a small shop.

- 3.9 The largest media owners have built up substantial portfolios of sites, with contracts covering many of the most important or desirable locations for Outdoor. In addition, these media owners may have contracts with local authorities for sites that provide for exclusive advertising rights on local authority sites in the surrounding area. Smaller media owners tend to be regional or may specialise in a particular type of site, and may supply innovative, premium or niche sites that can attract the interest of specialist buyers.
- 3.10 Three media owners (JCDecaux, Clear Channel and CBS Outdoor) account for around 80 per cent of Outdoor revenues. Primesight accounts for up to 10 per cent, and over 80 smaller and regional media owners account for the remainder.

JCDecaux

- 3.11 JCDecaux UK Ltd ('JCDecaux') is a UK subsidiary of the French company JCDecaux SA, which has around 1,040,000 advertising panels in 56 countries. JCDecaux entered outdoor advertising in the UK in 1983 with the provision and maintenance of Automatic Public Conveniences. In 1991 JCDecaux started to sell commercial advertising space on street furniture contracts. JCDecaux SA acquired the French Company, Avenir, in July 1999. A subsidiary company of Avenir was the UK based Mills & Allen which had been operating in UK Outdoor well in excess of 25 years. JCDecaux has since acquired the Outdoor business Allam Group in January 2006 and assets out of administration of Titan in January 2010.

3.12 JCDecaux has the largest overall share of Outdoor ([30 – 40]¹¹ per cent by revenue) and has acquired a diverse portfolio across various sectors. It owns a substantial share of both small and large format advertising space in the important roadside sector, the largest of the three sectors. JCDecaux is the biggest owner in the retail/POS/leisure sector, following its acquisition of assets of Titan Outdoor Advertising,¹² and supplies space at Asda, Morrisons, Tesco and Waitrose, as well as at shopping centres. JCDecaux also has a large share of the transport sector, supplying space at airport and railway stations.

Clear Channel

3.13 Clear Channel UK Limited ('Clear Channel') is a UK subsidiary of Clear Channel Communications, a New York Stock Exchange ('NYSE') listed US media conglomerate. Clear Channel Communications entered outdoor advertising in the UK in 1998 by acquiring More Group, which under the 'Adshel' name had been active in providing street furniture in the UK for nearly 40 years. Clear Channel has since acquired the Outdoor businesses Score Group (2002) and Van Wagner (2006).

3.14 Clear Channel has a [25 – 35] per cent share of Outdoor. Clear Channel has the majority share of the small format roadside sector ([50 – 60] per cent) and holds the largest number of contracts with UK local authorities for the provision of street furniture displaying small format advertising. It also has a substantial share of roadside billboards. In addition, it has presence in airports (at Birmingham International Airport) and in

¹¹ The range given in parentheses is to protect commercially sensitive information.

¹² In May 2010, JCDecaux completed the acquisition of all of Titan Outdoor Advertising Limited's (Titan) assets, with the exception of large billboards (Titan was placed into administration on 18 January 2010). These assets included six-sheet advertising space in retail and transport locations including at two major supermarket chains.

retail (POS advertising at Sainsbury's and in shopping malls across the UK).

CBS Outdoor

- 3.15 CBS Outdoor ('CBSO') is a UK subsidiary of CBS Corporation, a mass media company listed on the NYSE. CBSO was known as Viacom Outdoor prior to 2006. Through its predecessor companies including London Transport Advertising, CBSO has been active in the UK for over 30 years.
- 3.16 CBSO has a [20 – 30] per cent share of Outdoor, concentrated in the transport sector. It holds the contract for providing advertising space on the London Underground, provides virtually all advertising space on buses, and offers National Rail advertising space, which together amount to a [60 – 70] per cent share of the transport sector. CBSO also provides advertising space in the leisure/POS/retail sector, with small and large format advertising space in the Westfield shopping centre in London.

Primesight

- 3.17 Primesight operates in the UK only and is owned by GMT Communications and the Primesight senior management team. Primesight has been active in outdoor advertising in the UK since 1984, focusing on bus advertising until 1994 when it began developing its six-sheet portfolio. In 2009, Primesight acquired Titan's roadside billboard assets.
- 3.18 Primesight is significantly smaller than the three largest media owners, with a share of up to 10 per cent of Outdoor. Primesight operates primarily in the roadside sector,¹³ where it sells both small and large format advertising space. It also has

¹³ In September 2009, Primesight acquired Titan's large billboard portfolio

a small share in leisure, consisting of six-sheet advertising space in cinemas and leisure clubs, and in transport where it has advertising space on the Glasgow Subway and at Guernsey Airport. Primesight also has a small number of contracts with local authorities for the provision of street furniture capable of displaying small format advertising.

Other media owners

3.19 We identified over 80 smaller media owners that together account for [10 – 15] per cent of gross Outdoor billings. Some of these have a history in Outdoor going back 10 years or more. Their portfolios vary in terms of format (from small format six-sheet panels through to premium 48- or 96-sheet billboards), location and geographic coverage. Some examples are:

- Admedia – specialises in small format advertising in locations including 131 shopping centres, 125 motorway service stations, over 50 leisure clubs and up to 900 late night venues.
- Ocean Outdoor – specialises in premium, high-profile large format sites, primarily in Birmingham, Leeds, Liverpool, London and Manchester.
- Outdoor Plus – provides large format advertising space in London. Outdoor Plus has an agreement with JCDecaux to market and sell around 40 of Outdoor Plus' billboards.
- Signature Outdoor – operates in and around Birmingham, focusing on large format Outdoor advertising space.
- Ubiquitous Taxis – advertising on and in taxis nationwide.

Market sectors and substitutability

- 3.20 The Outdoor market can be divided by type of environment, such as roadside, transport, and retail/POS/leisure, and by type of format, such as small versus large format. The views we received on the substitutability of different formats and types of environment varied. While for many campaigns advertisers appear to prefer specific environments and formats to reach their target audience in the right context, some informed us that they considered certain formats and environments to be substitutable for others.
- 3.21 The biggest distinction in Outdoor appears to be between small and large format advertising. Most parties suggested that substitution between small and large formats is less likely as six-sheet panels and large formats (48- and 96-sheet panels) typically target different audiences and are therefore used for different purposes. Furthermore, different poster designs are used for six-sheet panels versus large roadside billboards. Six-sheet panels are often used by advertisers as a high-frequency, 'return on investment' medium. In contrast, large formats are more typically used for brand advertising, to create impact on sight. For example, one advertiser, which predominantly used large format advertising, informed us that if prices of large format were to rise significantly, it would switch to other advertising media rather than small format.
- 3.22 Local or regional geographic coverage can be a useful distinction for some campaigns. An advertiser wishing to advertise in a particular region must use space provided by media owners with a presence in that region. National campaigns may require advertising space in the major urban conurbations for effective coverage.

Barriers to entry and expansion

- 3.23 Consolidation at the media owner level has been in the context of high barriers to entry and expansion for small and new

entrant media owners. Small and new entrant media owners face difficulties both downstream in the supply of advertising space to specialist buyers and upstream in competing for and securing sites. We identified the following potential barriers to entry and expansion:

- contracts for sites between large media owners and local authorities
- rebate agreements between large media owners and specialist buyers
- economies of scale
- planning consent
- switching costs for site owners.

3.24 Rebate agreements reflect competition between media owners for advertising spend, but also have the potential to foreclose smaller media owners and further consolidate the market. Rebate agreements may add to barriers to entry and expansion that may result from contracts with site owners as well as from scale economies and related purchasing efficiencies for specialist buyers in dealing with media owners. We consider rebates in more detail in the section that follows.

3.25 Media owners also compete upstream for Outdoor sites. Small and new entrant media owners seeking to expand must either displace incumbents in agreements with site owners for existing sites or find new competing sites. Switching costs for site owners may favour the incumbent and it may be difficult to obtain planning permission for new sites. We are concerned that long duration and potentially restrictive contracts with some site owners, in particular with local authorities, may act to impede effective competition between media owners as well as being poor value for some site owners. We consider contracts with local authorities after the section on rebates.

Rebate agreements

- 3.26 The large media owners have volume rebate agreements with the specialist buyers, under which the specialist buyers receive end of year rebate payments based on their total annual spend with each media owner. These agreements are negotiated bilaterally between the media owners and specialist buyers before and around the beginning of each year. In 2009, volume rebate payments from all media owners to the three leading specialist buyers (Kinetic, Posterscope and IPM) amounted to [0 – 10]¹⁴ per cent of the gross billings that these specialist buyers represented.
- 3.27 The rebate agreements reflect competition between media owners for Outdoor spend. Each wishes to incentivise the specialist buyers to place volume with it rather than with other media owners. For instance, if any one large media owner were not to offer volume rebates, it would risk losing share to others. The high level of rebates in Outdoor is in part a consequence of the power of specialist buyers to shift volume at the margin from one media owner to another (buyer power is discussed in more detail in Chapter 4).
- 3.28 Smaller media owners also pay rebates to the specialist buyers. These rebates are often greater in percentage terms than the rebates paid by the large media owners. Rebate arrangements are either negotiated (as with the large media owners) or put to the small media owners by the specialist buyers as a condition for doing business with them.
- 3.29 A number of parties have expressed the view that rebate agreements act as a significant barrier to entry and expansion in the Outdoor market. We have considered whether that may be the case and our assessment is set out below.

¹⁴ The range given in parentheses is to protect commercially sensitive information.

The rollback structures of rebate agreements

- 3.30 To increase the effectiveness of the incentive, the large media owners typically negotiate a retrospective, tiered structure to rebate agreements (hereafter referred to as 'rollback'). Under this rollback structure, higher volumes are rewarded with higher percentage rebates applying retrospectively to **all** the specialist buyer's spend with the owner from the beginning of the year. The specialist buyers may accept rollback structures since the media owner may be prepared to offer higher volume rebates than they would under a flat rate structure. All but two of the 36 rebate agreements in place between the specialist buyers and large media owners in the three year period from 2007 to 2009 had rollback structures.
- 3.31 Rollback structures are generally not renegotiated during the course of the year. If the specialist buyers expected them to be renegotiated, the structures would have limited value as an incentive. However in 2009 some agreements were renegotiated, since the sharp fall in advertising expenditure put higher percentage tiers outside the reach of specialist buyers. In most cases this renegotiation involved lowering the volume thresholds at which given percentage rebates were to be paid.
- 3.32 A small minority of expenditure with the large media owners is not incorporated into rollback agreements. For example, there may be different rebate agreements specific to certain media to incentivise spending on those media. Other media may be exempt from rebates where locations or displays are sufficiently high quality that the media owner does not need to incentivise spending on them.
- 3.33 Both legal precedent and economic literature recognise that while rollback agreements may have the anticompetitive effect of raising barriers to entry or foreclosing rivals and thus weakening competition in certain cases, they may also have pro-competitive effects. The OFT considers that the use of price discounts in general is pro-competitive, and that even

where price discounts are applied by a dominant firm, this does not necessarily imply that they are anti-competitive. The existence of rollback rebate agreements therefore does not imply anticompetitive behaviour in itself. The agreements must be analysed on a case by case basis to determine whether such anticompetitive effects exist.

Illustrative example

- 3.34 Rollback rebate agreements may affect a specialist buyer's marginal incentives to buy from particular suppliers. The following illustrative and hypothetical example shows how this works.
- 3.35 Consider a specialist buyer that can choose to spend either with a large incumbent media owner or with a smaller media owner. The large media owner operates the rollback rebate scheme shown in Table 3.1 below.

Table 3.1: Rollback agreement of a large media owner (illustrative)

Amount spent (£m)	Rebate (per cent)
Below 50	4
50-55	5
55-60	6
60 or more	8

- 3.36 Suppose that the specialist buyer projects that it will spend about £60m over the course of the year and that it is likely to spend at least £55m of this with the large media owner, based on the large media owner's share of media sites, putting it just into the six per cent rebate band. Additional spend of £5m, from £55m to £60m results in an additional rebates of £1.5m. The small media owner would have to offer 30 per cent in rebates to match the large media owner.

- 3.37 The example shows how rollback rebates create marginal incentives for the specialist buyers to buy Outdoor space from the media owners that they expect to place greater volumes with over the course of the year, rather than necessarily those that are offering comparable space at the lowest net price before rollback. The specialist buyer's expectation of the expenditure that it is likely to place with each media owner over the course of the year is very important in its decision on where to place incremental expenditure.
- 3.38 For several of the 2009 rebate agreements between the large media owners and the specialist buyers, there were levels of expenditure where an additional £1m spent by the specialist buyer would result in more than an additional £1m in rebates.

The impact of rebate agreements in Outdoor

- 3.39 The sales which a supplier can be highly certain of achieving are sometimes referred to as the supplier's 'assured base of sales'. It is possible for the supplier to design rebate schemes that provide strong incentives to buy beyond its assured base of sales.
- 3.40 In Outdoor, the three largest media owners (CBSO, Clear Channel and JCDecaux) all have similar revenues. However, we have been told that specialist buyers are able to shift or threaten to shift significant expenditure from one media owner to another. Further, we have been told that for many Outdoor campaigns a significant proportion of spend is contestable between media owners.
- 3.41 As a result, none of the large media owners individually can be certain of selling a substantial proportion of its space. Consequently none individually has a particularly large assured base of sales and consequently a significant share may be contestable. The large media owners appear to compete with one another through their rebate agreements with specialist buyers to attract marginal spend. Over the past decades, the

level of rebates has increased, with each large media owner offering roughly comparable schemes. This competition between the large media owners and the resulting high level of rebates should be good for advertisers, to the extent that rebates pass through to them, since it reduces the net price that they pay for space.

- 3.42 However, a specialist buyer has an incentive to steer additional spend towards one or more of the large media owners in order to achieve higher rollback tiers, even where space is available from smaller media owners at a cheaper invoice price.
- 3.43 The effect of the incentives of specialist buyers may be stronger as each year draws to a close and the specialist buyer can see how close it is to achieving higher tiers with particular large media owners. Smaller media owners may find it hard to attract the interest of specialist buyers in such circumstances.
- 3.44 We analysed the rollback agreements currently in place between specialist buyers and media owners in some detail. The agreements do appear designed to win marginal business based upon expected spend levels and so the specialist buyers will commonly face such rollback incentives.

Specialist buyers' views on whether buying decisions are influenced by rebate agreements

- 3.45 Both Kinetic and Posterscope submit that the influence of rebate agreements on buying decisions is not significant, partly because individual buyers are unaware of the details of the agreements.
- 3.46 Kinetic explained that volume rebate agreements are not decisive in its decisions to spend with a particular owner. The key factor is always the individual client requirement to reach the desired audience of the individual brief for a particular spend. Kinetic also noted that only the most senior staff are

aware of individual agreements, and that those staff are not involved in day to day planning and trading decisions.

3.47 Posterscope submitted that the influence of rebate agreements on buying decisions is limited because there are so many other factors that feed into the media purchasing process.

Posterscope submitted that its individual buyers are not aware of the details of individual rebate agreements and therefore the incentive to select a media owner based on the status of Posterscope's volume rebate with that media owner is limited.

3.48 We note the specialist buyers' submissions that individual buying staff do not know about rebate agreements. However, the specialist buyers have also confirmed that trading directors do know about rebate agreements. We consider that trading directors are likely to have a significant influence over decisions made by individual buyers. This is also the view of a number of parties who expressed strong concerns that senior staff or trading directors do influence buying decisions. In addition, the very existence of the rebate agreements suggests that media owners believe that they may influence buying decisions made by the specialist buyers.

3.49 We also note that, to the extent that rebates ultimately pass through to advertisers, advertisers might be expected to want rebate agreements to be taken into account. Rebates mean lower prices for media. If an advertiser were buying directly from media owners, the advertiser would clearly take into account any rebate agreements it might have in deciding which media owners to buy from.

3.50 However, rebates are calculated across the specialist buyer's total spend across all its advertiser clients, and not for each advertiser individually. Any individual advertiser might therefore want the buyer **not** to take marginal rebates into account when buying for it and instead buy the quality-adjusted cheapest space appropriate for its needs to achieve the lowest invoice price.

Potential adverse impact on small media owners

- 3.51 Despite the existence of rollback rebate agreements, a number of smaller media owners have been able to enter the Outdoor market and develop portfolios of sites. Several parties submitted to us that even though rollback rebate agreements exist, if a media owner has high quality, high profile or innovative products then advertisers will want these and specialist buyers will purchase them.
- 3.52 However, concerns were also expressed that smaller media owners have struggled to attract volume from specialist buyers beyond certain levels due to rollback rebate agreements. In some cases where smaller media owners have built up substantial portfolios of sites, we have been told that they were subsequently unable to attract enough volume from specialist buyers to maintain or expand these portfolios. As a result, these owners had to sell their portfolios to the larger media owners and exit the market.
- 3.53 Another concern expressed to us was that where smaller media owners have high quality sites, these may not be sold ahead of lesser quality sites held by large media owners because specialist buyers will look to direct spending to the large media owners in order to achieve higher rebate payments.
- 3.54 Some small media owners who might otherwise have struggled to attract sufficient volume from specialist buyers have entered into marketing agreements with large media owners. Under these agreements, the small media owners pay commissions to the large who then sell the small media owner's advertising space. We have been told that these commissions can amount to more than 20 per cent of the revenue from the smaller media owner's space. The existence of such agreements suggests that some small media owners do have difficulty in selling space directly to the specialist buyers.

Conclusion on the impact of rollback agreements

- 3.55 We have considered whether the effect of rebate agreements between media owners and specialist buyers may be harmful to small media owners. Rollback rebate agreements are such that a specialist buyer may have a strong incentive to divert marginal spend to large media owners even when a small media owner offers a lower price for space of comparable or higher quality. Small media owners have submitted that the rollback structure of agreements means that it is very difficult for them to offer rebates that would match the marginal incentive of specialist buyers to place volume with large media owners. As a result, small media owners may find it hard to attract volume from specialist buyers.
- 3.56 Kinetic and Posterscope have both submitted that rebate agreements do not influence buying decisions. While we note their explanations as to why they believe this to be the case, we think that the senior staff aware of the rebate agreements with each media owner would be in a position to influence the decisions of individual buyers and planners. This may be more likely to happen towards the end of the year, when senior staff can better estimate the achievability of higher tiers with different media owners.
- 3.57 The effect of the rollback rebate agreements may be to make it harder for small media owners to sell their space. However, the agreements have the effect of attracting marginal spend away from other large media owners as well as from small media owners. As such, the high level of rebate payments may reflect competition between the large media owners to attract volume from specialist buyers. This may work to the advantage of advertisers, to the extent that rebates ultimately pass through to them.
- 3.58 We note that the specialist buyers may be able to negotiate higher potential rebates in return for allowing a rollback structure. Where all large media owners negotiate rollback

structures, this may not impact greatly on their relative shares. Rollback structures may mean that advertisers achieve a lower net price.

- 3.59 In the longer term, the specialist buyers (and agencies and advertisers) have a strategic incentive not to allow the supply side to consolidate further, since this may weaken their negotiating strength in negotiating on price and future rebate agreements as well as chilling innovation. Furthermore, the specialist buyers are paid commission for the complexity of planning and buying effective Outdoor campaigns across the media owner landscape. Further consolidation might weaken the rationale for their existence.

Media owner contracts with local authorities

- 3.60 Media owner contracts with local and regional authorities ('local authorities' for convenience) are a potential barrier to entry and expansion at the media owner level. For some of these contracts, long durations as well as clauses that restrict a local authority's ability to contract with other media owners may protect the position of incumbents. The large majority of such contracts are held by just two media owners – Clear Channel and JCDecaux.
- 3.61 Local and regional authority sites represent around 25 per cent of all Outdoor panels by number and around 20 per cent by revenue. In urban settings the proportions can be considerably higher. There are two main types of agreement:
- agreements for the installation of street furniture, for example bus shelters, with associated advertising rights ('street furniture' contracts)
 - agreements for the right to use sites where large format billboards can be erected ('large format' contracts).

3.62 Street furniture contracts are typically for the installation of bus shelters capable of displaying small format advertising, but may also include or be for the installation of council information panels and other free standing furniture capable of displaying information. The media owner typically supplies and maintains the street furniture, in exchange for which it is granted the right to display advertising on the furniture. The media owner may also pay rent to the local authority.

3.63 Large format contracts with local authorities are typically leases for a small number of sites at which 48- or 96-sheet billboards can be installed. The media owner pays rent for the right to install advertising equipment at the sites and to sell advertising space on the equipment.

3.64 Table 3.2 below contrasts these two types of media owner contract with local authorities:

Table 3.2: Comparison of street furniture and large format contracts

	Street furniture contracts	Large format contracts
Illustrative number of contracts per local authority	1	1 – 5 (small authorities) 10 - 30 (large authorities)
Illustrative number of sites per contract	50 – 250 (depending on size of local authority)	1 – 5
Illustrative duration	15 - 20 years	3 - 7 years
Approximate percentage of local authority panels overall	> 95 per cent	< 5 per cent
Approximate percentage of local authority outdoor revenue overall	85 per cent	15 per cent

Note: the illustrative figures in this table are based on the evidence available to us and may not be representative

3.65 The local authorities we spoke with before and during the course of the study expressed concern about the street furniture contracts. In addition to their long durations, in some cases up to 25 years, these contracts contain clauses that confer exclusivity on the media owner over the provision of advertising space in the local area. For example, some contracts provide for exclusivity over all small format advertising space on local authority sites. In addition, street furniture contracts may be perceived as poor value in terms of rents paid (if any) to local authorities.

Our review of street furniture contracts between media owners and local authorities

3.66 During the course of the study we requested and received a sample of 38 street furniture contracts from certain media owners. These contracts had been entered into by a selection of both small and large local authorities.¹⁵ We received a further seven contracts from local authorities directly, bringing the total number of contracts received to 45.

3.67 We reviewed these contracts as part of our market study and not using our power under the Competition Act 1998. The objective of the review documented here was to understand better the characteristics of street furniture contracts. No assumption should be made that any of these contracts would infringe UK and/or EU competition law.

3.68 Our review of the contracts that we obtained identified the following potential concerns:

- very long contract durations

¹⁵ We specified the local authorities, from lists provided by the media owners indicating the local authorities with which they had entered into contracts.

- tacit renewal clauses
- exclusivity clauses
 - clauses giving media owners exclusive rights to advertise on street furniture in a particular local authority area and/or the exclusive right to display advertising of a particular size and/or format in a particular local authority area
 - clauses requiring local authorities to cancel or not renew existing contracts and/or not to enter into new contracts that conflict with exclusive rights clauses
- other potentially restrictive clauses, including first refusal, priority rights and 'English' clauses
 - clauses giving incumbent media owners 'first refusal' on new sites for installing new equipment and/or displaying advertising material
 - 'English' clauses allowing a local authority to contract with another media owner **only** where the incumbent has had the opportunity to match the terms offered by the competitor but declined to do so

3.69 We set out our potential concerns in more detail below.

Long contract durations

3.70 We have been told that the long contract durations reflect commercial reality in that media owners must recoup the capital and installation costs of street furniture. However, we are concerned that the durations of contracts in our sample may be longer than needed for this purpose. Excluding the contracts sent to us by local authorities, since these may not be representative, around 80 per cent of contracts had durations of 15 years or more at inception of the agreement.

Around 30 per cent had durations of 20 years or more at inception.

- 3.71 The majority of agreements were concluded at least a decade ago. Nevertheless, given the long durations, only around 10 per cent were due to terminate or be renewed in the next three years. The majority (around 70 per cent) had between three and nine years remaining, and around 20 per cent had 10 years or more remaining.
- 3.72 The long durations mean that local authority agreements seldom come up for renewal. Local authorities told us that this, in conjunction with variable contract commencement dates and tacit renewal clauses, may make it difficult for a new entrant media owner to bid for and win enough contracts to successfully enter and expand in this part of the market.

Tacit renewal clauses

- 3.73 Tacit renewal clauses result in the automatic renewal of agreements if the local authority does not give notice that it wants the agreement to terminate at the end of the contractual period. A little over half of the contracts in the sample included tacit renewal clauses.
- 3.74 The renewal clauses varied in how much notice must be given (the 'notice period') and how many years the agreement will be extended by (the 'renewal period'). Most notice periods were a year in length, although some were longer. Renewal periods varied between one and five years.

Renewal in practice

- 3.75 Most of the 45 contracts were in their first life cycle and therefore have not yet been automatically renewed. Out of the sample, only one has entered a period of automatic renewal. The authority in question has now renegotiated the renewal clause to reduce the notice period from 12 months to three

months. Another three local authorities renegotiated renewal clauses while the original agreements were still in place.

- 3.76 The inclusion of tacit renewal clauses can make it difficult for local authorities to exit an agreement, depending on how much notice they must give and how long the renewal period may be. For example, one local authority that had signed an agreement in the mid 1990s recently found that it may now be unable to retender for another five years as it has failed to give sufficient notice to the media owner.
- 3.77 Such situations could occur if local authorities find it difficult to monitor the agreements. It may, for example, not be clear where the responsibility lies for overseeing agreements within a local authority, or staff changes throughout an agreement's life could mean that notice periods are accidentally overlooked. In addition, local authorities may not have the resource to challenge and successfully vary provisions they find unduly restrictive.

Exclusivity clauses

- 3.78 All the agreements we reviewed contained exclusivity clauses. From a media owner's perspective, clauses that prevent or restrict the installation of competing equipment at nearby locations help protect the value of its advertising space. The level of exclusivity available is a factor that media owners may take into account when considering how much to bid for such contracts.
- 3.79 The contracts varied in terms of the degree of exclusivity conferred on the media owner. For the purposes of the review, we divided our sample of contracts into three categories according to our assessment of the exclusivity conferred.
- 3.80 The widest form of exclusivity was where an agreement appeared to provide in substance for exclusivity over all advertising of a similar size on street furniture, and not just the

type of furniture supplied under the agreement. As small format panels are generally installed on street furniture, this potentially confers exclusivity over all small format advertising on street furniture in a local authority area. In one clause appearing in a number of contracts, the media owner was granted the exclusive right to install commercial advertising equipment for the display of advertisements of six to 12 sheet size, plus or minus 25 per cent. In another example, a clause gave the media owner exclusivity over all street furniture in the local authority area to which advertisements less than 10m² in size could be attached. Excluding the seven contracts provided by local authorities directly, around 50 per cent of our sample contained similar types of exclusivity provision.

- 3.81 Some agreements provided exclusivity purely over the type of furniture supplied, for example conferring the exclusive right to install bus shelters for the display of commercial advertising. Excluding the seven contracts provided by local authorities directly, a little under 40 per cent of our sample contained this and similar types of exclusivity provision.
- 3.82 A small number of agreements (around 10 per cent) provided an exclusive right to advertise only on the specific furniture installed under the contract. This was the narrowest form of exclusivity found in our sample.
- 3.83 Clauses might also contain specific geographic exclusivity, for example providing complete exclusivity within a certain radius of installed furniture. Such exclusivity only covers land belonging to the local authority in question and may not, for example, cover all large format sites.
- 3.84 A media owner told us that exclusivity provisions create efficiencies and allow for both the media owner and the local authority to plan with more certainty the future advertising revenues and costs associated with the contract.

- 3.85 Local authorities expressed concerns that exclusivity clauses can dissuade them from tendering for new sites where it is not clear to them whether these sites are covered by the clauses. In cases where local authorities do actually contract with other media owners, we have been told that incumbents have cited exclusivity clauses in an attempt to prevent them from contracting.

Other potentially restrictive clauses

- 3.86 A small number of agreements in the sample contained first refusal or priority rights clauses. Broadly, these specify that where a local authority wishes to make additional sites available for advertising, they must first offer them to the incumbent. The priority rights clauses we encountered differed in scope to exclusivity clauses in the same contract, potentially extending to opportunities for advertising other than those covered by the exclusivity clauses. This could allow media owners to use their position as the incumbent supplier of, for example, bus shelters, to prevent another media owner securing the use of other sites for the installation of street furniture. However, we have no evidence of clauses being used in this way in practice.
- 3.87 In addition, one of the agreements included in the sample contained an 'English clause'. This allows a local authority to contract with another media owner **only** if the incumbent has had the opportunity to match the terms offered by the competitor but has declined to do so. This type of clause could be used in a similar way to first refusal and priority rights clauses.

Ownership of street furniture

- 3.88 The very large majority of contracts in the sample provided for street furniture to remain the property of the media owner at the end of the agreement. This may give the incumbent an

advantage over other potential bidders for any new agreement, since the incumbent may not have to install new furniture.

- 3.89 In addition, local authorities may find it difficult to switch supplier because of the risk of local residents being without street furniture, such as bus shelters, for some period of time. Generally the agreements allow the media owner three to six months following termination of the agreement to remove their street furniture. Even if removal by one supplier and replacement by the next proceeds swiftly, there is the roadside disruption to consider.

Tender processes

- 3.90 From our conversations with local authorities and others with experience of media owner contracts with local authorities, we understand that many existing street furniture agreements were concluded in the 1990s without tender processes. There appears to be relatively little competition for contracts between the current incumbents primarily because the long contract durations and tacit renewal clauses mean that they have not often been put out to tender.
- 3.91 During the course of the study, concerns were expressed about the level of competition between media owners during tender processes. We were told by some parties that where media owners are not the incumbent in a local authority area, they may make bids that are less attractive than those made by the incumbent or withdraw from tender processes at a late stage, ultimately leaving local authorities with little choice but to award the contract to the incumbent. In other cases, media owners may not bid for contracts where they are not the incumbent.
- 3.92 However, this does not necessarily indicate that there are any irregularities in tender processes, and no evidence on possible irregularities has been provided to us during the course of the study. Media owners may recognise that incumbents are in a

strong position to win new contracts, for example because of the costs to local authorities of switching suppliers, and local authorities may be satisfied with an incumbent's performance. In some cases a media owner may simply decide that a contract is unlikely to prove profitable for them. In addition, we note that local authorities appear to take divergent approaches to procurement. The form that bids must take varies significantly across local authorities, which may increase the likelihood that a media owner submits a bid which later has to be disqualified or withdrawn.

- 3.93 Some local authorities that have run tenders relatively recently have secured improved commercial terms for themselves, such as higher revenue payments. Large local authorities may be better placed to do this, particularly those covering major urban centres and attractive locations for Outdoor campaigns.

Conclusion on media owner contracts with local authorities

- 3.94 The long duration and exclusive nature of many agreements may limit the ability of local authorities to contract with other media owners. This could result in them failing to secure additional revenue or failing to benefit from innovative products. In the longer term, the agreements could act as a barrier to entry and expansion of media owners that might otherwise seek to compete for local authority sites. The rebate agreements between large media owners and specialist buyers may act to compound the potential barriers to entry and expansion resulting from street furniture agreements.
- 3.95 Our review of contracts during the market study highlighted potential issues with contracts between media owners and local authorities. We are currently assessing street furniture contracts for their compatibility with UK and/or EU competition

law.¹⁶ No assumptions as to the outcome of this investigation should be made.

- 3.96 Some agreements may not provide good value for local authorities. In the agreements we reviewed, revenues per site received by local authorities varied widely. In a number of cases, local authorities receive either a nominal rent or no revenue at all. Others received rents that were a fraction of the likely advertising revenue generated from the sites today
- 3.97 We remain concerned that competition for new contracts put out for tender may be weak and may result in poor value for local authorities. We provide guidance for local authorities in Chapter 6.

¹⁶ The Chapter 1 prohibition of the Competition Act 1998 and/or Article 101 of the Treaty on the Functioning of the European Union

4 COMPETITION BETWEEN SPECIALIST BUYERS AND BETWEEN MEDIA AGENCIES

Summary

- 4.1 Outdoor buying is highly concentrated with two large specialist buyers, Kinetic and Posterscope, representing over 75 per cent of the market. The Outdoor volume that the specialist buyers control puts them in a powerful position relative to media owners, despite the concentration at the media owner level.
- 4.2 The specialist buyers use their power to negotiate lower prices and higher rebates from media owners. Lower prices benefit advertisers directly, although some advertisers may benefit more than others. On rebates, competition between specialist buyers and between media agencies is important to ensure that the benefits pass through to advertisers.
- 4.3 For the majority of advertising clients, the specialist buyers do not compete directly with one another, but indirectly through media agencies. Media agency pitches to advertisers involve an Outdoor element and may include evidence of the buyer's service quality and buying performance. The media agency looks to the buyer that they partner with to contribute to the pitch and deliver on any commitments made to the advertiser.
- 4.4 In addition to this constraint on the performance of specialist buyers, there appears to be a reasonable degree of competition between them for the business of media agencies outside of their parent groups, as well as for large advertisers that might want to contract with them directly. This competition results in the very large majority of rebates passing through to media agencies and advertisers contracting directly.
- 4.5 Competition between media agencies appears intense. Outdoor rebates help subsidise lower fees and commissions charged to all advertisers. Some large advertisers negotiate direct pass on of their proportional share of the rebates received by the media agency.

- 4.6 In this chapter we begin with the highly concentrated specialist buyer level of the market and consider whether specialist buyer power may benefit advertisers. A key issue is the extent of competition between specialist buyers, since this determines whether the benefits of their buyer power stay at this level of the market or pass through to media agencies and to advertisers contracting directly with specialist buyers.
- 4.7 We go on to consider competition between media agencies, and whether the rebates that media agencies receive pass through to advertisers. The threat of new entry can act as a competitive constraint, so we assess barriers to entry at the specialist buyer level.

The specialist buyers

- 4.8 Most Outdoor campaigns are planned and bought by the specialist buyers. Advertisers typically contract with a media agency, which uses its in-group specialist buyer, or preferred specialist buyer if its group does not own a specialist buyer, for the Outdoor component of campaigns. Some large advertisers with substantial Outdoor spend contract directly with a specialist buyer, alongside their contract with a media agency.
- 4.9 The specialist buyer level is highly concentrated, with two major players Kinetic and Posterscope representing over 75 per cent of all Outdoor buying and over 85 per cent of buying by specialist buyers. A third smaller player, IPM, represents under 10 per cent of all Outdoor buying. Competition for larger advertiser or media agency business is by and large limited to these three players.
- 4.10 Included in the above shares are a few smaller specialist buyers connected with either Kinetic or Posterscope. These smaller buyers may have access to the back office services of Kinetic or Posterscope, or may be part owned by them. Expenditure from these buyers is considered part of Kinetic's and

Posterscope's spend in the calculation of volume rebates by media owners.

Buyer power

- 4.11 The relative concentration of the specialist buying side in Outdoor suggests that the large specialist buyers' bargaining position with the media owners is likely to be strong. Outdoor media ownership is concentrated but not to the same degree. The specialist buyers are in a powerful position because media owners cannot access demand from advertisers except through the specialist buyer representing them. Each specialist buyer therefore represents a discrete part of market demand.
- 4.12 A specialist buyer has considerable discretion over where to place spend, and is in a position to withhold a proportion of demand from a particular media owner or threaten to do so. Withholding substantial demand from a large media owner may lead to higher prices for the specialist buyer's advertisers as well as distortions to their campaigns, since the specialist buyer would be concentrating demand with other media owners. However the threat of switching demand may be sufficient to enable negotiation of substantial rebates or lower prices.
- 4.13 In general, for any given campaign, the specialist buyer is in a position to direct some proportion of advertising volume such that one or more media owners receive more volume and the rest receive less. Where comparable or substitute space is available, it can do this with little impact on the effectiveness of an advertiser's campaign. While the specialist buyers may not exercise this ability to steer volume, it puts them in a strong negotiating position relative to the media owners.
- 4.14 The possible market power of the specialist buyers has been a consistent theme of submissions to us during the course of the study. Large media owners told us that where advertisers have negotiated pricing commitments, they may agree to low prices

at the request of specialist buyers even if they have limited capacity available that would otherwise command a high price. Large media owners also submit that they are required by specialist buyers to provide at regular intervals information on their remaining capacity for future Outdoor periods.

- 4.15 In addition to negotiating on price for individual advertiser campaigns, the specialist buyers use their power to negotiate around the beginning of each year volume rebate agreements with media owners. This may be an efficient use of buyer power, since the buyer can leverage the anticipated spend of all its advertising clients to achieve higher levels of rebate. The large majority of these rebates pass through to media agencies and to advertisers contracting with specialist buyers directly. However, the specialist buyers also benefit financially, since a proportion of rebates may be retained by them.
- 4.16 For agencies belonging to groups without a specialist buyer, the vertical integration of the specialist buyers has been raised with us as a possible concern. One media agency that we spoke with explained that the specialist buyer they partnered with would have information about prices achieved for its clients that would be valuable to media agencies competing with it in the specialist buyer's group. The specialist buyers were adamant that they do not share such information with the media agencies in their respective groups and that to do so would put at risk their relationships with non-group agencies.
- 4.17 We consider that high concentration at the specialist buyer level works to the advantage of advertisers, provided that the benefits pass through to them. This depends on competition between the specialist buyers and the expectations of their media agency partners, as well as competition between media agencies. These are covered in the sections below.

Competition between specialist buyers

- 4.18 The specialist buyers compete on the following main dimensions:
- buying performance: the quality-adjusted prices of Outdoor media they are able to achieve for advertisers
 - planning performance: their ability to deliver tailored and effective Outdoor campaigns
 - the commission that they charge for their services
 - the level of rebates offered to media agencies and to advertisers contracting with them directly, which acts to reduce the effective price paid for their services.
- 4.19 Advertisers pay a Specialist Agency Commission (SAC) to the specialist buyer, which is in addition to the commission that they pay to their media agency. In general, the level of SAC appears to be an industry standard five per cent of gross billings. This suggests that the specialist buyers may compete less on the SAC charged and more on the level of rebates that they are prepared to pay media agencies and advertisers for volume.
- 4.20 The rebate agreements that a specialist buyer negotiates with its media agency and advertiser clients are distinct from its rebate agreements with media owners. Rebate payments to media agencies are typically volume based and may come out of a specialist buyer's income from both SAC and rebates from media owners. Rebate payments to advertisers contracting directly with a specialist buyer may similarly be volume based or may simply pass on the advertiser's share of rebates received from media owners. While most advertisers pay the industry standard five per cent SAC, some large advertisers contracting directly may prefer to receive less than their

proportional share of rebates or no rebates at all and instead pay a lower SAC.

- 4.21 The specialist buyers compete for relationships with media agencies belonging to agency networks without a specialist buyer, so that they can represent the Outdoor needs of advertisers using those agencies. Competition between media agencies for contracts with advertisers may act as a competitive constraint on specialist buyers, since the buyer's performance in Outdoor will be part of an agency's pitch to potential advertiser clients. The specialist buyers also compete for contracts with larger advertisers that may wish to contract directly with a specialist buyer in addition to contracting with a media agency. We consider these in more detail in the sections below.
- 4.22 The available evidence suggests that few advertisers are likely to be able to switch to purchasing directly from media owners. The specialist buyer (whether accessed directly or via a media agency) has purchasing power, deals with large numbers of media owners, and has proprietary tools and expertise used to plan and buy campaigns. In the WPP Group/Portland merger, a large group of advertisers suggested that they would not switch to purchasing directly from media owners because of the services they receive from the specialist buyer. This is consistent with the views expressed by advertisers in this study. Purchasing directly from media owners is therefore not considered further.

Specialist buyers compete for media agency relationships

- 4.23 Media agencies typically have an agreement with a particular specialist buyer for the planning and buying of Outdoor campaigns. While there are cases where an advertiser requests that the agency use a different specialist buyer, these are exceptional and tend to be where an advertiser has a pre-existing relationship with a specialist buyer but has switched media agency.

- 4.24 Media agencies in the WPP, Aegis and Interpublic agency groups generally use the specialist buyer owned by their agency group (Kinetic, Posterscope and IPM respectively) unless the advertiser specifically requests otherwise. Other agency groups, such as Havas, Omnicom, or Publicis, do not own a specialist buyer. Media agencies in these groups generally have a relationship with either Posterscope or Kinetic as their preferred specialist buyer.
- 4.25 For agreements with media agencies outside their parent groups, the specialist buyers appear to compete strongly on the amount of rebate they are prepared to pass on, in addition to competing on their planning and buying performance.
- 4.26 Stakeholders have told us that media agencies belonging to groups without a specialist buyer tend not to hold formal pitches to appoint their specialist buyer. Further, there are very few examples of media agencies that have switched specialist buyer. Posterscope notes that 'there are no recent examples of a major media agency that has moved their Outdoor buying arrangements from one specialist to another'.
- 4.27 However, the threat of switching or of an agency group setting up its own specialist buyer appears sufficient to provide a competitive constraint on specialist buyers. We have been told by specialist buyers and by media agencies that the buyers have conversations with prospective agency partners on a regular basis. We understand that more than one agency group has recently carried out an informal review of its Outdoor buying arrangements and has chosen to remain with its existing specialist buyer.
- 4.28 The specialist buyers do not compete for the business of media agencies belonging to groups that already own a specialist buyer. Nevertheless, rebates and profit share are passed on to intra-group agencies to a similar extent as to agencies within other groups and independent agencies. This is so that the

intra-group agencies are not put at a competitive disadvantage when bidding for business from advertisers.

Competition between media agencies acts as a competitive constraint on specialist buyers

- 4.29 Media agency pitches to advertisers generally include an Outdoor element and are therefore likely to impose some competitive constraint on buying performance and planning services provided by the specialist buyer. Specialist buyers provide information to the media agency to feed into the process. This information will typically consist of a strategic element, planning details and a 'buying matrix' with indicative prices for a range of Outdoor media specified by the advertiser.
- 4.30 Some media agencies may wish to offer Outdoor media price commitments, which must be agreed with the specialist buyer. These commitments may take the form of specified prices or of discounts against an audited pool, the specialist buyer's pool or against the advertiser's historic prices.
- 4.31 For out-of-group media agencies, there is the implicit threat that the agency may switch its allegiance if the specialist buyer does not demonstrate its value to advertisers as part of the agency's pitches and in subsequent campaigns. For in-group media agencies, there is little threat to the specialist buyer of the agency switching its allegiance. Nevertheless there may be strong pressure on the specialist buyer to support in-group media agency bids through price commitments and demonstrations of service quality.

Specialist buyers also compete for direct advertiser clients

- 4.32 Some large advertisers contract with a specialist buyer directly, in addition to their contract with a media agency. While large advertisers constitute only a small proportion of advertisers

using Outdoor, these large advertisers account for around 15 – 20 per cent of Outdoor expenditure. Competition between specialists for advertisers who either are or who might contract directly provides a constraint on buying performance and service quality as well as on remuneration, including the extent to which rebates are passed on to advertisers.

- 4.33 We have heard from several large advertisers who appoint their specialist buyer directly. There was very little concern expressed by these advertisers that there is insufficient competition between the three main specialist buyers to ensure that they receive good value for money.
- 4.34 While switching by direct advertiser clients is rare, the threat of switching appears to have resulted in pressure to pass on rebates as well as strong constraints on buying performance and service quality. In particular, advertisers that have chosen to appoint their specialist buyer directly appear in general to have ensured transparency of rebates and that a proportion is passed on to them directly.
- 4.35 Some large advertisers with substantial Outdoor expenditure do not currently contract directly with a specialist buyer and might consider switching to a direct relationship. However there are costs to contracting directly, including the cost of implementing a competitive process to select a specialist buyer and the expertise required to monitor the specialist buyer's performance. Further, some advertisers have told us that appointing a specialist buyer directly may lead to a loss of the benefits of having Outdoor strategically integrated as part of the overall media planning process. For these reasons the large majority of advertisers by number may not spend enough on Outdoor to justify a direct relationship, and may anyway be too small to be of interest to the specialist buyers as a direct client.

Pass through of rebates by specialist buyers

- 4.36 This section considers the extent to which rebates are passed through by specialist buyers to media agencies and advertisers contracting with them directly. It is followed by sections considering competition between media agencies and the extent of pass through of rebates from agencies to advertisers.
- 4.37 The rebates paid by specialist buyers to media agencies and to advertisers contracting directly with them are in general not linked directly to the rebates that the specialist buyers receive from media owners. Instead the specialist buyer negotiates separate agreements that may be profit share arrangements or rebates contingent on the volume of business that an agency or advertiser places with the specialist buyer. Examples of some more common types of agreement are set out below:
- Pot share agreements: under a pot share arrangement, the five per cent SAC and the volume rebate are placed into a shared pot, where the percentage rebate payable at year end is dependent on the rebates received from the media owners. The percentage of the pot that the agency receives is dependent on the individual agency spend level at year end.
 - Flat rebate agreements: a straight percentage rebate arrangement where the percentage rebated to the agency is fixed dependent on the agency spend level achieved at year end.
- 4.38 For some direct advertiser clients, the specialist buyer may agree to pass on all rebates and be paid a fee. At the other extreme, some smaller and independent agencies that lack significant spend in Outdoor may not seek or be able to obtain any rebate.

4.39 The following table shows payments received and passed on by the specialist buyers in aggregate, and the net payments that they retain.

Table 4.1: Payments received and passed on by specialist buyers

	Amount (£m)	Percentage of Gross Billing
Payments received:		
SAC	[£30-35m]	Typically 5%
Rebates from media owners	[£0-65m]	[0-10%]
Total received	[£30-100m]	[5-15%]
	Amount (£m)	Percentage of Gross Billing by Category
Payments passed on:		
To intra-group (vertically integrated) agencies	N/A	[0-10%]
To non-group agencies	N/A	[0-10%]
To advertisers contracting directly with specialist buyers	N/A	[0-10%]
Total passed on	[£0-65m]	[0-10%]
(while the range of payments passed on starts at zero, a large proportion of the sum of SAC and rebates is passed on to agencies and advertisers contracting directly)		
	Amount (£m)	Percentage of Gross Billing
Payments retained:		
Total received less passed on	[£0-65m]	[0-10%]

Note: Ranges and missing information in the above table are to protect confidential information at the request of the parties. The percentage ranges for rebates passed on are not intended to imply that specialist buyers necessarily make rebate payments at the top end of the range to any individual clients.

- 4.40 We observe that competition between the specialist buyers results in a very large proportion of rebates received from media owners passing through to media agencies and advertisers contracting with them directly. Further, the proportion of gross billings paid as rebates to own-group agencies is similar to the proportion paid to non-group agencies. We have been told that this is so that own-group agencies are not disadvantaged when competing with other agencies for advertiser accounts.
- 4.41 While the overall proportion of rebates passed on is high, there appears to be substantial variation across clients, with smaller clients typically receiving lower proportions.

Competition between media agencies

- 4.42 While a detailed assessment of competition between media agencies is outside of the scope of the study, the OFT has considered the extent to which such competition imposes a constraint on Outdoor media prices, and the extent to which it results in volume rebates passing through to advertisers, either directly or indirectly via lower media agency remuneration.
- 4.43 Overall, competition between media agencies appears fierce and to be delivering benefits to a large number of advertisers. However, evidence of a wide variation of Outdoor media prices obtained for different advertisers suggests that some benefit more than others.
- 4.44 There are a very large number of media agencies operating in the UK. The majority of advertising expenditure is consolidated into four large agency networks, WPP, Aegis, Omnicom and Publicis, each of which owns a number of agencies. There are also two smaller networks, Havas and Interpublic, and a long tail of independent agencies.
- 4.45 The overall consensus from parties contributing to the study is that tender processes to appoint media agencies have become

very competitive and focused on price elements, including both media prices and agency remuneration. We have been informed that, as a result of the economic downturn, many advertisers have chosen to put their advertising business out to tender and several have started to require fixed price guarantees from their media agencies, including for Outdoor media.

Pass through of rebates from media agencies to advertisers

- 4.46 As a result of this high level of competition, rebates that media agencies receive from specialist buyers for Outdoor volume may pass through to advertisers as lower fees or commissions. In effect, the rebates that media agencies receive subsidise the low price that agencies may charge for their services. This indirect pass through is in addition to the rebates passed on directly by media agencies to some large advertisers.
- 4.47 Evidence from media agencies suggests that the proportion of rebates passed on directly to advertisers, mostly large advertisers, varies widely from agency to agency and client to client. However, some advertisers may prefer to receive the benefit of rebates in the form of additional media value in the current year rather than waiting for a share of rebates in the next. In addition, some advertisers may negotiate lower agency fees in return for allowing the media agency to retain some or all of the rebates attributable to their Outdoor spend.
- 4.48 In general rebates appear to be passed on directly only to advertisers with substantial advertising expenditure. The very large majority of advertisers do not receive any rebate relating to their Outdoor spend.
- 4.49 Advertisers not receiving rebates may nevertheless benefit from paying lower commission or fees to their media agency. Stakeholders have informed us that strong competition between media agencies has resulted in winning agencies relying on rebates to subsidise low agency fees.

Potential competition

Barriers to entry

- 4.50 The principal barriers to entry for specialist buyers identified during discussions with parties are the fixed costs of developing planning systems and the volume of business required to negotiate effectively with the media owners. For most potential new entrants these barriers seem to be a major deterrent. However, the existing large agency networks appear relatively well placed to set up their own in-group specialist buyer should they so wish.
- 4.51 A number of parties during the course of the study informed us that the service provided by specialist buyers relied on complex campaign planning systems that would be costly to set up. Both Posterscope and Kinetic have invested in sophisticated tools to carry out campaign planning functions, for example Posterscope's 'Posterbase' (a £1.5m investment in a campaign administration and management system).
- 4.52 As part of the commercial relationship arising from Posterscope's minority shareholding, Open Outdoor has access to Posterscope's tools to carry out campaign planning. Open Outdoor has been successful in winning small advertiser clients, including some that previously used Kinetic as their specialist buyer. It submitted that it was able to do this by marketing itself on quality of service, as it would have senior staff managing the account. Open Outdoor, however, does not compete for Posterscope clients. Entry via partnership with one of the large specialist buyers is unlikely to act as a significant constraint on the buyers.
- 4.53 The specialist buyers rely on their control of substantial volumes of outdoor spend to secure large volume rebates from the media owners. This gives them a competitive advantage in winning new clients, since they have more rebates to pass on. A new entrant buyer may not be able to negotiate rebates that

are as proportionally large from media owners. Indeed, some small buyers and agencies buying directly may be unable to place sufficient volume with some media owners to be recognised as a specialist buyer and thereby paid the SAC.¹⁷

- 4.54 Further, the buyer power of the two large specialist buyers may enable them to secure lower media prices selectively for individual advertiser clients where they face competition. Media owners have submitted that specialist buyers are able to demand low prices where certain advertisers have negotiated low pricing commitments, even if the media owner has limited capacity available that would otherwise command a high price.
- 4.55 The large agency networks currently without a specialist buyer may have sufficient volume of business to set up an in-group buyer able to achieve prices and rebate pass through comparable to those achieved by the existing large specialist buyers. In doing so they would take away a significant volume of business from the existing specialist buyers.
- 4.56 One media agency told us that it would not consider carrying out Outdoor planning and buying functions in house owing to the costs of setting up such a system. Another belonged to a group that was actively considering setting up an Outdoor planning and buying function, but this had not been a priority.
- 4.57 Aside from the costs of systems and the expertise required, there do not appear to be any significant barriers for an agency network to set up an in-group specialist buyer. However, they may lack the incentive to do so, since a large proportion of volume rebates are passed on to them by the specialist buyer that they currently partner with.

¹⁷ Media owners pay the SAC on behalf of the advertiser

5 AGENCY ISSUES

Summary

- 5.1 While competition between media agencies appears strong, a substantial proportion of rebates is not being passed directly to advertisers. These rebates are in addition to the commissions/fees paid by advertisers and place both specialist buyers and agencies in an apparent 'double agency' situation.
- 5.2 The specialist buyers may not have a strong incentive to negotiate hard on price. The specialist buyers appear to achieve substantial improvements in price in certain situations, such as where a campaign will be audited and a commitment has been made on price. This suggests that buyers could have achieved better prices in the first place.
- 5.3 The pass through of rebates on Outdoor spend to media agencies may contribute disproportionately to their income. Both media agencies and specialist buyers may therefore have an incentive to encourage the use of Outdoor over other advertising media, particularly for clients who do not have rebates passed on to them directly. We have been told that specialist buyers promote the use of Outdoor media in exchange for rebates.
- 5.4 As noted in previous chapters, the rollback structure of rebate agreements may provide an incentive for specialist buyers to concentrate spend with larger media owners. As a result campaigns may be less effective because they do not make use of innovative or quality-adjusted cheaper sites from smaller media owners. This may be to the detriment of those advertisers not receiving full benefit from rebates.
- 5.5 The potential harm arising from agency issues and the lack of transparency is difficult to assess. Smaller and/or less savvy advertisers may be at greater risk of harm, since they may not contract for rebates to be passed back to them and may not seek to mitigate distortions.

- 5.6 In this chapter we consider the potential distortion to the incentives of specialist buyers and media agencies arising from rebate payments. If rebates were fully and directly passed on to advertisers there would be no potential distortion. However, while the large majority of rebates appear to pass through, some proportion may not. Furthermore, much of the pass through is indirect, with media agencies charging lower fees and relying on rebates to help pay for their services. As a result, there may still be agency issues despite high levels of pass through.
- 5.7 We explore the agency issues that may arise, in the context of a lack of transparency of rebates and rebate pass through. We consider a lack of incentive to negotiate lower prices, a potential incentive to increase spend on Outdoor relative to other media, and possible skews within Outdoor campaigns. Finally we discuss the possibility of mandating an agency at law relationship and explain why we do not recommend this.

Why advertisers use media agencies and specialist buyers

- 5.8 Advertisers benefit in a number of ways from using specialist buyers and agencies to buy advertising media on their behalf.
- 5.9 First, media agencies and specialist buyers are in contact with many media owners and have access to information that advertisers lack. This information asymmetry relates to:
- rebate arrangements and rebate payments
 - the prices and availability of Outdoor media
 - the best composition of campaigns (in terms of the quality of different formats and locations)
 - the value of Outdoor media compared to other advertising media.

- 5.10 In addition, and related to the information asymmetry, specialist buyers and media agencies have access to proprietary tools and expertise enabling them to plan effective campaigns and campaign strategies.
- 5.11 Second, specialist buyers and media agencies can spread the transaction costs of negotiating with multiple media owners across the advertisers that they represent, reducing the cost per advertiser.
- 5.12 Third, by consolidating the expenditure of a number of advertisers, specialist buyers and media agencies benefit from greater negotiating strength, enabling them to negotiate greater discounts with the media owners.

How agency issues arise

- 5.13 Agency issues may arise if there are differences in incentives between the advertiser and agency that are not contractually mitigated. There is a financial incentive for the media agency or specialist buyer to 'skew' advertising expenditure where there is a divergence between what is profitable for the agency or specialist buyer and what is good value for money for the advertiser. This divergence of incentives may mean that agencies do not choose the best value for money campaigns that are available for their advertising clients.
- 5.14 The current payment structure in Outdoor, in particular the payment of volume rebates, potentially creates such a divergence in incentives. Specialist buyers buy on behalf of advertisers but receive a substantial part of their remuneration as rebate payments from media owners. Indeed on average these payments exceed the commission payments paid by advertisers.
- 5.15 This may result in a 'double agency' situation – while the specialist buyer is acting on behalf of the advertiser and should be looking for the best media at the lowest cost, its financial

incentives are to encourage greater spend on Outdoor media. Several of the media owners and specialist buyers have recognised in discussion with us that they share a common interest in increasing the total amount of revenue spent in Outdoor and share of Outdoor versus other media.

- 5.16 As discussed in Chapter 4, the specialist buyers do pass through a very large proportion of the volume rebates they receive to their media agency and direct advertiser clients. However, the pass through may come out of both SAC and volume rebates received, and given that rebate agreements with their clients may be structured differently from agreements with media owners (for example, flat rate versus rollback) there may still be agency issues at the specialist buyer level.
- 5.17 The first potential concern for advertisers is that specialist buyers appear poorly incentivised to negotiate lower prices on behalf of advertisers, who may therefore end up paying higher prices than they need. The payment structure implies that specialist buyers benefit financially from spending more in Outdoor. They are paid a percentage of the price of the media and in addition receive rebates from the media owners, which are larger the more they spend with media agencies.
- 5.18 Second, because rebates are a significant source of income for media agencies and specialist buyers and a substantial proportion of rebates are not directly passed on to advertisers, rebates may be a significant source of distortion to advertising campaigns. Media agencies may skew expenditure towards Outdoor away from other media if they earn more in retained rebates from Outdoor than they do from other media.
- 5.19 Third, and to the extent that rebate payments are not passed through, advertisers may be paying more for Outdoor media buying services. However, as discussed in Chapter 4, evidence that we have received during the course of the study suggests that competition between specialist buyers and between media

agencies has led to a large proportion of these rebates passing through to advertisers, in particular to advertisers with significant volumes of advertising expenditure.

- 5.20 As discussed in Chapter 3, the rollback structures of rebate agreements create strong marginal incentives for the specialist buyers not to deal with small media owners. This may result in advertisers buying more expensive (before considering rebates) or worse quality campaigns from the large media owners, when there may be better value alternatives available from smaller media owners. To the extent that rebates pass through to advertisers, this might be in the advertiser's best interests, at least in the near term. However, some advertisers may benefit more from than others, and smaller advertisers in particular may be disadvantaged.
- 5.21 Finally, ancillary services such as print production are provided by third parties via the specialist buyers. These ancillary services are unlikely to be considered by advertisers in choosing their agency and so may not be constrained by competition. We have considered whether specialist buyers may receive rebates or fees from print production companies.

Lack of transparency

- 5.22 There is little transparency of the payment structure for the majority of advertisers, in particular of the rebates paid to the specialist buyers, and of any pass on of these rebates to media agencies. The existence of volume rebates in Outdoor has been widely reported in the trade press and most advertisers appear to be aware of them. However, a minority of advertisers are unaware or uncertain of the very existence of volume rebates. Further, while most advertisers are aware of rebates, very few know the proportion of rebates achieved by their specialist buyer attributable to the volume of business that they have placed with it.

- 5.23 Advertisers told us that the lack of transparency on rebates made the market difficult to negotiate and a 'grey area'. A view expressed by one advertiser was 'as funders of the Outdoor industry it is important for advertisers to have clear visibility of payment trails and to be assured that media budgets are spent directly on media owner inventory, as opposed to funding the profitability of the supply chain.'
- 5.24 Lack of transparency was also cited in reference to measurement of Outdoor efficacy. Advertisers pointed out that to date there has been no single reliable audience measurement and accountability of Outdoor formats and it has been difficult to get visual proof of posting across the market and confirm the dates advertising was posted for. The validity of Visibility Adjusted Contacts¹⁸ scores was also raised as a concern.
- 5.25 Despite concerns raised about transparency, some of the advertisers – mainly large advertisers – that we spoke with felt confident that they had established ways of working within the market that were appropriate for them. These included contracts which required all rebates to be transparent and passed back to the advertiser and confidence that the rates paid for Outdoor were very competitive (based on auditors pool or knowledge of the market).
- 5.26 However, even some of these advertisers submitted that they are unable to check whether rebates provided are 'correct'. In most cases the advertiser contracts with the media agency, so may not have the possibility of directly observing the rebates received by the specialist buyer, only those passed on to the agency. Some advertisers suggested that the structure of the market could mean that less sophisticated advertisers suffer,

¹⁸ A visibility adjusted contact or VAC is the audience rating for an advertising panel. It is a measure of the scale of the audience. Further detail can be found at www.postar.co.uk/research/postar-model/vac

since they would not be shown certain information by agencies and would be unaware that they should ask for it.

- 5.27 The lack of transparency of rebates may allow agency issues to persist. Advertisers rely on specialist buyers to choose the best value Outdoor media for their campaigns and have very little information of alternative media or sites available. They may be unaware of cheaper or more appropriate alternatives for their campaigns.
- 5.28 Further, without transparency they are unable to take steps to mitigate these possible distortions. Because most advertisers do not have a direct relationship with a specialist buyer it may be difficult for them to obtain transparency of rebates. There may be in addition be little incentive for advertisers to seek establishing transparency if Outdoor is a small component of their advertising expenditure.

The contractual position

- 5.29 Currently, specialist buyers and media agencies are entitled to keep rebates from media owners unless their contracts with advertisers specify that these must be passed through. Despite the term 'media agency', they are acting as principals at law rather than agents, and have no general legal responsibilities to pass rebates back or act on behalf of the advertisers engaging them.
- 5.30 Media agencies and specialist buyers are therefore constrained principally by the individual contracts they have with advertisers. These contracts are established and monitored through competitive processes to select media agency or specialist buyer, through the implicit threat of the advertiser switching and through auditing. Some contracts may specify that commissions or rebates earned from the business of the advertiser are declared or passed back to the advertiser. However, many contracts do not specify that rebates are passed back and in these cases the payment of rebates to the

agent and specialist buyer may result in a potential conflict of interest as described above.

- 5.31 There have been recent changes to the law which may have an impact on the advertising industry, and may affect the obligations of media agencies. The Bribery Act 2010¹⁹ replaces the previous regime of common law bribery offences and is expected to come into force in April 2011. The Act is broadly worded, and no guidance is yet available as to its likely application. However, a number of articles in trade press have suggested that it could apply to practices which are common in the Outdoor industry, such as volume rebates.
- 5.32 Media agencies and media buyers will need to ensure that they are in compliance with the new law. In some cases this may involve adjusting contractual terms to ensure greater clarity around the role of the media agency and/or the specialist in relation to the advertiser.

Specialist buyers poorly incentivised to negotiate lower prices

- 5.33 The payment structure implies that specialist buyers benefit financially from paying more for Outdoor media. Specialist buyers are, however, constrained from seeking higher prices by the pricing commitments they have negotiated with their clients and by the threat of advertisers switching. Pricing commitments can be negotiated in the context of competition between the specialist buyers and between media agencies, and monitored and enforced by auditing.
- 5.34 During the course of the study, in evidence provided by specialist buyers, media owners and media auditors, the OFT observed a surprisingly wide differential in the prices obtained

¹⁹ The full text of the Act is available at www.legislation.gov.uk/ukpga/2010/23/contents; further information is available from the Ministry of Justice at www.justice.gov.uk/publications/bribery-bill.htm

by different advertisers for apparently similar Outdoor media. Some of the disparity can be explained by structural features of the industry, in particular that Outdoor media is heterogeneous and because prices will depend on the remaining capacity available at the time of booking. In addition, many advertisers with substantial Outdoor spend have obtained significant discounts. However, the OFT observed examples of relatively large advertisers that were paying significantly higher prices than others for similar space across a similar time period.

- 5.35 There are a number of interrelated reasons for the residual variation in prices. Responses from media owners and the specialist buyers indicate that it may largely be due to the differential in pricing commitments provided to different advertisers by the specialist buyers. Less than half of advertisers have such commitments and they appear to typically arise as a result of competition between media agencies. Further, while many advertisers rely on media auditing to monitor the performance of specialist buyers, a significant proportion of Outdoor media bought is not audited.
- 5.36 Since the majority of advertisers select their media agency rather than appointing the specialist buyer directly, tender processes between media agencies are one of the most important sources of competitive pricing commitments. Posterscope has submitted that the principal driver of competition comes from advertisers' demands for strong pricing and value commitments, and their requirement for media agencies to achieve these commitments. However, the strength of these demands, and thus the degree of competitive constraint on prices imposed by the choice of media agency, appears to vary across advertisers.

5.37 For most advertisers the Outdoor media expenditure is only a small part of the total media expenditure²⁰ and may be weighted accordingly in judging media agencies' bids. In addition, a substantial part of the advertiser's decision of which agency to appoint may focus on service elements provided by the media agency, such as strategic planning. Advertisers' views of the importance of the Outdoor buying element when selecting the media agency varied. Some regarded it as pre-packaged with the services of the media agency or secondary to the integrated communications strategy of the media agency, while others appeared to regard it as more important. Posterscope submitted that 'In the context of a media agency securing advertiser business, Outdoor media is almost never the 'clincher' or 'breaker'.' Since Outdoor media accounts for a relatively small proportion of advertisers' overall media spend, its significance in terms of achieving an advertiser's overall media pricing objectives may be similarly small.

5.38 Further, a number of advertisers have not put business out to tender for a number of years. Certain advertisers informed us during the course of the study that selection processes were costly and that there were significant costs involved in switching media agency or specialist buyer, due to the time needed to develop a productive working relationship.

5.39 The OFT has observed cases where an advertiser's specialist buyer achieved dramatic reductions in price following instances of direct competition with another specialist buyer. This suggests that certain advertisers that have not instigated a competitive process between specialist buyers (or alternatively in media agency bids) may currently be paying significantly higher prices than advertisers that have.

²⁰ Expenditure on Outdoor is only approximately five per cent of total advertising expenditure in the UK (7.5 per cent excluding internet which has been growing rapidly).

- 5.40 More than half of expenditure on Outdoor media is neither audited nor has specified pricing commitments. Posterscope submits that most advertisers with significant levels of spend (for example at least £1million per annum) will seek to have pricing commitments, but that the level of pricing does not always correlate with the advertiser's spend.
- 5.41 Where media prices are not subsequently audited, competition between agencies, either through active competitive processes or through the implicit threat to switch agency or specialist buyer, is less likely to be as effective in constraining the prices achieved by the specialist buyer.
- 5.42 For campaigns that are audited against pricing commitments, there are broadly two types of commitment in place. A small number of advertisers have commitments to achieve specified media prices. These may, for example, take the form of a commitment to achieve a discount against the prices the advertiser has paid the previous year. Other advertisers have commitments to achieve an overall price for the client's campaign that is at or below the auditor's pool, which where possible will be drawn from similar media bought in the same period. Media auditors may also audit commitments against a range of other factors, including campaign delivery, quality, panel distribution and audience measurement results. In total about [30 – 50]²¹ per cent of expenditure on Outdoor media was audited in 2009, a percentage that has been increasing and is expected to have increased further in 2010.
- 5.43 Even where campaigns are audited, it appears that the heterogeneity of Outdoor media and the consequent range of different benchmarks used by different advertisers allow apparently conflicting pricing commitments to be achieved by the specialist buyers. For example, Kinetic submits that while

²¹ Range to protect confidential information at the request of the parties

clients using a media auditor will have commitments to achieve prices at or below the average price of the audited pool, failure for Kinetic to deliver on a pricing commitment is rare. The heterogeneity of Outdoor media used in different campaigns therefore increases the complexity and reduces the efficacy of the auditing process to some extent.

- 5.44 The difficulty for advertisers to observe differences in quality of heterogeneous Outdoor media may also give scope for the specialist buyers to pay a significant premium to advertise at particular sites, when this may not necessarily be in the advertiser's interest. Billetts, an independent media auditor, informed us that it had audited campaigns where the premium paid to advertise on particular sites did not appear to be justified given the alternatives available.

Rebate payments may distort campaigns

Media agency skew towards Outdoor

- 5.45 Media agencies receive rebates from media owners in a range of different advertising media and not just those passed on by the specialist buyers in respect of Outdoor. Where retained rebates are higher for Outdoor than for other advertising channels, it may be more profitable for the media agency if the advertiser allocates a greater proportion of its budget to Outdoor at the expense of other media.
- 5.46 Industry figures for advertising expenditure²² suggest that Outdoor has been growing at the expense of other traditional media over the last 10 years. This is consistent with a skew towards Outdoor caused by rebates. However, it is not direct evidence that campaigns are being skewed, as it may also reflect quality improvements in Outdoor relative to other media

²² <http://expenditurereport.warc.com/Default.aspx>

and improvements in the way the performance of Outdoor can be measured.

- 5.47 Responses from media agencies indicate that the rebates received from the specialist buyers in Outdoor are proportionally greater than rebates received from other advertising media. While Outdoor represented only 5.4 per cent of total advertising expenditure in 2009, rebates from Outdoor can be up to half of total rebates received by media agencies. That said, evidence from one media agency suggests that rebates received from media owners in other channels, particularly press and digital, have increased substantially relative to rebates in Outdoor over the last few years.
- 5.48 A proportion of rebates received from all advertising channels are passed directly back to advertiser clients. Only the remainder that is retained and contributes to the agency's income may give a financial incentive to the media agency to divert campaigns towards a particular advertising channel. Currently a substantial proportion of rebates are retained by media agencies (some contracts may explicitly provide for retention of rebates by the media agency). However, evidence from one media agency suggests that the proportion of rebates passed on to advertisers across all advertising channels has increased significantly over the last three years. This is likely to be due to more advertisers contractually requiring greater pass on of rebates.
- 5.49 As noted in paragraph 4.47, evidence from media agencies suggests that the proportion of rebates passed on directly to advertisers, mostly large advertisers, varies widely from agency to agency and advertiser to advertiser. Evidence from one media agency shows that almost double the proportion of rebates in Outdoor are currently passed on to advertisers relative to other media. It suggests that that the greater rate of pass through in Outdoor may be because Outdoor rebates have been established for longer, Outdoor is well-known as specialist medium with the result that rebates and SAC are

more widely discussed, and Outdoor clients are typically advertisers with a high expenditure.

- 5.50 Overall, however, retained rebates from Outdoor appear for many agencies to be a significantly larger proportion of advertising expenditure than those received from other advertising channels. Further, some particularly smaller advertisers do not receive any rebates from their media agency. For these advertisers the media agency would financially benefit from steering expenditure towards Outdoor.
- 5.51 Media agencies have the ability to steer expenditure towards Outdoor as they are largely responsible for campaign planning. At the margin it is likely to be difficult for advertisers to ascertain which media channel is likely to deliver better value so is likely to be scope for media agencies to be able to steer significant expenditure.
- 5.52 During the course of the study several stakeholders have highlighted these incentives to us. Some stakeholders have also suggested that media agencies have in practice steered volume towards Outdoor at the expense of other media that may be better value for money for the advertiser. For example, Billetts informed us that it reasonably often advises clients that they have spent more on Outdoor media than might have been appropriate for their advertising campaigns. We did not find direct evidence of particular individual advertising campaigns that had been disproportionately skewed to Outdoor, as it is very difficult to know what the appropriate expenditure on Outdoor would be for a given advertiser's individual requirements.
- 5.53 All media agencies we spoke to, however, denied that the rebates received in Outdoor had a significant influence on their campaign planning. We were informed that individual buyers at agencies are unaware of the details of rebate deals and so are not influenced by them when buying Outdoor media, and that rebates contributed little to agency income. Evidence provided

by one media agency showed that retained rebates contributed less than five per cent of total agency income and that this had almost halved in the last three years.

Skew within Outdoor campaigns

- 5.54 To the extent that the specialist buyers retain revenues from rebates rather than passing them on to media agencies or advertisers, they have a financial incentive to divert expenditure to media owners offering the highest rebates and potentially away from those offering lower prices (net of rebates).
- 5.55 The large majority of rebates that the specialist buyers receive from media owners pass through to media agencies and to advertisers contracting with them directly. However, the specialist buyers may still have a strong financial incentive to achieve higher levels of rebate. This is because they do not pass on rebates directly, but instead have distinct rebate agreements with their clients. These agreements may be profit share or flat rate, with payments that may come out of both SAC and the rebates that they receive from media owners. As a result, higher rebates from media owners may contribute significantly to their profitability.
- 5.56 Furthermore, the specialist buyers may not pay rebates to many smaller media agency and advertiser clients. These clients represent a small proportion of the advertising expenditure, but a large proportion of their client base.
- 5.57 Financial incentives for the specialist buyers to skew campaigns to media owners offering higher rebates rather than lower net prices may therefore exist, particularly when buying for clients who do not receive rebates. These incentives have to be considered in the context of the rollback structure of the rebate agreements. As discussed in Chapter 4, rollback structures create strong marginal incentives for the buyers not

to deal with small media owners, even when the small media owner is prepared to offer high rebates.

- 5.58 The rebate agreements themselves can be thought of as causing skew, as well as foreclosure, as they may result in advertisers buying more expensive or worse quality campaigns from the large media owners, when there may be better value alternatives available from smaller media owners.
- 5.59 The effect of the rollback structure on the specialist buyer's incentives to concentrate spending with the large media owners may be stronger than if an advertiser were buying directly. Rebates may have a larger impact on the specialist buyer's income than on the net price that the advertiser pays. This effect is exacerbated because, as noted above, the specialist buyers benefit financially from paying more for Outdoor media and therefore do not have the same incentives to take into account the price and quality of the media when deciding from which media owner to buy.

Print production

- 5.60 Both Kinetic and Posterscope offer print production, which is the making of posters displayed on Outdoor equipment. This service is optional for clients. We understand that most print production consists of producing paper and paste posters, although the use of vinyl 'skins' is increasing where Outdoor equipment has been converted to use these. The total combined value of print production provided by Kinetic and Posterscope in 2009 represented approximately one-fifth of all print production for Outdoor.
- 5.61 Posterscope provides print production services to its clients through an in-house team. Posterscope told us that it does not have facilities to print posters so will always engage third party printers to carry out print production for clients. Posterscope told us that it provided print production services for approximately 22 per cent of its clients in 2009.

- 5.62 Posterscope submitted that it does not charge clients any fees in addition to those charged by external printing companies for print production work. However, Posterscope does receive a share of revenue from the third party printers it contracts with. Posterscope told us that its clients are aware that revenue sharing arrangements between Posterscope and third party printers exist, but not the details of those arrangements.
- 5.63 Kinetic has a subsidiary company, Hi Resolution (Production) Limited (Hi Resolution), which provides print production and related services such as print buying and art working. Kinetic told us that Hi Resolution does have small scale capacity for printing posters but will be more likely to contract with a third party printer. As with Posterscope, the services offered by Hi Resolution are optional for Kinetic clients.
- 5.64 Kinetic told us that when Hi Resolution uses a third party printer to provide print production services for its clients, it adds a management fee to the costs quoted to it by third party printers. Hi Resolution also receives rebates on total annual spending from most of the third party printers it uses to provide print production services. Kinetic submitted that in practice clients are not interested in who is providing the services so long as their campaign is being managed and delivered effectively.
- 5.65 Both Kinetic and Posterscope told us that clients are not always aware of which printing company is carrying out print production for them. Kinetic submitted that in practice clients are not interested in who is providing the services so long as their campaign is being managed and delivered effectively. Posterscope said that its clients' primary concern is that the work is done to a high standard, not the identity of who is doing the work.
- 5.66 We note that some clients who may use media agencies, Hi Resolution or Posterscope for print production may not be aware of additional fees that may be charged (above those

charged by third party printers) or any rebate or revenue sharing arrangements that may exist between media agencies, Hi Resolution or Posterscope and third party printers.

Assessment of harm arising

- 5.67 The individual requirements of advertising campaigns may vary significantly from campaign to campaign. It is also difficult to determine the alternatives to any given campaign. As a result it is very hard to ascertain the extent to which advertisers may be suffering as a result of potential distortions to buying incentives.
- 5.68 That said, the financial incentives that create the potential for such distortions are clear. Consequently, there does appear to be a significant risk that certain campaigns are distorted.
- 5.69 The retention by media agencies of greater rebates from Outdoor than from other channels does appear to present a risk for advertisers that some campaigns are skewed towards Outdoor. The OFT notes evidence that suggests the pass through of rebates to advertisers has increased over the past few years, mitigating the potential issue to some extent. However, smaller or less sophisticated advertisers appear to be at greater risk from such distortions, since in general they do not have rebates passed on to them nor have sight of them.

Should agency at law be mandatory?

- 5.70 Adopting a formal agency at law relationship would fundamentally change the way that advertisers and media agencies interact across all media formats and not just Outdoor. Agents at law are held to stringent standards which require them to act in the best interests of their principal. In particular, an agency relationship is likely to involve a

prohibition on conflicts of interest and secret profits,²³ which could apply to situations where a media agency acting as agent at law retained rebates from media owners without the knowledge of the advertiser.

- 5.71 In principle, adopting a formal agency relationship should not impose a greater burden on any of the parties to the agreement, and should not require advertisers to take a more active role in monitoring the performance of agencies or become more involved in the media buying process. Indeed, a formal agency relationship may most benefit those advertisers that do not want to take an active role, since it would legally require that agencies act in their best interests. Formalising the agency relationship may also promote transparency on prices and facilitate access to media owner invoices for advertisers and their representatives.
- 5.72 Individual advertisers may find it difficult to negotiate a formal agency relationship given that it goes against standard industry practice. Media owners would have to be willing to accept bookings for space made by an agent acting on behalf of a disclosed principal, which might require some variation of their standard terms and conditions. Media agencies would also need to ensure they have sufficiently robust procedures in place to deal with potential conflicts of interest arising from representing competing advertisers.
- 5.73 During the course of the study we found isolated examples in the UK of formal agency relationships whereby the advertiser has been established as principal. In some cases these have been at the instigation of the media agency, where the agency has found the cost of credit insurance prohibitive for certain advertisers. In others, an advertiser has sought to contract on

²³ For a recent case concerning the duties of a commercial agent to its principal, see *Imageview Management Ltd v Jack* [2009] EWCA Civ 63

a global basis and wanted contracts to be consistent (in some jurisdictions, such as the US, agencies typically act as agents at law). The fact that media owners have been prepared to vary their standard terms and conditions in certain situations suggests that this should not be an insurmountable obstacle.

- 5.74 In France, the media buying process has been regulated such that media buyers and media agencies are required to be agents at law. In part, this was to address wider issues, including corruption involving bribes and payments to individuals. These practices are not evident in the context of the UK Outdoor industry. Furthermore, the Bribery Act 2010 may apply to such practices.

Loi Sapin in France

In France, concern about lack of transparency, payments to individuals, very high levels of rebates and the retention of rebates by media buyers without the knowledge of advertisers led to the passing of the 'Loi Sapin' in the early 1990s.

Media planning agencies and central buyers now have their relationship with advertisers formalised in a written 'mandat' contract. Under a 'mandat' a person gives another person the power to do something on his behalf and in his name, and it contains loyalty provisions, similar to a formal agency arrangement.

Advertising space is now bought by the agencies on behalf of the advertisers, in their name and on their behalf. This prevents brokerage, and intermediaries are now directly remunerated by advertisers.

- 5.75 In the US, media agencies are generally treated as agencies at law. Volume rebates are not common in the US advertising industry, which may in itself indicate that they expose media agencies to a conflict of interest. Legislation such as the Sarbanes-Oxley Act may limit the extent to which media agencies belonging to a publicly listed company can retain rebates. In 2005, the Interpublic Group returned large sums of

money to advertisers worldwide as part of accounting restatements following a Securities and Exchange Commission investigation and in line with its Sarbanes-Oxley compliance programme.²⁴ We are not aware of any situations where the position of agencies as agents at law has been used to compel the pass-through of rebates or benefits deriving from media buying activities.

Media agency as agent at law in the US

In the USA, standard terms and conditions for the purchase of advertising media are drafted so the advertiser is the disclosed principal and the media buyer is an agent at law. This position is reflected in contracts between media buyers and media owners.

The contracts also provide that the media agency will be liable for payment and the media owner will look solely to the media agency for payment, unless and until the media agency defaults in its payments to the media owner, or insolvent. If this happens, the advertiser will be liable jointly to the media owner on all unpaid billings, without relieving the media agency of liability until the media owner is paid in full.

Conclusion

- 5.76 We have considered whether to recommend a change in the law to mandate that specialist buyers and media agencies be agents at law. Unless very narrowly drafted, this change would have implications beyond Outdoor. As advertisers appoint a media agency to plan and buy across all the media formats they use, adopting an agency at law relationship would affect every media format an advertiser wishes to use.
- 5.77 The transition costs of moving to such an arrangement could be substantial, as advertisers and media agencies would need

²⁴ www.sec.gov/litigation/complaints/2008/comp20547-ijpg.pdf (paragraph 7)

to adapt their fee arrangements in addition to their contracts. If a large proportion of media agencies' revenue comes from rebates they retain, upfront fees may need to rise to compensate for the loss in revenue from rebates.

- 5.78 Given the considerations above, we are currently of the view that regulation of the advertising industry would be a disproportionate response to the agency issues we have identified in Outdoor. Nonetheless, we recognise the possibility for individual advertisers to change their contractual arrangements to designate themselves as principal, and we suggest that for some advertisers this structure may be preferable. We further note that even in the current legal relationship it is possible for advertisers to include loyalty provisions in their contracts that may achieve similar objectives if correctly drafted.
- 5.79 Steps to mitigate risks to advertisers arising from agency issues are considered in the Chapter 6.

6 NEXT STEPS AND RECOMMENDATIONS

Summary

- 6.1 While the majority of rebates may ultimately pass through to advertisers, agency issues arising from rebate payments have the potential to distort campaigns and increase the price that advertisers pay. We strongly encourage advertisers to engage more directly with the media buying process and to seek greater transparency of rebates and how their campaigns are bought.
- 6.2 Contracts with media agencies may only cover rebates received by the media agency and may not reach up a level to the specialist buyer. Advertisers should consider clauses that explicitly provide for the treatment of rebates received by sub contractors including specialist buyers. Advertisers should also ensure that contracts are not open to misinterpretation, since rebates calculated on aggregate spend may not be directly attributable to a particular advertiser.
- 6.3 For some advertisers, an agency at law model may be preferable. This would place the agency under an obligation to act in the best interests of the advertiser. For others, contracting directly with a specialist buyer may improve transparency and allow for more direct involvement in the design of outdoor campaigns. Fee structures which incorporate pay for performance bonuses can help to mitigate possible distortions to incentives.
- 6.4 On media owner contracts with local authorities, we are concerned that these may be unduly restrictive and have opened an investigation of street furniture contracts between certain media owners and local authorities.
- 6.5 Local authorities can take steps themselves to ensure competitive procurement procedures and contracts that represent good value for them. Some local authorities have not monitored the progression of their existing agreements carefully, with contracts tacitly renewing even when the local authority may have wished to retender.

- 6.6 In this chapter we set out possible actions to address concerns identified in the market study. Increased transparency of both rebate payments and the prices charged by media owners should help mitigate potential distortions. We provide guidance for individual advertisers on the steps that they might take. We also make recommendations to the industry towards greater transparency.
- 6.7 While the OFT has decided to review certain street furniture contracts for their compatibility with UK and/or EU competition law, we believe that local authorities could also take steps to get a better deal. We provide guidance for local authorities on awarding contracts and monitoring existing agreements in this chapter.
- 6.8 At the end of this chapter, we set out our reasons as to why the OFT provisionally believes that it would not be appropriate to make a market investigation reference to the Competition Commission and we invite views on our proposed decision.

Increasing transparency should help mitigate potential distortions

- 6.9 The key concern raised by advertisers about the Outdoor sector related to its lack of transparency, both of rebates and media owner prices. At the supply end of the market, media owners were similarly concerned about transparency. Media owners lack visibility over whether their invoices to specialist buyers/media agencies correspond to the invoices made out to advertisers. In particular, media owners were unsure as to whether the prices that they charged were the prices that advertisers paid, and whether any additional value (such as free space), which would be shown on their invoices, would always be used to the benefit of the advertiser for whom they were intended.
- 6.10 Greater transparency of rebates should make advertisers more aware of potential scale of any distortions and would allow

them to question specialist buyers and media agencies. Transparency of rebates should also encourage competition over the proportion passed back to the advertiser. Under current arrangements the relative lack of transparency may mean that competition is overly focused on agency fees and prices, and less on rebates and on the overall value of the advertising. Transparency of both rebates and overall value is likely to result in more negotiation between advertisers and agencies over payment structures. Over time, this may result in more efficient payment structures that appropriately balance the incentives of the agencies to deliver greater rebates with the potential for distortions to arise.

- 6.11 Further improvements in tools and techniques to measure the effectiveness of campaigns would also help mitigate the potential for harm and allay concerns that advertisers may have. Robust metrics would better enable advertisers to link fees to performance, through performance bonuses and other incentives.
- 6.12 The OFT considers that transparency is best achieved by advertisers demanding visibility of rebates and prices at all levels in their contracts with media agencies. Guidance for advertisers is presented in paragraphs 6.13 – 6.32 below.

Guidance for individual advertisers

Advertisers should seek greater visibility for themselves and their auditors of rebate payments and media owner invoices

- 6.13 From the outset, advertisers should be aware of rebate payments to specialist buyers and media agencies, and establish whether these will be passed through. Advertisers should also establish how much visibility they will have of invoices from media owners. Currently, market participants at various levels of the industry indicate that in general advertisers do not seek access to invoices between media owners and specialist buyers for themselves and their

representatives. Auditors may rely on feeds from specialist buyers in assessing the value and effectiveness of a campaign. Using these feeds has the potential to reduce costs and complexity, but direct access to invoices between media owners and specialist buyers would ensure transparency of prices and additional value such as free space (though this would not cover rebates calculated at year-end).

- 6.14 The advertisers' association ISBA and IPA Outdoor (which represents the specialists) have worked together to add a new clause into the IPA's Outdoor Charter.²⁵ It states that specialists will 'ensure clarity in the remuneration terms of the contractual arrangements with [their] clients while respecting commercial confidentiality'.
- 6.15 This clause enables direct advertiser clients and their auditors to request sight of their specialist's activities. If advertisers are going through their media agencies, they and their auditors can ask that the media agency request the information on their behalf. As there will be liaison between media agencies and their specialist buyers during the initial pitch phase, advertisers should be aware that they can negotiate clauses which relate to the specialist buyer's performance as a subcontractor, even though their primary focus is appointing a media agency.

Advertisers should consider negotiating clauses that explicitly require pass on of rebates from agencies and their sub contractors

- 6.16 Some advertisers have clauses in their contracts with media agencies that provide that advertisers receive the benefit of commissions, discounts and rebates relating to their accounts. This should apply to rebates received by agencies for Outdoor spend. However, such clauses might be open to misinterpretation, since rebates for Outdoor are typically

²⁵ www.ipa.co.uk/Content/IPA-Outdoor-Charter

calculated on aggregate agency spend with a specialist buyer and are not directly attributable to a particular advertiser. In addition, these clauses do not in general state explicitly the calculation of rebates to be passed back, for example as a proportional amount of the total rebate received by the agency according to an advertiser's spend.

- 6.17 Furthermore and importantly, since these contracts are with the media agency they may apply only to rebates received by the agency. They may not reach up a level to the rebates received by the specialist buyer from media owners.
- 6.18 A number of advertisers have negotiated clauses in their contracts with media agencies which require the pass-through of rebates received by the sub-contractors of agencies (the specialist buyers) as well as by the agencies themselves. Contractual provisions should also specify how the rebate will be allocated to an advertiser. The amount due to the advertiser will not be known until after the year end, since reconciliation of total rebates due to the specialist buyer from media owners does not take place until after the year end, typically in the months January to April.
- 6.19 In some situations, advertisers may consider it appropriate to allow specialists and/or media agencies to retain rebates. Where advertisers do allow retention of rebates, we recommend that in the interests of transparency and clarity this be explicitly provided for in contracts between the parties. We acknowledge that fees are due this year whereas rebates will be passed on in the next, and that the media agency's fees may rise if an advertiser requires that rebates are to be passed on.
- 6.20 It is also important that advertisers ensure clauses requiring pass-through are consistent across all the levels at which they may have contracts. Some large advertisers may have global relationships with media agencies, but may also contract at a

national level. In such situations it is important to ensure the contracts contain parallel provisions.

- 6.21 An advantage of including contractual provisions regarding rebates as opposed to establishing a formal agency relationship is that it is easier to provide for retention of rebates in specified situations.

Contractual pass-through in Germany

In Germany as in the UK, media agencies or media buyers are generally principals at law. Some advertisers have clauses in their contracts with agencies which require the pass through of rebates or benefits in kind received by the buyer when working on the advertiser's behalf.

From 2006–2009, a series of German courts confirmed that an advertiser (Danone) had the right to use contractual provisions to force the disclosure of information about rebates and other benefits from TV broadcasters. These had been paid to its media buying agency, Carat, and other agencies in the Aegis Group in the period 2003–2005.

Press reports suggest that the relevant clause in the agreement between Danone and Carat read: 'Carat is required to achieve for the customer all feasible market benefits that are achievable in the context of business relationships, and pass these in full to the customer.'²⁶

The trade association representing advertisers in Germany, the OWM, has welcomed the decision in Danone/Carat. It has been active in promoting transparency, and has published various best practice guides and sample advertiser-agency contracts which require pass-through of rebates and other benefits. The OWM suggests that 'this creates clear structures for the contract, the flow of money and dealing with rebates and other

²⁶www.absatzwirtschaft.de/Content/Communicat/b=69510,p=1003213,t=ftprint,doc_page=0;printpage

benefits...This is about establishing that [benefits]...be forwarded to the advertiser to avoid conflicts of interest.²⁷The OWM also considers how rebates could be returned to advertisers when they are calculated across the entirety of a media agency's spend with a media owner. It suggests 'the media agency must pass on a generally proportional amount of these benefits to the volume of the respective advertisers relative to the total volume of the Agency.'

The OWM suggests that agreements where advertising agencies keep a proportion of rebates/benefits are acceptable where this has been specifically negotiated with the advertiser and provided for in the contracts.

For some advertisers, contracting directly with a specialist buyer may allow for greater transparency on rebate agreements, prices, and the effectiveness of Outdoor campaigns

6.22 It is relatively simple to draft clauses requiring transparency in the relationship between the advertiser and the media agency. However, the situation is complicated by the fact that the majority of media agencies themselves engage a specialist buyer to plan and buy Outdoor campaigns. Because advertisers often have no direct relationship with the specialist buyers, it can be difficult for advertisers and their auditors to monitor the performance of buyers and to calculate the share of rebates due to the buyer (rather than the agency) relating to an advertiser's Outdoor spend.

6.23 For greater transparency down to the level of the specialist buyer, and for effective monitoring of the buyer's performance, some larger advertisers have found it worthwhile to contract directly with a specialist buyer for Outdoor, in addition to their contract with a media agency for their overall campaign. Other large advertisers might consider doing the same. This

²⁷ www.owm.de/dokumente/empfehlungen_vorlagen/coc.php

arrangement works best for advertisers with an in-house media team and sufficient resource available to actively engage with a specialist buyer in the planning and subsequent buying of Outdoor space.

Advertisers can mitigate potential distortions to incentives with bonuses for performance on price and/or campaign effectiveness

- 6.24 Fee structures which contain incentives or penalties based on the delivery of the campaign may encourage media agencies and specialists to plan and buy campaigns with a greater emphasis on audience impact. Price is only one of the indicators which could be used to monitor effective delivery, and the appropriateness of particular indicators will vary from advertiser to advertiser and from campaign to campaign.
- 6.25 Advertisers seeking to negotiate price guarantees with media agencies should also be aware that incentives or penalties can also be incorporated which relate to the performance of sub-contractors. Media agencies which subcontract their Outdoor buying will need to discuss with the specialist buyers the achievability of price commitments before proposing or agreeing to them with advertisers.

Advertisers should seek to monitor the delivery of campaigns and the effectiveness of Outdoor relative to other media channels

- 6.26 Advertisers using auditors should ensure that they understand how the pool price is calculated relative to the price that they pay. If their price is adjusted down (or quality up) to reflect added value such as free space or upgrades, so too should the pool price/quality for a like-for-like comparison.
- 6.27 Advertisers should also ensure they are confident as to the rationale behind their media agency's recommendation to use Outdoor and the specialist buyer's recommendation of a particular campaign plan. Advertisers should endeavour to keep up-to-date with industry developments which enable effective

measurement of Outdoor via organisations such as ISBA, the Outdoor Media Centre²⁸ (OMC) and the Institute of Practitioners in Advertising (IPA) An example of a recent and ongoing development is POSTAR, which provides poster audience research data.

Advertisers should consider contracts in which agencies and buyers are their agents at law. At a minimum, advertisers should consider loyalty clauses

- 6.28 Advertisers concerned about monitoring and auditing burdens arising from clauses requiring pass back of rebates, and of other additional value such as free space, might wish to consider establishing themselves as principals and their agencies as agents at law. This would place the agency under an obligation to act in the best interests of the advertiser. An agency at law relationship might be suitable for mid-sized advertisers who wish to ensure their campaigns deliver value for money, but are deterred from greater involvement by the complexity of the market and the time and resource that greater scrutiny would require.
- 6.29 Under an agency relationship, if an advertiser pays in advance for space that will be booked in its name and the media agency in turn books the space, the advertiser is exposed to the risk that the media agency becomes insolvent before paying the media owner (that is, a media owner may be entitled to seek payment for the booked space from the advertiser as principal). The size of this risk should be considered in conjunction with the benefits of a formal agency at law relationship, and will vary from advertiser to advertiser.
- 6.30 Even in the absence of a formal agency at law relationship, it may be possible for advertisers concerned about skew to their media plans to include limited loyalty provisions in their

²⁸ Formerly the Outdoor Advertising Association

contracts. Agents at law typically owe their principals the duties of obedience, care and loyalty. This loyalty includes an obligation to use reasonable care and diligence in carrying out the principal's objectives, in addition to a prohibition on secret profits and conflicts of interest.

- 6.31 The loyalty obligations imposed on agents at law are broad, and vary according to the nature of the relationship and the extent of fiduciary duties. By contrast, loyalty obligations established through contractual clauses tend to be construed narrowly, as the agency is acting as an independent commercial unit rather than on behalf of the principal. It is therefore difficult to strike a balance between clauses that are sufficiently specific to be effective, and those which are flexible enough to have broad application.
- 6.32 However, including loyalty provisions may clarify that a media agency is expected to act in the best interests of advertisers both in securing competitive prices for media and in constructing media plans which deliver effective campaigns. Improvements in measurement technology may help media agencies to demonstrate this more directly.

Recommendations for the industry

- 6.33 ISBA has already issued a transparency statement and provides a standard contract for media buying, which includes clauses requiring the pass-through of rebates and other benefits. This standard contract is the result of a joint industry initiative between ISBA, IPA and the Chartered Institute of Purchasing and Supply (CIPS). Advertisers can use or adapt the standard contract as they see fit.
- 6.34 Some of the recommendations made in this report would be strengthened by further action from ISBA. For example, ISBA has discussed with us the potential to develop the standard contract for media buying to incorporate clauses extending transparency to third parties and subcontractors, and in

particular to specialist buyers. We acknowledge that the standard contract is a joint industry initiative and that some in the industry may find it difficult to support such modifications, in particular since the contract covers media buying across all advertising channels and not just Outdoor. Nevertheless, as the representative body for advertisers, ISBA may be in a strong position to propose and negotiate changes to the contract.

- 6.35 On pass through of rebates, the standard contract provides that advertisers 'shall receive the benefit of all commissions, discounts and rebates' relating to their accounts. As currently worded, there may be some ambiguity as to how volume rebates are to be treated, since these may be considered not to relate directly to an advertiser's account. In addition, the relevant clause may be interpreted as relating only to those commissions, discounts and rebates that the media agency receives, rather than extending to those received by third parties and subcontractors. While each individual advertiser's arrangements may differ, there may be some opportunity to be more explicit in the standard contract as to how volume rebates will be accounted for and allocated, both in Outdoor and (to the extent relevant) in other media channels. This might be the default position, which could then be adapted to meet the requirements of individual advertisers in their negotiations with media agencies. Alternatively, ISBA might consider a guidance note for advertisers as a more practical way of addressing potential ambiguities.
- 6.36 The standard contract also provides that the media agency shall 'use reasonable care and skill to make the Advertising as successful as is to be expected from a competent media agency'. This might be extended to include loyalty provisions, as discussed in paragraphs 6.30 – 6.32, which make clear that a media agency is expected to construct the most effective media plan possible in addition to seeking competitive prices.
- 6.37 For some advertisers, it may be appropriate to consider contracts in which agencies and buyers are their agents at law,

and they are the principal. We understand that ISBA has considered this possibility, and is well placed to advise on the advantages and disadvantages of this model.

- 6.38 We recommend that the OMC should also promote transparency in Outdoor. The OMC has been active in the development of measurement technologies such as POSTAR, but has not made any public statements regarding transparency. We note that in Ireland the Outdoor Media Association (the equivalent in Ireland of the OMC) includes in its Charter a requirement that the media owner send to the advertiser a monthly statement of account. In Ireland, however, the advertiser is generally principal and the agency an agent at law, which may mean that the media owner is better placed to contact the advertiser directly.
- 6.39 The OMC could include clauses in its Charter²⁹ relating to transparency of rebates and commissions, for example, requiring media owners to inform advertisers on whose behalf space has been booked of end of year rebate payments. Advertisers would then be able to seek more information from their media agency or specialist buyer.

Media owner contracts with local authorities

Competition Act investigation

- 6.40 At the launch of this market study, the OFT indicated that contracts between media owners and site owners would be one of the areas under consideration. In Chapter 3 we identify concerns about the possible restrictive effects of agreements between media owners and local authorities. We remain concerned that some of these contracts may be limiting

²⁹ Available at www.outdoormediacentre.org.uk/resources/OMC%20Charter%20-%20Standard%20of%20Best%20Practice%20Jan%202011.pdf

competition at the media owner level and are currently assessing certain street furniture contracts for their compatibility with UK and/or EU competition law. No assumption as to the outcome of the investigation should be made.

Guidance for local authorities

- 6.41 Given the investigation referred to above, we do not in this report make any recommendations which relate to the specific provisions frequently contained in street furniture contracts. However, this section provides guidance for local authorities in following best practice for the award of contracts, and in monitoring existing contracts.
- 6.42 Each year, local authority sites generate [£100 – 150m] of revenue for media owners, who pay [£25 – 50m] in rent to local authorities.³⁰ While media owners incur other costs in operating the sites (such as, for example, maintenance and administration costs) some contracts appear to be very profitable. Many local authorities do not appear to be aware of the advertising revenues that sites on their land generate. This makes it difficult for them to negotiate from an informed position.
- 6.43 Local authorities can take some steps themselves to protect their interests. We set these out below.

Local authorities should consider contracts making them the owner of street furniture installed as well as shorter contract durations

- 6.44 Most existing contracts provide for street furniture to remain the property of the media owner. At the end of the contract, and if the contract is not renewed or renegotiated, the incumbent media owner will remove their street furniture and

³⁰ The ranges given in parentheses are to protect commercially sensitive information.

make good the sites. This means that local authority residents may be without street furniture (such as bus shelters) until such time that new furniture is installed under a new contract with a new media owner. In addition to this inconvenience, local authority residents may suffer disruption during the removal and subsequent re-installation, which may take months to complete. From a local authority's perspective, allowing a media owner to retain ownership of street furniture may add to the costs of switching to a competing media owner at the end of a contract.

- 6.45 Some large private site owners require in their contracts that Outdoor equipment be their property rather than the property of media owners. For instance, Network Rail in its contracts with JCDecaux and Primesight is the owner of the Outdoor advertising assets. In addition, Network Rail's contracts are for five years, much shorter than a typical street furniture contract between a media owner and a local authority. In awarding a new contract at the end of the five years, as the owner of the installations Network Rail may find it easier to encourage competitive bidding for the rights to advertise on those installations.
- 6.46 Local authorities should consider the advantages of contracts structured such that they are the owner of street furniture assets before or at contract termination. In conjunction with much shorter contracts, local authorities would be in a position to sell the rights to advertise on existing street furniture. Without the need to install furniture, more media owners may want to compete for such rights.
- 6.47 A short duration contract with ownership transferring to the local authority would be less valuable to a media owner. Moving to this arrangement may have a near term cost to the local authority. Further, the local authority may need to contract separately for maintenance and repair, as well as for any additional installations of furniture. Nevertheless, beyond the first contract the local authority should see an increase in

revenue. In addition, the shorter durations allow for more flexibility to negotiate improvements in response to changes in the market, such as increased competition from new companies entering the market or increased expenditure in Outdoor.

Where appropriate, local authorities should ensure a competitive tender process when awarding contracts

- 6.48 The award of some large street furniture contracts will require local authorities to follow the procurement processes set out in the EU procurement directives, if the relevant financial thresholds are met.³¹ However, there appears to be some confusion on which procedures local authorities should apply. In particular, authorities appear to have divergent views on the status of street furniture contracts under European law.
- 6.49 One local authority takes the view that a street furniture agreement could be considered a 'concession' contract, which would not require retendering on termination. An agreement involving an upfront payment to the local authority could change the status to that of a 'services or supply contract', which would require retendering and publication in the European Official Journal. It is not clear whether this approach is taken by other local authorities. Some councils treat advertising contracts as a 'disposal of land' which requires a less rigorous and less costly procurement procedure.
- 6.50 This uncertainty may make it difficult for local authorities to carry out a meaningful comparison between competing bids, and makes it harder for media owners to submit bids which are in compliance with the procedure applied. This could lead to bids being disqualified, ultimately reducing the number of

³¹ The current thresholds are set out at www.ogc.gov.uk/procurement_policy_and_application_of_eu_rules_eu_procurement_thresholds_.asp

companies competing to supply street furniture. In addition, there is no easy way for local authorities to compare directly across cities and local authority areas since advertising values (and by association, the value of street furniture for the display of advertising) are heavily dependent on location.

- 6.51 We recommend that in general local authorities should employ an open formal tender process when awarding new street furniture contracts. Local authorities should be clear and consistent in their procurement approach, so as to encourage the submission of competitive bids.
- 6.52 We note that tendering will require a local authority to incur costs initially, which are likely to vary according to the level of detail in the initial tender specification. In particular, smaller local authorities may not wish to incur large costs in preparing tender documents. However, given the substantial potential value of street furniture contracts, encouraging competitive bids through a tender process is likely to result in a better deal for local authorities in the long run, especially if the contract has never been tendered before.
- 6.53 Local authorities should decide in advance if their existing agreements should be allowed to renew or to retender on contract termination. Where an agreement is likely to be renewed, local authorities can consider renegotiating the terms of the agreement.

Local authorities should ensure procedures are in place to monitor their current agreements
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- 6.54 There is considerable variation between local authorities in the extent to which agreements and the operation of tacit renewal clauses are monitored. Some local authorities have procurement teams monitoring existing contracts and dedicated Asset Management Officers experienced in managing contracts and renewals. Other local authorities do not appear historically to have monitored their agreements carefully.

- 6.55 Local authorities that do not monitor their agreements run the risk of being accidentally 'locked in' to an existing contract. Many contracts appear to have tacit renewal clauses of up to five years and may require notice of intent to terminate of 18 months or more. The best practice for local authorities is to start work on renewal or re-tendering at least two years in advance of the contract termination date. Local authorities should also ensure they are clear what the original commencement date of the term was, as in some cases the commencement date will be later than the date the agreement was concluded.
- 6.56 At a minimum, local authorities should implement procedures which alert them to notification periods and the need to decide on whether to allow a contract to renew, to renegotiate the agreement, or to retender. There may be opportunities for local authorities to share experience and best practice in a local authority group, for example, the existing Cross Council Revenue Group.³² Where contracts include an element of revenue share, local authorities should consider auditing the payments that they receive.

Consultation on non-referral to the Competition Commission

- 6.57 As part of the market study the OFT has considered whether it would be appropriate to make a market investigation reference to the Competition Commission (CC). In order to do so the OFT must have reasonable grounds for suspecting that any feature or combination of features of a market in the UK for goods or services, prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or

³² The Cross Council Revenue Group meets to discuss the Outdoor market and share best practice. The Group is open to Council Officers whose responsibilities cover income generation from Outdoor advertising. The Group is currently led by council officers from Leeds and London Tower Hamlets.

services in the UK or part of the UK (the 'reference test').³³
Where this threshold is met, the OFT has discretion as to whether in fact to make a reference.³⁴

- 6.58 The OFT has concluded that there may be reasonable grounds to suspect the presence of features of the Outdoor sector that may restrict, prevent or distort competition. The reference test is met in relation to these features. However after consideration of the relevant criteria, the OFT considers that it would not be appropriate to exercise its discretion in this case and make a reference to the CC at this time.

The reference test

- 6.59 The reference test sets out the three types of market feature that could have an adverse effect on competition for the purposes of a Market Investigation Reference – structural features, conduct of firms, and the conduct of customers. Our guidance says that there will often not be clear separation between structural features and those relating to conduct.³⁵
- 6.60 The OFT is also not required to draw firm conclusions on the definition of the relevant market for the purpose of a market investigation reference provided it has sufficient understanding of the relevant competitive constraints to enable it to reach a view whether the effects on the competitive process are sufficient (or otherwise) to justify a reference.³⁶

³³ The reference test is set out under section 131 of the Enterprise Act 2002.

³⁴ Paragraph 1.10, OFT, 2006, *Market investigation references: Guidance about the making of references under Part 4 of the Enterprise Act*, OFT 511. Available at: www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft511.pdf ('Guidance').

³⁵ Paragraph 1.9 of the Guidance.

³⁶ Paragraphs 4.8 to 4.12 of the Guidance.

- 6.61 In examining the sector the OFT identified two potential features of the Outdoor market that could have an adverse effect on competition:
- the high level of concentration at the level of media owners, in combination with high barriers to entry and expansion, including those relating to pricing practices within the supply chain (as described more fully in Chapter 3)
 - an asymmetry of information between advertisers and the specialist buyers and media agencies with regard to rebate arrangements and payments as well as the price of Outdoor media and most effective composition of campaigns (as described more fully in Chapter 5).
- 6.62 The OFT considers that this combination of features gives reasonable grounds to suspect that competition in the sector may be prevented, restricted or distorted.
- 6.63 Given our view that the reference test is met, the decision on whether to make a reference rests on the exercise of the OFT's discretion. The OFT's guidance on market investigation references sets out four criteria that must, in our view, be met before we decide to make a reference:³⁷
- alternative powers – whether it would be more appropriate to deal with the competition issues identified by applying the Competition Act 1998 (CA98) or using other powers available to the OFT, and
 - proportionality – the scale of the suspected problem, in terms of its adverse affect on competition, is such that a reference would be an appropriate response to it

³⁷ Paragraph 2.1 of the Guidance

- availability of remedies – there is a reasonable chance that appropriate remedies will be available
- undertakings in lieu – it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference.

6.64 These four criteria are considered below.

Alternative Powers

- 6.65 The OFT's guidance indicates that it will consider whether use of powers under the Competition Act 1998 would be more appropriate before exercising its discretion to make a reference. As set out in paragraphs 3.95 and 6.40, we are currently assessing certain street furniture contracts for their compatibility with UK and/or EU competition law.
- 6.66 For this reason the OFT considers that it would be inappropriate to exercise its discretion to make a reference while an investigation into these contracts is underway.
- 6.67 In relation to the asymmetry of information between advertisers and the specialist buyers and media agencies, we have concluded that this can be tackled most effectively by advertisers engaging more directly with the media buying process and seeking greater transparency of rebates and of how their campaigns are bought. We provide guidance to advertisers and recommendations for the industry earlier in this chapter.
- 6.68 In addition, in coming to its view the OFT has taken into consideration the limits on the powers of the CC to address any adverse effects on competition arising either from these contracts or from the rebate agreements between media owners and specialist buyers. To the extent that any agreements affect trade between Member States, pursuant to

Article 3(2) of Council Regulation No1/2003,³⁸ ('the Modernisation Regulation'), the application of national competition law cannot lead to the prohibition of agreements, decisions or concerted practices which may affect trade between Member States but which do not restrict competition within the meaning of Article 101(1) TFEU, which fulfil the conditions of Article 101(3) TFEU, or which are covered by a block exemption.

Scale of harm

- 6.69 In examining the scale of harm to advertisers the OFT notes that expenditure on Outdoor was £782m in 2009. This is a significant sum. The adverse effects of the high concentration and barriers to entry at the media owner level may be expected to lead to higher prices or less innovation in the development of new sites.
- 6.70 However we also note that many advertisers are major corporations that may be capable of using their negotiating power to mitigate in part any adverse effects that may arise from the asymmetry of information between advertisers and specialist buyers. The OFT believes that the publication of this report will in itself provide greater clarity on the structure of the market and enable advertisers to take some steps to protect themselves.

³⁸ Article 3(1) of the Modernisation Regulation imposes an obligation on competition authorities to apply Articles 101 or 102 TFEU where they apply national competition law to agreements or practices which may affect trade between Member States. As set out in the OFT's MIR Guidance, this means that the CC would be unable to impose remedies in respect of any agreements within the meaning of Article 101(1) TFEU without parallel proceedings being opened by the OFT. For this reason, as noted in the OFT's MIR Guidance, the OFT would not generally make a MIR to the CC which includes agreements within the meaning of Article 101(1) TFEU.

Availability of remedies

- 6.71 In the course of the market study the OFT has identified a number of courses of action to address issues in this market. In particular it has opened an investigation of street furniture contracts between certain media owners and local authorities under the Competition Act 1998. As indicated in paragraph 6.68 the CC would be constrained in the remedies it could impose in respect of any agreements by EU Competition law.
- 6.72 In addition the OFT is providing guidance to advertisers as to how they may seek to protect themselves from the adverse effects of the asymmetry of information between advertisers and the specialist buyers and media agencies. Stronger remedies, for example requiring specialist buyers or media agencies to provide transparency about rebates or otherwise act more closely as agents on behalf of advertisers, could be available to address such concerns if the CC considered that these were proportionate.

Undertakings in lieu of a reference

- 6.73 Under section 154 of the Enterprise Act 2002, the OFT may accept undertakings instead of making a reference where it has power to make a reference and otherwise intends to make a reference. Since OFT does not currently intend to make a reference, it cannot accept undertakings.

Conclusions on the case for a reference

- 6.74 The OFT considers that the statutory test in section 131 EA02 for making a reference may be met. However taking into account the relevant criteria set out in the OFT's Guidance on market investigation references we do not consider that a reference to the CC would be appropriate at this time. In coming to this decision we have been particularly mindful of the potential for use of the OFT's powers under the Competition Act to address competition issues in this sector.

- 6.75 We invite views on our proposed decision. Our analysis is set out in Chapter 6. We are consulting on our provisional decision and responses should be emailed to outdooradvertising@oft.gsi.gov.uk by 5pm on Friday 18 March 2011. Alternatively, they can be sent to:

Outdoor Advertising Market Study (Floor 2C)
Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London EC4Y 8JX

- 6.76 We will consider any responses received and will publish our final decision on a market investigation reference in due course.