UBMISSIONS BY RADIO IGAGASI 99.5 (PTY) LTD ("iGAGASI") AND RADIO HEART 104.9 (PTY) LTD ("HEART") TO THE INDEPENDENT COMMUNICATIONS AUTHORITY OF SOUTH AFRICA ("THE AUTHORITY") ON THE DISCUSSION DOCUMENT ON DIGITAL SOUND BROADCASTING

1. This submission is a joint submission by iGagasi and Heart on the discussion document on digital sound broadcasting ("DSB"). Both iGagasi and Heart are broadcasters holding a commercial sound broadcasting service licence.

2. iGagasi and Heart hereby give notice that they wish to participate in the oral presentations/hearings in relation to the discussion document when these take place.

3. These submissions deal with only certain limited aspects of the discussion document focusing on two issues. These are:

3.1. Reasons as to why there should not be a total switch-off of the traditional analogue AM and FM sound broadcasting services, at least in the short to medium term; and

3.2. Competition related issues.

4. **SHOULD THERE BE A TOTAL SWITCH-OFF? (SEE QUESTION 6.2 OF THE DISCUSSION DOCUMENT)**

4.1. Converting to the DSB will require listeners to buy a digital receiver. This will come at a cost which, at present, is undetermined. While no doubt the cost of such receivers will decrease over the passage of time once more receivers are manufactured and purchased, it will clearly be out of reach of a substantial portion of the population due to, inter alia, the disparity in income levels and demographics existing in South Africa.

4.2. As a benchmark, the current cost of an FM/AM receiver is not less than R400.00 (see the Hi Fi Corporation website). Given that the introduction of DSB will require a new technology, it is submitted that a DSB receiver will be more costly. The aforesaid position is not a novel one. When discussions took place in the United Kingdom regarding the switchover to DSB, the Shadow Culture Minister at the time, Helen Goodman, stated the following:

> "Given the cost of living crisis, this is not the time to force the majority of people in this country to spend £50 or more buying a new digital radio".
>
> and
>
> "The socio-economics of this, show that people on low incomes are less likely to be using digital radio than people on higher incomes, so the cost will fall disproportionately on the people with lower incomes".

4.3. It is clear that the above situation is exacerbated in South Africa given the disparities in income levels that exist and the extremely high levels of unemployment.

4.4. The situation will clearly be worse in rural areas where, due to income levels, the cost of a digital receiver will be more pronounced than in urban areas. This could have the unintended effect of denying those in rural areas access to radio which is clearly an important mode of communication in such areas.

4.5. Accordingly, while recognizing the additional costs which broadcasters will need to incur if there is not a total switch-off in the initial phase after the introduction of DSB, it is submitted that there should not be a total switch-off in the short or medium term.

5. COMPETITION RELATED ISSUES

5.1. The competition issues referred to above are not directly covered in any single question posed in the discussion paper. However, the additional questions to broadcasters as set out in Annexure A enquire about the following:

5.1.1. Concerns as broadcasters with respect to DSB (**Question 1**);

5.1.2. The impact of DSB on a broadcaster's sound broadcasting service licence (**Question 2**);

5.1.3. The financial implications associated with DSB (**Question 3**);

5.1.4. Areas of concern which the Authority needs to be wary of when implementing and planning for the regulations of DSB with respect to **competition**, spectral concerns, **financial considerations**, etc (**Question 4**); and

5.1.5. Whether DSB will encourage growth alternatively create unnecessary financial pressures on existing broadcasters (**Question 5**).

5.2. The information set out below, goes towards dealing with (i) concerns for broadcasters, (ii) the impact of DSB on sound broadcasting service licensees, (iii) the financial implications of DSB and the pressure it may create on sound broadcasting service licensees and (iv) the impact on competition between sound broadcasting service licensees.

5.3. It is trite that a conversion to DSB creates greater opportunities for existing sound broadcasters by, inter alia, increasing the capacity in broadcasting transmission networks by improving spectrum efficiency. This means that those in possession of a sound broadcasting licence will be capable of transmitting more data per unit bandwidth. Hence, it will be possible for licensees to have more than one station.

5.4. Experience from other jurisdictions has shown that the costs for the transition to digital broadcasting are substantial particularly in the early phases of digital switchover. This means that this will create greater opportunities and ease of switchover for the "bigger" / "more profitable" players in the industry. For the most part, these "bigger" / "more profitable" players are those who have been established for a longer period of time and have thus had a greater opportunity to build an income / advertising base. In the main, these are the radio stations which were privatized and licensed prior to the licensing of the Greenfields Sound Broadcasting Services in 1997. In other words, those radio stations which were licensed for some time prior to early 1997 (The SABC radio stations) have had the advantages created through the passage of time. This is particularly so for The SABC sound services which were privatized in 1996 including radio stations such as East Coast Radio, Highveld and KFM. The National Association of Broadcasters has recognized, in a discussion document on "Broadcasting in South Africa", that the SABC stations which were privatized were "six lucrative SABC stations". Insofar as iGagasi and Heart are concerned, the relevant competitive radio stations are East Coast Radio in Kwa-Zulu Natal and KFM in the Western Cape.

5.5. At the time when both iGagasi and Heart were licensed, East Coast Radio and KFM had a substantial head-start in Kwa-Zulu Natal and the Western Cape respectively. Not only did they take over lucrative existing SABC stations with an established audience base and hence an established advertising base, but having taken over existing radio stations, East Coast Radio and KFM, had the benefit of acquiring an existing profitable business. For this reason, even if they did not use existing facilities but had to incur capital outlay associated with starting a new radio station from inception, they could easily do so. They would have had cash flow from day one to assist in funding the acquisition of new studio equipment and would therefore not have had the downside of the "J Curve" (which we refer to below).

5.6. It is common in the broadcasting industry generally (including sound broadcasting services) that the initial years following the establishment of a broadcasting service are not profitable. In the initial establishment phase of a radio broadcasting service, such stations incur losses for a number of years before they become profitable. This is demonstrated by what is commonly known as the "J Curve". The downward trend of the J Curve is longer for some stations than others but experience has shown that on average, it takes between 7 and 10 years before there is an upward trend in the J Curve. In the initial phase, huge losses are encountered due to the costs of the capital outlay incurred in the establishment of a radio station, the ongoing operating costs of a radio station coupled with the fact that at inception, a sound broadcasting service will have minimal listenership and hence advertising spend. Such listenership and advertising spend is only established over time, usually between 7 and 10 years.

5.7. Additionally, given the head-start that the privatized SABC radio stations had and hence their ability to attract a loyal advertising base, it is exceedingly difficult for the players subsequently introduced into the market to convince advertisers to shift their allegiances. Using Kwa-Zulu Natal as an example (and the situation is similar in the Western Cape), East Coast Radio's profitability is estimated to be almost seven times higher than iGagasi while Vuma, given that it is in the early phase of its development, is still making losses. Revenue for East Coast Radio is estimated to be 3.4 to 4 times higher than iGagasi and 10 times higher than Vuma. Taking into account the fixed costs associated with running a radio station, which, as set out below, is substantially similar between radio stations, generating greater revenue results in an even greater and disprortionate profitability.

5.8. The aforesaid anomaly in Kwa-Zulu Natal is also exacerbated by the following:

5.8.1. Given that iGagasi has a greater listenership than East Coast Radio, the question that must be asked is why East Coast Radio with a smaller listenership has greater revenue and profitability which substantially outstrips that of iGagasi. In this regard, the following pertinent facts need to be taken into account:

5.8.1.1. The target market and hence audience of East Coast Radio is largely Indian and White with only approximately 400 000 Black listeners of which 85 000 are in metro areas. Advertising in respect of sound broadcasting licensees has tended to favour the White and privileged listeners. This, notwithstanding the fact that in Kwa-Zulu Natal, of the approximately 10,2 million people as measured in the

2011 census, 429 000 were White, 757 000 were Indian, 142 000 were Coloured and the remainder were Black;

5.8.1.2. In terms of the previous audience measurements conducted by the South African Advertising Research Foundation (SAARF), East Coast Radio was said to have up to 2.1 million listeners of which 900 000 were Black. This represents a gross over-statement of East Coast Radio's Black audience. The aforesaid measurements are now recognized as having been inaccurate and have subsequently been replaced by different more accurate measurements conducted by the Broadcast Research Council of South Africa (BRCSA). Previously, the measurements sampled listeners in an unrepresentative manner. Not only were Whites over-sampled and Blacks under-sampled, but when Blacks were sampled there was a bias in favour of more affluent areas. This resulted in a distortion resulting in the figures for East Coast Radio being overstated particularly insofar as the Black listenership was concerned. So, whereas the old sampling under SAARF showed that East Coast Radio had 900 000 Black listeners, in terms of the new sampling under BRCSA which is substantially more accurate, they are shown to only have 340 000 listeners. This resulted in advertisers spending their ad-spend disproportionately in favour of East Coast Radio.

5.8.1.3. Although the manner of measuring listeners changed approximately two years ago, until then the ad-spend followed these skewed audience figures. It will take a substantial period of time to change this trend and hence ensure that ad-spend is proportionate to listenership;

5.8.1.4. Additionally, as set out above, the fixed costs of running a radio station including, inter alia, capital costs, studio costs, staff, presenters and all operating costs, are not overly dissimilar between sound broadcasting licensees. This means that after the break-even costs, profitability increases disproportionately to revenue. So, for example, if sound broadcaster A has fixed costs amounting to say R50 million per annum, and generates a revenue of R100 million per annum, it will have a profitability of R30 million or 30% of revenue (the R100 million of revenue translates to R80m of gross profit less the fixed costs of R50 million). Conversely, if sound broadcaster B generates revenue of R200 million per annum, it will have a profitability of R110 million (the R200 million of revenue translates to R160m of gross profit less the fixed costs of R50 million) being more than 3,5 times the profitability of sound broadcaster A. Its profit to revenue ratio will be 55%;

5.8.1.5. The demographics of the audiences attracted by the private sound broadcasters in Kwa-Zulu Natal are equally important to analyze. iGagasi focusses on the young Black market aged between 18 and 35. Historically, East Coast Radio has targeted primarily Whites and Indians between the ages of 25 to 49. The demographics of the province (there were fewer Whites and Indians in Kwa-Zulu Natal in the 2011 census than there were in the 1996 census) dictate that, East Coast Radio has to increase its percentage of Black listeners particularly as Vuma also focusses on Black listeners aged between 30 and 50.

5.8.1.6. However, in order to attract greater Black listenership, East Coast Radio will need to change the nature of the music it broadcasts. Should it do so, it would run the risk of alienating its current listeners. Importantly, with the implementation of DSB, given the bandwidth obtained by existing private sound broadcasters which will allow such sound broadcasters to have multiple stations, a radio station such as East Coast Radio could retain its licensed format on its existing station (unless prohibited from doing so by regulation or licence conditions), and use the second station to target either the iGagasi or Vuma audience and formats. This would result in iGagasi and Vuma's audiences and targets being eaten into.

5.8.1.7. While the same is obviously true for iGagasi and Vuma, East Coast Radio would have a substantial advantage given its revenue base and profitability. Given the initial costs of moving to DSB and of setting up a new radio station with fixed costs of R50 million per annum, only it would have the necessary revenue and profitability to quickly and easily establish a new station. Should it do so before any of the other stations who do not have the money to compete in the market, this will give East Coast Radio a substantial and long-term competitive advantage.

5.8.2. Additionally, those stations who are (i) able to cross-sell advertising, (ii) give discounts if advertisers advertise on sister stations, (iii) insist that if an advertiser wants to advertise on radio station A, it must also advertise on radio station B or (iv) act in other such anti-competitive manner, have an unfair strategic and competitive advantage.

6. CONCLUSION AND RECOMMENDATIONS

6.1. For the aforesaid reasons, iGagasi submits that when it comes to the Authority regulating the transition to DSB and issuing new licences to existing private sound broadcasting licensees with the transition to DSB, it needs to take into account that it is essential to level the playing fields and to therefore create a regulatory and licensing framework which does not entrench the bigger and longer-standing licensees by ignoring the current trends. This could be achieved by, for example:

6.1.1 Providing regulations that existing broadcasters be limited to just one station under DSB for a period of 10 to 15 years and that new licences under DSB should only be issued to new entrants in the market;

6.1.2 Alternatively to 6.1.1 above, regulations should provide that existing licensees who wish to operate more than one station, be required to keep their existing formats as contained in their current licences in respect of any further stations they elect to operate or at least do so for a period of 10 to 15 years;

6.1.3 Prohibiting cross-selling or cross-subsidizing advertising where a licensee holds more than one licence.