2 Conclusions

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Terms of reference

2.1. Under our terms of reference (see Appendix 1.1) dated 31 July 1997 we are required to investigate and report whether arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation, as defined in the Fair Trading Act 1973 (Fair Trading Act), in that enterprises carried on by or under the control of Capital will cease to be distinct from enterprises carried on by or under the control of Virgin Holdings. If we establish that such arrangements are in progress or contemplation, then we are further required to consider whether the creation of the merger situation may be expected to operate against the public interest.

The parties

Capital Radio plc

2.2. Capital was founded in 1972. In October of that year it was awarded one of the first two independent local radio (ILR) franchises for London for a station providing a general and entertainment service. Capital began broadcasting 12 months later on both the AM and FM wavebands. In 1988 separate programmes were introduced on the AM and FM frequencies. The FM station, Capital FM, concentrates on playing current or recent hit records, ie music that has registered among the top 40 records of pop single sales or airplay charts, and has a target audience of adults under 40 years old. Current audiences are around 3 million people a week (the weekly reach). The AM station, called Capital Gold, concentrates on hit records from the 1960s, 1970s and 1980s. It has an older target audience of adults from 30 to 54 years old and currently reaches about 1.3 million people a week, out of a potential London audience of 9.9 million.

2.3. In the late 1980s and early 1990s, as the Government moved to increase the level of competition in the provision of commercial radio services, Capital expanded its activities by acquiring licences in Birmingham and Oxford and along the south coast.

2.4. It purchased a 42 per cent share in Independent Radio News Ltd (IRN) in 1987 and established its own national advertising sales house, Media Sales and Marketing (MSM), in 1989. Subsequently, Capital has expanded its activities into other sectors, namely restaurants, through its purchase of the ‘My Kinda Town’ restaurant chain in 1996 (recently renamed as Capital Radio Restaurants), new media (web sites) and a joint venture record label.

2.5. Capital is a public company listed on the London Stock Exchange. Its market capitalization at 29 November 1997 was £349 million. Capital’s preliminary results for 1996/97 showed a profit of £35 million before tax on a turnover of £114 million. It had about 1,300 employees of whom about 500 were in radio broadcasting.

Virgin Radio Holdings Limited

2.6. Virgin Holdings is a private company. The majority of shares are currently held by a number of Branson family trusts, with a small number of shares held by individuals. Virgin

Holdings owns 100 per cent of the shares of Virgin which won its first licence in May 1992 when it was awarded one of only three national commercial licences. It began broadcasting rock-orientated music in April 1993, principally on the 1215 AM wavelength, and can be heard by 91 per cent of the UK population. Subsequently, Virgin successfully applied for a licence to broadcast an FM service in London, where the AM signal is generally regarded as poor. The London FM station came into operation in April 1995. The majority of the national AM service is simulcast on the London FM wavelength, but there are local London news, sport and traffic reports and up to two minutes of advertising specific to the FM service each hour. The AM service has a current weekly adult reach of 2.9 million adults out of a potential audience of 47.5 million and the FM service has a reach of 0.9 million out of the potential London audience of 9.9 million.

2.7. Virgin was loss-making in its first three years of operation, but made a profit of about £1.6 million before tax in 1996 and unaudited profits of £3.3 million in 1997. At July 1997 cumulative operating losses were reduced to £6.9 million. Virgin currently employs 45 full-time staff and 14 contract staff.

The development of commercial radio in the UK

2.8. The first ILR station in the UK, LBC (the London Broadcasting Company), began broadcasting in October 1973, closely followed by Capital. Further stations came on stream between 1973 and 1976 and between 1980 and 1985. Development then ceased while a new broadcasting regime was established. The old Independent Broadcasting Authority (IBA), which had been responsible for both radio and television, was abolished following the Broadcasting Act 1990 (the 1990 Act), which paved the way for the establishment of two new sectoral regulators: the Independent Television Commission (ITC) and the RA.

2.9. Since that time commercial radio has developed rapidly. Around 200 local licences have now been awarded across the country and there are three national licences which have been awarded to Classic FM, Talk AM and, as mentioned in paragraph 2.6, Virgin AM. Atlantic 252, which broadcasts from the Republic of Ireland, can also be heard in most parts of the UK (see paragraph 2.42) albeit that it does not have a licence to broadcast in the UK.

2.10. Commercial radio stations obtain their revenues chiefly from advertising and sponsorship and to a lesser extent from promotions and commercial production. Radio stations report their advertising revenue to the RA on a quarterly basis. This is an obligation under the terms of their licences. The Radio Advertising Bureau Ltd (RAB) is responsible for publicizing the revenue data. It also collects revenue data to which the RA does not have access, for example data for Atlantic 252 and IRN's Newslink package (see paragraph 4.66). It is for this reason that we have used both the RA's and the RAB's estimates.

2.11. Income of radio stations is divided into two categories: that derived from national advertisers (known as national revenue) and that derived from local advertisers (known as local revenue). Whilst there is no widely agreed definition of these terms within the industry, the RAB has its own definitions, which we have used in this report. These are as follows:

(a) national revenue is that which is derived from the sales department which deals with advertising agencies and advertisers which are interested in promoting their products across the whole of the UK; and

(b) local revenue is that which is derived from the sales department which deals with advertising agencies and advertisers which are only interested in promoting their products within the total survey area (TSA) of the station.

2.12. National radio advertising can be sold by individual commercial radio stations or groups or by what are known as national sales houses. National sales houses sell radio airtime on behalf of a number of radio stations. There are currently three principal national sales houses: MSM, owned by Capital (although MSM is being wound down—see paragraph 2.36); Katz Radio Sales (Katz, formerly Independent Radio Sales (IRS), ultimately owned by Chancellor Media Corporation, a major US radio group); and Scottish Radio (sometimes known as Scottish & Irish Radio Sales (SIRS), owned by Scottish Radio Holdings plc (SRH)).

2.13. In 1996 UK radio airtime[1] advertising expenditure totalled £273.1 million, of which £144.5 million was revenue from national advertisers and £128.6 million was revenue from local advertisers (see Table 2.4). In the London station area (LSA)[2] radio advertising revenue for London-based ILR services (ie excluding national stations) totalled £63.6 million, of which by far the bulk came from national advertisers (see Table 4.10).

The role of the Radio Authority

2.14. The RA's function under the terms of the 1990 Act is to regulate independent radio services. It has no role in the regulation of the British Broadcasting Corporation's (BBC's) analogue radio services. The RA awards national commercial radio licences on the basis of cash bids for an initial period of eight years. Local licences are also awarded for an initial period of eight years, but no cash bids are involved; applicants are judged against the criteria set out in section 105 of the 1990 Act.

2.15. The RA is required to ensure compliance with the rules governing the ownership of independent radio licences which are set out in the most recent broadcasting legislation, the Broadcasting Act 1996 (the 1996 Act). These rules are designed, *inter alia*, to ensure that unsuitable persons are not allowed to hold licences and to place limits on the accumulation of interests in radio or in radio and newspapers by any one party. There are currently no restrictions on the total number of local licences that any one person may hold across the UK. But no one may hold more than three licences in any locality that share a potential audience nor two such licences on the same waveband unless the RA determines that such an accumulation is not against the public interest. Nobody may hold more than one national licence. Also, no one may hold more than a 15 per cent share of the total number of points allocated to all the national and local radio services licensed in the UK. The RA allocates points to stations on the basis of the size of the potential audience within their transmission area. As at 1 September 1997 there were 737.33 points allocated. This means that no one person may account for more than 110.6 points. At present Capital owns 11 licences and has 65.67 points (an 8.91 per cent share) and Virgin owns two licences and has 31.67 points (a 4.3 per cent share). If the merger proceeds, the Capital/Virgin group will hold 13 licences and have 97.34 points. This will represent a 13.21 per cent share of the total points allocated and will fall within the limits specified in the 1996 Act.

2.16. Under the 1996 Act a person is allowed to own one AM and one FM licence which share a potential audience. However, the acquisition of a second licence on the same

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[1]Airtime revenue is revenue which arises from the broadcasting of radio commercials. It excludes revenue that is attracted as a result of programme sponsorship or product promotions.

[2]The LSA is slightly larger than the area within the M25 (see paragraph 2.33).

waveband, ie either AM or FM, which would also share that potential audience, is subject to the RA determining that the holding by that person of the licences in question could not be expected to operate against the public interest within the area concerned. The RA's determination of the effect on the public interest of the accumulation of local radio licences which would result from the merger is described in paragraphs 2.29 to 2.31.

2.17. The RA is required to ensure that licensees comply with the terms of their licences. National and local radio licences contain a 'promise of performance' which describes the character of the service which must be provided by the licensee. The promise of performance is based on the programming proposals put forward by the licensee when applying for the licence. The RA seeks to maintain diversity in the types of service available in the UK; diversity is an important criterion in the award of licences and the promises of performance are intended to prevent a licensee, without the RA's approval, from substantially changing the character of the service offered. The RA does not actively monitor whether stations are complying with their promises of performance, but will investigate any complaints it receives.

Digital audio broadcasting

2.18. DAB is a new way of transmitting radio services. Instead of sound being transmitted by a series of waves, as with the current analogue system, sound is processed electronically and converted into a series of binary digits. This series is then transmitted on a carrier wave as a bit stream and is converted back to sound by an appropriate receiver. Through compression techniques, several streams of digital information can be carried on one frequency at the same time. This technique is termed multiplexing, and the carrier frequency has come to be known as the multiplex. Multiplexing improves the efficiency with which the radio spectrum is used. The sound quality is also better because DAB is not subject to the interference experienced by analogue methods of transmission, particularly the AM frequencies.

2.19. In the 1996 Act the Government made provision for the introduction of DAB. The RA will be responsible for awarding digital licences and for the subsequent administration of the system. There will, initially, be two national digital radio multiplexes. One has already been allocated to the BBC for its five national services which began broadcasting digitally in September 1995. The other will be allocated to independent national radio (INR). There will be guaranteed places on this multiplex for the three existing national radio stations (Classic FM, Talk AM and Virgin AM) and there will also be capacity for three to five additional services. The three national licence holders will be guaranteed an eight-year renewal of their existing analogue licences if they take up the places reserved for them on the national independent radio multiplex.

2.20. A multiplex will also be available in most parts of the UK for six to eight local radio stations, with two multiplexes in major conurbations. In the London area the RA expects to make available two or possibly three multiplexes. The capacity of digital spectrum available in London will barely be sufficient for the 20 commercial stations currently broadcasting in the area.

2.21. It is not yet clear exactly how DAB will develop in the UK. The RA is currently consulting interested parties. Broadly, it is envisaged that companies or consortia will bid for multiplex licences. The bidder for a multiplex will be offering a package of channels based on his negotiations with individual radio service providers. In adjudicating on bids, the RA will look nationally at how effective the applicant's proposals will be in developing digital terrestrial radio overall. For local multiplexes greater emphasis will be placed on the content and variety of the services proposed. It is not clear, though, what the nature of the commercial relationship between the owner of the multiplex and the radio service providers will be. Nor is it clear whether multiplex owners will have to subsidize the uptake of digital receivers (which seem, initially, likely to be much more expensive than traditional receivers) or will look to subscription radio, along the lines of pay television.

2.22. Most of the parties which gave evidence to us thought that it would be between five and ten years before DAB became established in the UK. Even though the RA was expecting to advertise the national multiplex licence in spring 1998, many thought that unless the cost of DAB receivers came down dramatically, there would be little take-up of the service domestically because the improvements in quality compared with FM broadcasting would be slight. The chief initial market was likely to be DAB receivers for cars, where radio interference was a particular problem.

The transaction

2.23. Virgin told us that concerns about the high costs of developing DAB in the UK were at the heart of Virgin Holdings' decision to enter into a merger transaction with Capital. Virgin Holdings could not easily raise additional funds through borrowing. It was already highly geared because it had undergone refinancing at the beginning of 1997 to buy out the minority shareholders (see paragraph 3.30). Nor could it grow satisfactorily either through new licence applications or acquisition of existing licence holders, because those licences or companies which might be available did not complement Virgin's existing holdings. Capital could also enhance Virgin's programming skills. Virgin said that it had been disappointed by this element of its performance. The merger with Capital could help it improve its audience ratings.

2.24. Capital told us that its strategic objective was to grow its UK radio business by increasing radio's share of total advertising revenue and by acquiring radio companies capable of improved performance. In 1996 it had failed to win the last London FM licence that was advertised—it was awarded to Xfm Ltd (Xfm)—when it sought an FM frequency for its Capital Gold station, whose AM signal was poor and whose audiences had been declining in the face of the increasing competition for audiences in the area within the M25. Subsequently, informal discussions were held with a number of parties, including Virgin Holdings. After evaluating the options, Capital approached Virgin Holdings which offered the most appropriate strategic fit.

2.25. Under the original terms of the proposed transaction (see paragraphs 3.2 to 3.4) Capital was to acquire all the shares in Virgin Holdings, together with its AM and FM licences. In return Virgin Holdings was to receive around 14 per cent of the shares in Capital, was to have one non-executive director on the Capital board and its indebtedness up to £22 million was to be paid off. Capital was to have exclusive use of the Virgin name in the UK market for 25 years. The overall value of the transaction was £86.7 million. On 13 November 1997 Capital reconfirmed, subject to contract, the principal terms with the exception that Capital now has the option to increase the cash element of the consideration and the vendors of Virgin have agreed to be capped at 9.99 per cent of the shares of the enlarged group.

2.26. Capital told us that despite Virgin's financial performance to date, it felt the price was justifiable. Virgin's financial performance was improving; there was significant growth in earnings between 1996 and 1997 and both Capital and Virgin thought improvements in programming could further enhance Virgin's performance. Capital said that the price agreed was in line with other recent deals in the radio sector.

2.27. Capital told us that it planned to invest in Virgin on a greater scale than the present owners, applying its programming and sales skills to enhance Virgin's attractiveness to listeners and advertisers. In particular, Capital proposed to end the current arrangement whereby Virgin FM and Virgin AM shared their programming for all but nine hours each weekday. Instead Capital would create a separate station on 105.8 FM targeted specifically at Londoners, and a revamped Virgin AM with its own national distinctive style. The output of the London station would be adjusted to sharpen its differentiation from the other London stations, while Virgin AM would be designed to compete head-on with BBC Radio 1. The maximum time devoted to London advertising would increase from two to nine minutes an hour.

2.28. The target audience of Virgin FM would be 25- to 44-year-olds and male. The music would basically be rock, much of it contemporary guitar-based rock by mainstream bands formerly contracted to independent record labels. This would be backed by top-class presenters, focusing specifically on the target audience. Alternative comedians would also be used so that the whole radio station would become a complete entertainment appropriate to its target audience.

The Radio Authority's public interest test

2.29. The RA must have specific regard to the following matters when making a public interest determination under the 1996 Act with regard to an accumulation of local radio licences by any person in accordance with the thresholds set out in the 1996 Act:

(a) any reduction in the plurality of ownership of local radio services within the area concerned that would result from a decision to allow the licences to be held together; and

(b) the likely effect of such a decision on:

(i) the range of programmes available by way of independent radio services to persons living in the area concerned; and

(ii) diversity in the sources of information available to the public in the area concerned and in the opinions expressed on local radio services received in that area.

In considering the proposed merger between Capital and Virgin Holdings the RA examined the implications for the public interest in the Greater London area. It also had regard to its co-terminous duty under the terms of section 85(3)(b) of the 1990 Act to 'ensure fair and effective competition in the provision of such [independent radio] services and services connected with them'. The 1990 Act envisages circumstances where not only the RA, but other competition authorities such as the OFT and the MMC, may also be involved in assessing the competitive effects of a proposed merger.

2.30. The RA considered the proposed acquisition on 3 July 1997. Its view[1] was that it saw no reason in terms of plurality of ownership or diversity of output to disallow the acquisition. This decision was taken, first, in the light of a number of specific, binding undertakings which the RA had sought and obtained from Capital, namely:

(a) Capital undertook to ensure that the news broadcast on Virgin's services would be produced and presented separately from the news broadcast on Capital's services; and

[1]RA press release, 17 July 1997.

(b) Capital undertook to ensure that Capital's and Virgin's services would operate independent newsrooms for each station.

Secondly, Capital was informed that the RA would amend Virgin FM's promise of performance by specifying that the amount of 'alternative rock' and 'eclectic' music output on Virgin FM should not together exceed more than 20 per cent of the total music played (currently the figure is 32 per cent); and Capital was also informed that when the simulcast programming arrangements which currently exist between Virgin's services are ended (if the merger was approved), the RA would amend Virgin FM's promise of performance to prevent any simulcasting of programmes thereafter (other than at the off-peak times previously specified in Capital's public interest submission to the RA).

2.31. When the RA made public its findings on the proposed merger on 17 July 1997 it made clear that its assessment was not at that stage final. Whilst, in the light of the undertakings it had been given by Capital, the RA had no concerns about plurality of ownership or diversity of output, the RA reserved its position on the competition implications of the acquisition, which it would need to consider before reaching a final public interest determination, pending the Secretary of State for Trade and Industry's decision on our report.

Jurisdiction

2.32. The first question which we have to answer under our terms of reference is whether arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a merger situation qualifying for investigation, in that enterprises carried on by or under the control of Capital will cease to be distinct from enterprises carried on by or under the control of Virgin Holdings. We have seen an agreement between the current holders of shares in Virgin Holdings and Capital for the sale and purchase of the entire issued share capital of Virgin Holdings. That agreement has lapsed as a result of the reference of the proposed merger to us. Despite this and the fact that, at a very late stage in our inquiry, a competing bid by Ginger Productions (with the financial backing of a venture capital fund, Apax Partners) was announced in the press, Capital has confirmed to us its intention to proceed with the merger subject to the decision of the Secretary of State on our report. Virgin Holdings told us that whilst it was giving serious consideration to the new bid, it was continuing discussions with Capital and may still proceed with the merger, again subject to the decision of the Secretary of State. In the light of these views, we are satisfied that arrangements concerning the merger are still in contemplation.

2.33. In ascertaining whether there is a merger situation qualifying for investigation, we are also required to consider whether the proposed merger satisfies the share of supply test set out in section 64 of the Fair Trading Act. That test is satisfied where, as a result of the merger, the merged enterprise will supply at least one-quarter of the services of a particular description which are supplied in the UK or in a substantial part of the UK. Where an enterprise already supplies at least one-quarter or more of particular services, the test is satisfied so long as its share is increased as a result of the merger. Our terms of reference stated that it appeared to the Secretary of State that, as a result of the merger, the share of supply test would be satisfied with respect to both the supply of:

(a) local radio advertising services in the area lying within the M25, being a substantial part of the UK; and

(b) non-local radio advertising services in the UK.

For the purpose of establishing jurisdiction, we have considered the supply of radio advertising services by radio stations based within the M25 (which we refer to as London-based stations) targeting a London audience on behalf of local and national advertisers. The revenue figures we have used have been compiled in relation to the LSA.[1] In geographical terms, this area is slightly larger than the area within the M25 and we have no doubt that, given its size, character and economic importance, such an area constitutes a 'substantial part' of the UK, so as to make it worthy of consideration for the purposes of the Fair Trading Act.

2.34. As shown in Table 4.12, in 1996 Capital's two London stations supplied radio advertising services which accounted for 65.4 per cent (£41.6 million) of the total airtime revenue in the LSA of £63.6 million. In the same year, Virgin FM supplied radio advertising services which accounted for 6.6 per cent (£4.2 million) of the total airtime revenue in the LSA. On the basis of the 1996 figures, the proposed merger would therefore give a combined share of supply of radio advertising services in the LSA for Capital and Virgin of 72.0 per cent. Based upon data for the first six months of 1997, the respective shares are 62.5 per cent for Capital and 6.5 per cent for Virgin FM, giving a post-merger share of 69 per cent. We therefore conclude that the share of supply test is satisfied with regard to the supply of radio advertising services in a substantial part of the UK.

2.35. We have also noted the following in relation to the supply of radio advertising services in the UK, in terms of radio stations across the UK (both UK-wide and local) selling advertising to national clients. As shown in Table 4.13, in 1996 Capital's non-London ILR stations (currently sold through MSM) had a 13.5 per cent share of the market and sales of £20 million. Combining these figures with Capital's direct sales to national clients through its London stations (23.3 per cent) produces a total share in 1996 of 36.8 per cent. On the basis of the 1996 figures, if the proposed merger takes place, Virgin's 9.2 per cent would take the enlarged company to 46 per cent of national radio advertising services. Based on the first six months of 1997, the respective shares are 14.7 per cent for Capital's non-London services and 21.5 per cent for Capital's London stations, giving a pre-merger share for Capital of 36.2 per cent and a post-merger share of 44.2 per cent (Virgin having an 8 per cent share). This would meet the share of supply test with regard to the supply of radio advertising services in the UK.

2.36. The supply of national radio advertising services may also be considered in terms of those persons who sell the airtime made available by radio stations across the UK. If we were to combine all the sales of MSM,[2] Capital's sales house, with Capital's direct sales to national clients through its two London stations, in 1996 Capital would have had a share of 62.6 per cent (39.3 per cent and sales of £57 million through MSM and 23.3 per cent and sales of £34 million through its in-house sales). In the same year, Virgin FM and Virgin AM had national revenues of £13.4 million, or 9.2 per cent of the total supply of national radio advertising services. For the period January to June 1997 the respective shares were 62.9 per cent for Capital (41.4 per cent for MSM and 21.5 per cent for Capital's in-house sales) and 8 per cent for Virgin, giving a post-merger share of 70.9 per cent.

2.37. We therefore conclude that arrangements are in contemplation or progress which if carried into effect will result in the creation of a merger situation qualifying for investigation in that:

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[1]In relation to stations based in London and excluding national stations.

[2]Although Capital told us that it was winding down MSM's business, MSM was still trading at the date of the reference. MSM sells advertising outside the Capital Group and for Capital's non-London stations.

(a) enterprises carried on by or under the control of Capital (a body corporate incorporated in the UK) will cease to be distinct from enterprises carried on by or under the control of Virgin Holdings; and

(b) as a result the condition specified in section 64(3) of the Fair Trading Act (with regard to the share of supply) will prevail or will do so to a greater extent (see paragraphs 2.34 and 2.35).

Radio broadcasting

2.38. Since 1973, when LBC and Capital, the first ILR stations, began broadcasting in the UK, commercial radio has grown considerably. A number of major groups have entered the market, for example EMAP plc (EMAP) and GWR Group plc (GWR), and have built up interests in ILR stations throughout the UK. There are now around 200 ILR stations throughout the UK. Competition with the BBC for audience share has been fierce. In the UK as a whole, commercial radio's share of listening has doubled over the past ten years and in 1997 it had around 50 per cent of total listening hours. In London, where, as set out in paragraph 2.43, there are more commercial radio stations than in any other part of the country, commercial radio's share of listening now stands at 59 per cent.

2.39. For the purpose of our inquiry, we are interested in the UK and the London listener and the stations broadcasting to them, as described in the following section.

The radio stations and their audiences

UK-wide radio stations operated by the BBC

2.40. The BBC operates five UK-wide radio stations. Details of their weekly reach, primary target audiences and programme styles are set out in Table 2.1.

TABLE 2.1 **BBC radio stations: summary of weekly reach, on-air dates, target audiences and programme styles**

BBC stations	*Primary target audience*	*Frequency*	*Main broadcast output*	*On-air date*	*Weekly reach* (m)*
Radio 1	15- to 34-year-olds	FM	Contemporary pop music, live and specialist	Sept 1967	9.7
Radio 2	Over 40 years old	FM	Melodic, specialist and live music and speech	Sept 1967	8.6
Radio 3	Classical music fans	FM	Classical (50% live)	Sept 1967	2.3
Radio 4	ABC1 45+ adults	FM	In-depth news, current affairs and speech	Sept 1967	8.2
Radio 5 Live	25- to 44-year-olds	AM	Live news and sport	Aug 1990	4.9

Sources: BBC, RA and RAB.

*For Quarter 2, 1997.

UK-wide commercial radio stations

2.41. As noted in paragraph 2.9, there are three licensed UK-wide commercial radio stations. Details of their weekly reach and airtime revenue and a summary of their promises of performance are set out in Table 2.2.

TABLE 2.2 **UK-wide commercial radio stations: summary of weekly reach, on-air dates, airtime revenue, target audiences and programme styles**

Station	*Primary target audience*	*Frequency*	*Main broadcast output*	*On-air date*	*Weekly reach* (m)*	*Airtime revenue 1996 (£m)*
Classic FM	ABC1 35+ adults	FM	Classical music	Sept 1992	4.7	[†
Talk AM	BC1C2 25 to 54 adults	AM	Speech	Feb 1995	2.2	]
Virgin AM	25- to 44-year-olds	AM	Rock	April 1993	2.9	11.0

Sources: RA and RAB.

*For Quarter 2, 1997.

2.42. In addition to the three licensed UK-wide commercial radio stations, Atlantic 252, a station which is unlicensed in the UK and which broadcasts from the Republic of Ireland, is audible throughout most of the UK, including London. The station had a reach of about 3.5 million in Quarter 2 of 1997 and airtime advertising revenue of £[†] million in 1996.

Commercial radio stations operating in the London area

2.43. There are 20 commercial stations operating within the LSA. Details of the larger stations' weekly reach and airtime revenue and a summary of their promises of performance are set out in Table 2.3. All of the licensed national commercial radio stations and the five national BBC stations can also be heard throughout London.

2.44. As can be seen from Table 2.3, a large number of the London commercial stations have come on air within the last eight years. As required by their promises of performance, they have sought to target different groups of listeners, some aiming at the younger age groups, others at older listeners, and others have a particular ethnic, religious or musical slant. The two Capital stations, by contrast, are longer-established and (in particular Capital FM) have broader promises of performance and wider audience groups. The nature and size of a station's audience is important to the prospective advertiser, which will seek to match audience with its own target demographic group. For this reason, Capital FM and Capital Gold, with their large audiences spanning both the younger and older ends of the age spectrum and a broad range of social classifications, are attractive to a wide range of advertisers.

2.45. We analysed the proportion of the listeners by age group and by sex[1] to each of six leading London-based ILR services (Capital FM, Capital Gold, Virgin FM, Heart, Kiss 100 FM and Melody) in 1997 (Quarter 2). Table 4.4 shows that in the case of both male and female listeners and across the different age groups there is a high degree of overlap between the six stations. But it is also clear from Table 4.4 that the focus of the six stations is different:

[1]The number of listeners aged 15 years and over as estimated by RAJAR.

†Figures omitted. See note on page iv.

TABLE 2.3 **Commercial radio stations within the LSA: summary of weekly reach, on-air dates, airtime revenue, target audiences and broadcast output**

Radio stations	*Primary target audience*	*Frequency*	*Main broadcast output**	*On-air date*	*Weekly reach† '000*	*Airtime revenue (£m)‡*
ILR services						
95.8 Capital FM	15–40 adults*	FM	Current top 40 hits and new releases	Oct 1973	2,941	36.3§
1548 AM Capital Gold	30–54 adults*	AM	Older top 40 hits; also sports coverage	Nov 1988	1,275	5.3§
Heart	25–44 adults, core audience 30–40* (female bias)	FM	Contemporary music	Sept 1995	1,032	[
Melody Radio	35+ adults;* ABC1	FM	Easy listening	July 1990	1,026	§§
Kiss 100 FM	15–34 adults	FM	Dance; also house/soul	Sept 1990	902	]
Virgin 105.8 FM	25–44 adults* (male bias)	FM	Classic and contemporary rock	April 1995	856	4.2
LBC 1152	ABC1C2 35–64 adults	AM	Speech	Oct 1973¶	579	¤
Jazz FM 102.2	ABC1 25–54 adults	FM	Jazz; also blues/soul	March 1990	447	[§§
News Direct 97.3 FM	ABC1 30+ adults	FM	Speech	Oct 1994¶	333	]**
Sunrise Radio	Asian adults	AM	Asian (speech and music)	Nov 1989	291	[
RTL Country 1035 AM	BC1C2 25–54 (male bias)	AM	Country	Sept 1994	222	
Choice FM	African and Afro-Caribbean	FM	Soul/reggae/ragga	March 1990	212	§§
Premier Radio	35+ adults	AM	Christian (speech and music)	June 1985	111	
Spectrum International	Multi-ethnic communities	AM	Ethnic speech/music	June 1990	83	
963 Liberty Radio	ABC1 30–44 adults (female bias)	AM	Speech/post-1970s soft ballads	July 1985	60	]
Xfm	15–34 adults*	FM	Alternative rock	Sept 1997	‡‡	‡‡

Sources: RA and RAB.

*Stipulated in promise of performance.
†1997 (quarter 2). Data cover those stations which are covered by RAJAR data—exclude London Turkish Radio, London Greek Radio, Millennium and Thames.
‡1996.
§MMC estimate.
¶In October 1994 LBC changed hands and the new owners were also awarded a licence for News Direct.
¤Included in News Direct.
**Includes LBC.
[§§]
‡‡No figures yet available as Xfm commenced broadcasting in September 1997.

§§Details omitted. See note on page iv.

- Kiss 100 FM focuses on the younger age range, particularly those between 15 and 24 years of age;

- Melody focuses on the upper age range, particularly those aged 55 and over;

- Capital FM, Virgin FM and Heart have a broader focus which largely comprises those aged 44 and under; and

- Capital Gold also has a broader focus, but in this case it largely comprises those aged 25 and over.

2.46. We also looked at the number of listeners within each of the same six leading London-based ILR services (Capital FM, Capital Gold, Virgin FM, Heart, Kiss 100 FM and Melody) in 1997 (Quarter 2) by age and sex. This analysis, which is shown graphically in Figure 4.2, shows a similar picture to that described in paragraph 2.45. But we noted two additional points:

(a) the greater popularity of Capital FM, particularly for those between 15 and 44 years of age; and

(b) that there is little difference between Capital Gold and Virgin FM in the age groups under 45; however, among listeners aged 45 and over Capital Gold is far more popular.

2.47. Our analysis was carried out on the basis of data for the second quarter of 1997. But the listener breakdown may vary over time as a radio station is able to change the composition of its audience so long as its output remains within its promise of performance. The figures are also likely to be affected by the launch of Xfm across London in September 1997 with a target audience of 500,000 listeners a week. This station's output is designed specifically to appeal to 15- to 34-year-olds.

The radio advertising market

Display advertising

2.48. Display advertising comprises television, radio, cinema, transport and outdoor advertising. It also includes press advertising other than advertising in classified sections. In the year ending March 1997, £6.8 billion (in 1996 prices) was spent on display advertising in the UK. Television and press have by far the largest shares (42.5 and 46.2 per cent respectively), with radio at 4.7 per cent and cinema, transport and outdoor advertising making up the remainder. Radio's share has increased considerably, almost doubling over the last ten years. The RAB expects that radio's share will continue to grow over the next few years, a view shared by the radio stations which gave evidence to us.

2.49. Capital and others told us that the growth in radio advertising over the last few years was due to the following factors:

(a) the launch in 1992 of radio industry-wide figures by Radio Joint Audience Research (RAJAR) to provide advertisers with reliable and comprehensive data on radio listening. Prior to this, commercial radio and the BBC had produced separate figures;

(b) the launch of the RAB as a centrally-resourced, customer-focused organization to promote the effectiveness of radio advertising services and to help customers use radio advertising;

(c) a significant increase in the audience share and reach achieved by commercial radio (mainly at the expense of the BBC—see Figure 4.1) as a result of:

(i) the launch of Classic FM, the first national commercial radio station. For the first time advertisers could buy radio time across the country in one go. However, Classic FM's launch had a subtler impact as a confidence builder, as it was arguably the first commercial radio station whose format appealed to senior executives within national advertisers and their agencies; and

(ii) in the London area, in particular, the increased coverage of local radio, resulting from the launch of new local commercial radio stations with broad audience appeal, meant that commercial radio became better able to deliver access to wider audiences in a way required by advertisers; and

(d) the increased efficiency, skill and flexibility of radio stations in selling advertising.

The characteristics of radio advertising

2.50. Radio advertising has a number of features and advantages which clearly distinguish it from other forms of display advertising. Those who gave evidence to us cited a wide range of agreed features:

(a) Radio was an intimate, audio medium which could be used to deliver personal messages, for example of a financial nature or about healthcare, when an individual was at home, doing other things or was in the car.

(b) Radio was an excellent means of reaching young people, who tended not to watch a great deal of television or to read newspapers regularly.

(c) Radio was a type of advertising which could be bought at short notice and was therefore useful for advertising immediate forthcoming events, for example a concert, a newspaper with a special feature, a retail sale or a new record release.

(d) Radio offered advertising at specified times of day or days of the week which was useful to those targeting a particular audience, for example those driving to work.

(e) The costs of producing radio commercials were well below those for television commercials and this meant that radio was useful for those advertisers with restricted budgets.

(f) Radio was useful in supplementing television coverage in order to extend the length or the frequency of an advertising campaign.

(g) Radio was useful in building rapid awareness of a product because it was capable of offering a large number of impacts within a short time period.

(h) Radio offered unique sponsored programme and promotional opportunities—for example, Kellogg's Cornflakes has, until very recently, sponsored Virgin's breakfast show, and companies such as Vodafone sponsor traffic news reports.

(i) Local radio was a useful means of supporting small local brands, services and retail outlets. For example, Carphone Warehouse Limited (Carphone Warehouse), which started out as a small London business in 1989, began with London-only radio advertising and then began to use national radio advertising and ultimately television advertising when its network of retail outlets and financial strength were sufficiently developed.

(j) Radio was a good medium for encouraging listeners to respond, for example to phone for a brochure or to obtain a quotation.

2.51. As a result of radio's distinctive features and advantages, advertisers and advertising agencies told us that radio advertising was often used in a different way from television and press advertising. We noted that radio advertising was less suitable than television for developing a brand image for products because it offered no visual impact, but that it could be useful for advertising services where the style of the business could be emphasized. For example, a recent advertising campaign by Carphone Warehouse featured its own staff talking about real situations which they had faced in an effort to underline the 'human' approach adopted by the company and to differentiate it from the competition.

Setting advertising strategies

2.52. Advertising agencies told us that when advising a client on the appropriate advertising strategy, the first step was to find the most suitable medium or mix of media for the product or service. At this initial planning stage, radio was considered alongside other options and its characteristics were compared and contrasted with media such as press, television, outdoor and cinema. The advertising agency would assess the medium's ability to, among other things: communicate the message in an efficient and effective way; target the appropriate audience within the right geographical area; and meet the creative strategy. At this part of the planning process the client's budget and the relative costs of the different media could be important factors in what medium or mix of media was chosen for a campaign. Where it was concluded that radio had an appropriate part to play in the campaign, agencies were unlikely to be deterred by the exact price.

2.53. We were told that when radio became one of the chosen media it was at that stage that radio stations were assessed against each other. The decision to advertise on a particular station would be determined by consideration of factors such as: the demographics of the station's listeners; the geographical coverage and audience size of the station; the price per thousand people reached; and the profile of the station. It was at that point that price became an important determining factor in choosing a radio station, as there were a number of options available to the agency. For example, Capital's high coverage rate in London often made it the ideal choice for a campaign. However, if Capital's prices were too high then a mix of other stations could be used to target the same demographics while achieving a high coverage.

The effectiveness and pricing of radio advertising

2.54. We noted from the RAB's published literature that measuring the impact of a radio advertising campaign was not straightforward. Although various cost comparisons of different advertising media were produced showing the cost per thousand impacts (CPTs) (see Table 4.14 and paragraph 4.86), it was not easy to assess the cost-effectiveness of radio advertising against that of television, press and other forms of display advertising. Radio advertising offered such a different type of service and was used in such distinct circumstances that a comparison of CPTs did not seem to us to be particularly useful. Furthermore, there was a lack of transparency in the pricing of radio advertising. This was due to the fact that although radio stations had published ratecards, in practice deals were reached on the basis of individual negotiation.

The relevant market

2.55. In order to analyse the competition and other effects of the proposed merger, two issues need to be addressed: first, is the market for radio advertising distinct for the purposes of competition analysis; and second, what are the geographical aspects of the relevant market?

Is the radio advertising market distinct?

2.56. We received a wide variety of views on whether radio advertising represents a distinct market and the extent of substitution between it and other display advertising media.

Views of Capital and Virgin

2.57. Both Capital and Virgin considered that radio advertising should be treated as a part of the overall market for display advertising. Capital argued that radio was substitutable with other forms of media, particularly in London. The whole market was highly competitive and clients would divert advertising funds to other media if they did not think that radio advertising was providing value for money. Between 1992 and 1996 radio advertising revenue across the UK more than doubled and its share of all display advertising revenue grew from 2.8 to 4.7 per cent. Capital and Virgin argued that the increase in radio advertisers' share of the wider display market indicated that advertising which had previously gone to other media had been replaced by radio advertising. Capital gave us an analysis which had been carried out for it by the economic consultancy Case Associates (Case's first study). The analysis showed fluctuating shares of advertising expenditure for radio, press and television, which, in Case's view, suggested considerable substitution between these media (see paragraph 5.37 for further details of Case's first study). Capital also submitted to us further work carried out by Case (Case's second study) in relation to price data received from a large advertising agency showing a comparison of prices charged by London commercial radio stations with advertising rates charged by other London media. Case stated that the study showed large and positive correlations between the prices paid for radio advertisements on Capital FM both with the prices of other stations and other forms of display advertising (see paragraphs 4.91 to 4.93).

2.58. Capital told us that it was far from suggesting that all radio competed directly with any particular medium or all media for all display advertising in all circumstances. However, there was clear evidence that a substantial proportion of the £1.6 billion display market in London was contested both by radio and by other media.

2.59. Virgin, too, acknowledged that whilst radio did not compete with all other media all of the time, it did compete with all other media some of the time. It said that the MMC needed to decide on the degree of overlap.

Views of the RAB

2.60. The RAB also considered that much of radio advertising was substitutable with other forms of media. It considered that there was greater substitution for national as opposed to local revenue because national advertisers had a greater range of opportunities available to them, for example national press and magazines.

Views of advertising agencies and advertisers

2.61. Few of the advertising agencies and advertisers from which we took evidence addressed the question of market definition directly. Among the advertising agencies, one large agency told us that radio advertising was still a minority medium in national terms and that the real competition for commercial radio was with other media. J Walter Thompson Company Ltd (J Walter Thompson) said that rarely, if ever, was radio such an important element in the marketing mix that it could not easily be substituted with other media options. Zenith Media Services Ltd (Zenith) said that the removal of radio from the advertising mix would rarely be a serious issue. On the other hand, Expert Media Ltd said that radio was not directly substitutable as it had its own features and strengths.

2.62. Among the advertisers, Carphone Warehouse, Yellow Pages and Eurostar (UK) Ltd (Eurostar) thought radio advertising was in competition with other forms of media. On the other hand, Guardian Newspapers Limited (Guardian) and Kraft Jacobs Suchard Ltd (Kraft Jacobs Suchard) told us that radio advertising was a market in its own right, with stations competing against each other for a share of revenue. Weatherglaze PLC (Weatherglaze) agreed. It said that radio advertising was not easily substitutable as television advertising did not provide the same defined target audience and was more expensive. Polygram Record Operations Ltd (Polygram) said that the opportunities to reach a youth audience, especially in London, were relatively limited and that radio took a relatively high share of its total media expenditure from the London region.

2.63. Of those which did not directly deal with the issue there were many which felt that, whilst it was possible to compare prices between radio stations, it was difficult to assess the cost-effectiveness of different forms of advertising because the media had differing characteristics and were useful in differing circumstances.

Our assessment

2.64. Having reviewed all of the diverse pieces of evidence put to us, there are a number of factors, which are set out below, which we consider relevant.

2.65. First, creative considerations and the overall strategy of an advertising campaign for a particular product or service tend to dictate the choice of advertising media. The extent to which radio will be used is a decision taken early in a campaign, on a strategic basis. Whilst certain types of product, for example mobile telephones, are well suited to radio advertising, particularly in the breakfast and evening ‘drivetime’ slots, other items are less suitable and tend to be advertised on television. Television and press are particularly good for developing brand images because of the visual nature of these media; radio, by contrast, can be used to support a television or press advertising campaign and to reinforce the message. In this case, radio is complementary to, rather than a substitute for, the two other media.

2.66. Secondly, prices for radio advertising vary enormously from prices of other media advertising; also we have not seen any clear correlation between the movements in the prices of the various media. As we have noted earlier, and as was agreed by all those which gave evidence to us, radio has many unique features and advantages as an advertising medium. It is also a medium which is evolving and growing. The actual prices of media advertisements, as measured by CPTs, reflect qualitative differences between the various types of media (for example, a purely audio impact as compared with a visual one or a visual one with sound), as well as the size and nature of the audience that can be reached. These factors—which help to determine the effectiveness of a particular medium in a particular situation—make price comparisons between media difficult and dependent on creative strategies and on subjective judgments. This, together with the lack of price transparency in radio advertising (see paragraph 2.54), is likely to reduce the ability of advertisers and agencies to react consistently to price changes.

2.67. The third factor affecting our view of the market is that radio advertising accounts for a relatively small proportion of total display advertising spend (4.7 per cent). Changes in the price of radio would typically have a relatively small impact on total campaign costs for the majority of larger advertisers and the use of radio is thus likely to be less sensitive to price changes than the use of other media.

2.68. In assessing the nature of the radio advertising market, we took careful note of the material presented to us by Case (see paragraph 2.57). As regards Case's first study, we do not accept that the fluctuations in the use of radio that Case identifies are necessarily due to a significant degree of substitution between radio and other forms of display advertising. Fluctuations of spend on individual radio advertising campaigns will depend on many factors including: purely creative considerations, the stage of development of the product or service concerned, the particular audience being targeted, the effectiveness or otherwise of recent campaigns and tactical considerations such as major sales or promotional events.

2.69. We also find Case's second study unconvincing. Case sought to show that the prices of advertising on Capital's radio stations moved closely in line with the advertising prices of other media over a recent period of 33 months, and hence argued that the other media were close substitutes for radio. We do not think that the Case data can support these conclusions. We have three main reasons for this:

(a) The relatively high degree of correlation found by Case was based on a method that, in our view, is inappropriate. Simply comparing price levels fails to distinguish possible responses of one set of prices to another from the influence of trends such as inflation. When we carried out similar correlation analysis ourselves using the same basic data but using the more appropriate method of comparing price changes (instead of price levels), we found a much lower level of correlation.

(b) We have serious doubts about the robustness of the data for the purpose of the study. It was based on prices provided by only one media agency and the sparseness of the data was reflected in the need frequently to impute data because there were no actual price observations in particular months.

(c) We looked in more detail at the price series of Capital and some of the other media. In particular, in the comparison where there appeared to be the closest correlation with Capital, our analysis showed significantly diverging price trends. The growth in prices in percentage terms of the particular medium over the 33 months was twice that recorded for Capital's prices.

We found that Case's data did not show that the prices of radio and other media move closely together or that there is strong substitutability between the different media.

2.70. In summary therefore we believe that radio advertising, whilst being a type of display advertising, should be regarded as a separate economic market because:

(a) it has particular characteristics as an advertising medium;

(b) the qualitative differences between radio advertising and other display media are reflected in very different pricing arrangements which make price comparisons difficult; and

(c) most large advertisers are likely to be relatively insensitive to movements in radio advertising prices because radio advertising expenditure comprises a small part of most major advertising campaigns

In the light of the above view of the market, we believe that the constraint and hence the discipline afforded by the prices offered by other competing radio stations is likely to affect the price of radio advertising more importantly than the prices of other display media.

2.71. We noted that there are differences between radio stations themselves as regards the category of listener and thus the way in which radio advertising can be focused on different groups of listeners. However, there is significant overlap between listeners over many radio stations (see paragraphs 2.45 and 2.46) and we do not think it appropriate to segment radio advertising by category of listener.

The geographical aspects of the relevant market

2.72. We also considered the geographical aspects of market definition. On both the demand and the supply side, the scope of the radio advertising business is limited in geographical terms. On the demand side, advertisers (and their agents) are targeting audiences in particular areas when they buy airtime from radio stations; on the supply side, many stations can only be heard in a limited area. In defining the appropriate markets it is useful, first, to categorize advertisers in terms of their geographical scope.

2.73. As noted in paragraph 2.11, advertisers are usually categorized by the industry as either national or local, reflecting the extent of the advertising campaign. The RAB defines national advertising revenue as that which comes from advertisers promoting their products across the whole of the UK; and local advertising revenue as that which comes from advertisers promoting their products only within the TSA of a local radio station. We see this as an important and practicable distinction.

2.74. Whilst all radio stations do not apply this distinction in a consistent way, we think the data provided by both the RAB and the RA on this basis are sufficiently robust as to provide useful estimates of radio advertising revenue in the different sectors. We have used these data to analyse advertising revenue on the basis of region and type of advertiser. As the focus of the proposed merger at a regional level is London, we distinguish within the UK between London and other regions. Table 2.4 sets out our estimates of radio advertising broken down, on the one hand, on the basis of the local and national advertiser distinction, and on the other, by regional audience. For our purposes we have included only stations targeted at a London audience.

TABLE 2.4 **Radio airtime advertising revenue broken down by region* and by type of advertiser,† 1996**

£ million

	National	*Local*	*Total*
London	49.4	19.0	68.4
Non-London	95.1	109.6	204.7
UK	144.5	128.6	273.1

Source: MMC calculations on data provided by RA and RAB.

*London and non-London.
†National and local.

2.75. The proposed merger of Capital and Virgin affects ILR stations that aim at a London audience and also UK-wide stations. We have therefore considered whether there is both a London and a UK market affected by the merger. We are clear as to the former.

Advertisers wish to target the London audience and this is important to both categories of advertiser, albeit to different degrees: for local advertisers there is clearly no substitute at all for the London audience, whilst for national advertisers there is in many cases a preference for full UK coverage and London plays an important part in this. In our view, London advertising (defined by reference to the audience) is a separate market and one in which it is appropriate for us to consider the effects of the merger on competition. As shown in Table 2.4, the size of this market is £68.4 million.

2.76. Turning then to the question of whether there might also be a UK market affected by the merger, we thought the most appropriate market was total UK radio advertising of national advertisers (estimated at £144.5 million in Table 2.4), since that clearly has a UK dimension. On the other hand it might be argued that there is no UK market but a number of regional markets: the supply of airtime advertising for national campaigns comes not only from national, but also from local radio stations; and advertisers planning national campaigns generally look for coverage region by region and hence individual regions have some importance for the national advertiser. We think, nevertheless, that there is sufficient flexibility for national advertisers in both the choice of radio stations and in the balancing of regions, that national advertising campaigns can usefully be seen as a single market for the purpose of analysing competition. We would, however, add the rider that strength in particular regions is a factor that needs to be taken into account in assessing the position of individual radio stations supplying this market.

The public interest

2.77. We now turn to examine the effects of the proposed merger on the public interest, both from the perspective of the listener and the advertiser.

Listeners: public interest issues

2.78. The RA has legal obligations that relate explicitly to the public interest. Where the acquisition of multiple licences exceeds the limits laid down in the 1996 Act concerning licences to provide local radio services sharing potential audiences, the RA is required to determine whether that acquisition could be expected to operate against the public interest (see paragraph 2.29).

2.79. In its press release of 17 July 1997 the RA stated that it had already conducted a ‘radio specific public interest test’ in connection with the proposed acquisition and received 43 submissions as part of its public consultation exercise. Having sought and received from Capital the specific and binding undertakings which are set out in paragraph 2.30, the RA saw no reason in terms of plurality of ownership or diversity of output to disallow the acquisition on those public interest grounds. However, as we noted in paragraph 2.31, the RA has yet to make a final determination on the matter and has reserved its position on the competition implications of Capital’s proposed acquisition of Virgin’s licences pending the Secretary of State for Trade and Industry’s decision on our report.

2.80. We have studied the RA’s assessment and received evidence from it concerning its view of the acquisition in terms of a reduction in plurality of ownership and diversity. We did not consider it necessary or appropriate to repeat the RA’s detailed investigation of these matters. However, we did consider that we should examine whether, in the light of our detailed investigation of the competition aspects of the proposed merger, there would be implications relating to plurality of ownership or diversity of output (see paragraph 2.112).

2.81. As part of this inquiry we asked for views on the merger from listeners and bodies representing listeners. We received no response that raised any other public interest issue concerning listeners apart from diversity of output or a reduction in the plurality of ownership. Neither have we received any evidence from any of those parties with or representing other interests (such as advertisers and other radio stations) which indicated that there could be other public interest issues as far as listeners were concerned.

Radio advertising services: public interest issues

2.82. We look first at the London radio advertising market, then at the UK radio advertising market and finally the benefits and cost savings of the proposed merger.

The London radio advertising market

2.83. We described the stations operating in London and their target audiences in paragraph 2.43. As we explained in paragraph 2.75, we consider that it is appropriate to consider the effect of the merger on competition in the radio advertising market for those radio stations, both national and London-based, which target London audiences. On this basis, as shown in Table 4.11, in 1996 Capital already had a powerful position with a 60.9 per cent[1] share of total radio advertising revenue. The combined 1996 market shares of Capital and Virgin amount to 68.8 per cent. Although Capital's share of the market has fallen in recent years, the effect of the merger will be to re-establish its market share of three years ago. Following the merger, Capital intends to make improvements in the listening and advertising performance of the two Virgin stations, increasing substantially the London advertising minutes. This would lead to market share increases by Virgin FM helping to offset further anticipated drops in the market shares of Capital FM and Capital Gold.

Views of Capital and Virgin

2.84. Capital told us that the growing number and strength of commercial radio stations in London had brought benefits to Capital, by increasing audiences accessible to advertisers by radio and hence contributing to a growth in radio's overall share of advertising. New stations provided a continuing stimulus to good programming and introduced new ideas and techniques. Capital said that its acquisition of Virgin would not upset this, but rather would help all London commercial radio stations to cope with the expected further increase in competition, particularly from the BBC.

2.85. Capital said that it had been consistently losing revenue share as well as audience share in London as competitor stations gathered momentum. In the two years to the end of December 1996 its share of London advertising revenue had declined from 65.8 to 60.9 per cent. By the end of December 1997 this share would have fallen to [*] per cent, and in five years' time a continuing decline in its audiences would result in a further reduction to [*] per cent. Capital said that it had sustained its revenue share for as long as possible by attracting new advertisers to radio at the expense of other display advertising media. Success in winning advertising revenue initiated a virtuous circle, enabling investment in better programming, leading to higher audiences and hence increased demand from advertisers. Capital said that

[1]Since MSM is being disbanded regardless of the merger these figures exclude the revenues of stations which are not owned by Capital but use MSM as their sales house.

*Figures omitted. See note on page iv.

other radio stations had benefited from its lead, attracting advertising budgets of quality at rates higher than those they would be likely to have achieved in the absence of Capital.

2.86. If Capital were to merge with Virgin, then, despite the expected increases in audience and revenue for Virgin FM, Capital forecast that the combined group's share of London advertising revenue would actually decline over the next five years, because the growth in Virgin FM would not offset the loss of market share by Capital FM and Capital Gold. Capital forecast a decline in the Capital/Virgin share from [*] per cent by the time the merger could proceed in early 1998 to [*] per cent in 2002.

2.87. Virgin also firmly believed consolidation by merger with Capital would help to grow radio as an advertising medium. In Virgin's view, this merger and the formation of stronger, in-house sales points following Capital's disbandment of MSM's wholesaling operation marked the beginning of the next phase of consolidation in radio advertising sales which was necessary to drive the medium forward.

2.88. Capital told us that it had had discussions about the proposed merger with a number of its competitors in the London market. Capital's perception was that London News Radio and stations such as Kiss 100 FM and Jazz supported the merger on the basis that it would be good for the advertising market and for customers.

Views of Capital's competitors

2.89. In contrast to what Capital told us, a number of concerns were expressed to us about the proposed merger by Capital's competitors in London. Xfm, Heart and Melody gave oral evidence and we received written submissions from Choice FM (Choice), Talk Radio UK Limited (Talk) and Thames FM Ltd (Thames FM).

2.90. Melody said that Capital already had a dominant position in the commercial radio industry. That dominance would increase and become monopolistic if the merger went ahead. There would be reduced choice for listeners and advertisers. By acquiring potentially the most popular national commercial format (Virgin AM), Capital would be able to manipulate advertising rates at the national as well as the London level to the detriment of advertisers and other operators.

2.91. Talk made a number of similar points. It added that it was likely that Capital would not fail to take advantage of its increased market power to offer bonuses and incentives to sell more airtime on Capital and Virgin. The reduction in buying points that would arise if the merger went ahead would restrict choice for advertisers, raise barriers for new entrants and distort pricing structures. Capital and Virgin would effectively become the industry price setters.

2.92. Thames FM also feared that Capital could use marketing tactics to force smaller stations within the London market into serious financial difficulties.

2.93. Xfm said that the proposed merger would significantly reduce competition in the market for radio advertising in London and reduce the probability of new competition emerging in the future. It would not be in the interests of advertisers, listeners or Capital's competitors. Capital and Virgin had promises of performance that were more widely drawn than those of the new radio stations. This gave them, especially in combination, the advantage of directly target-

*Figures omitted. See note on page iv.

ing other radio stations' customers without exposing their own customer base to a reciprocal competitive threat.

2.94. Xfm also said that the proposed acquisition would create scope for anti-competitive practices, in particular the selling of advertising in the form of discounts for the use of several stations in the Capital/Virgin group or to the exclusion of competing stations. Over the past two years Virgin FM and Heart had made significant inroads into Capital's advertising base, reducing Capital's ability to raise rates further. The proposed acquisition would significantly reduce the competitive pressures on Capital and radio advertising rates would rise as a result.

Views of advertising agencies and advertisers

2.95. We sought the views of a range of advertising agencies and advertisers through a short questionnaire. Key points from the responses we received are set out in Chapter 6. In summary, the messages were mixed. Many advertising agencies were more concerned about the size and demographics of the audience that they could reach through radio advertising, and through one particular station, than the price. They saw the merger as strengthening the radio advertising market in London because of the improvements in programming and growth in audience that Capital would bring to Virgin FM. Agencies did not like to deal with too many different sales points and the merger would reduce the number of separate negotiations they had to undertake.

2.96. However, even among those agencies which expressed support for the merger, there were some whose support was conditional upon Capital not being able to abuse its market position and others whose view was coloured by their positive views of Capital's management team. For example, J Walter Thompson said that it had every confidence that Capital's acquisition of Virgin would result in growth in the market, rather than in the narrow pursuit of its own self-interest.

2.97. Some agencies and a number of advertisers expressed particular concerns. A key issue was the opportunity created by the merger for Capital to raise its prices. Procter & Gamble UK (Procter & Gamble), which carried out its own negotiations directly with radio stations, said that it was sensitive to price variations. Although there was nothing in the way Capital had conducted its business in the past that suggested it would misuse its dominant position in the London market place, if the merger proceeded the audience share in the London region represented by Capital FM and Virgin FM could be used to force prices upwards to a point where Procter & Gamble would have to review the viability of the medium in London and the UK. There would also be opportunities for Capital to offer packages of airtime across its stations. Express Newspapers plc (Express) voiced similar fears. Many advertisers thought that Capital might offer a discount for advertising on a package of the three Capital and Virgin stations, but that the price for advertising on one individual station would rise. Saatchi & Saatchi Group Ltd (Saatchi & Saatchi) was concerned that Capital's increased dominance would enable it to construct advertising packages with specially attractive rates if the clients agreed not to advertise on competing stations. These are termed 'solus' deals in the industry. Capital might also reduce prices on one of its stations in order to attract long-term volume advertising. Expert Media said that it was currently possible to 'buy around' Capital using a mix of other stations which cost less and delivered, in combination, similar audiences. However, Virgin FM was part of that mix and if Virgin FM's prices increased it might mean that that alternative was no longer open.

2.98. The Incorporated Society of British Advertisers Ltd (ISBA) said that as a result of the proposed merger Capital would supply more than half of adult commercial listening hours in London. This was the principal determinant of a station's ability to attract advertising revenue. This resultant control by Capital of more than half of the London and the national radio airtime markets raised similar concerns among advertisers to those voiced in April 1996 (see paragraph 6.118). The ISBA said that it would therefore need to be confident that undertakings similar to those currently in place regarding MSM would continue to bind the merged entity, and would be enforceable by the appropriate regulatory bodies. In particular, Capital should be prevented from practising conditional selling.

2.99. The Institute of Practitioners in Advertising (IPA) said that, bearing in mind the undertakings Capital had already made to the industry regarding its airtime trading policies (see paragraphs 4.23, 4.79 and the footnote to paragraph 4.85) and Capital's moves to make the radio advertising market even more accountable to buyers in terms of information technology and trading systems, it had no objections to the proposed merger.

2.100. Some advertisers also expressed concerns about the fact that Capital was taking over a close competitor for particular sectors of its Capital FM audience. The audience profile of the combined Capital and Virgin stations would give Capital even greater dominance than it already had in the area of pop-rock music and make it essential for advertisers to buy from Capital and Virgin to reach certain target audience groups.

2.101. Polygram said that, for most demographic groups, it was extremely difficult to reproduce significant levels of coverage without using Capital FM. For those audiences where a combination of stations would yield similar levels of coverage, Virgin FM would be an integral part of that mix, and therefore its loss of independence would severely restrict competition in the London area—this lack of competition within London might provide Capital with the opportunity to raise prices even further. However, Polygram said that Capital's involvement with Virgin AM (ie the national station) could have some positive benefits. For instance, increased investment by Capital might turn around a declining audience and ensure a strong involvement in the adoption of DAB, which could provide FM quality sound for Virgin AM in the future.

Our assessment

2.102. We have sought to analyse these differing views and understand the interests of all those who supplied evidence to us in order to reach a judgment. We examine the likely overall position of the merged companies in the market relative to other radio stations, the effect of the proposed merger on the prices of radio advertising and the potential for the merged companies to behave in a way which has anti-competitive effects on their competitors.

2.103. We look first at the effect of the proposed merger on the supply of radio advertising in London, and the ability of other stations to compete for business. Capital has proposed that following the merger the maximum amount of London-specific advertising time available on Virgin FM will increase from two to nine minutes an hour. It also plans to stop the daytime simulcasting of Virgin AM and Virgin FM and to reprogramme the output of Virgin FM to make it more relevant to the London audience. These actions will have the effect of making Virgin FM a much more focused competitor in the London market than it is at the moment. Given that Capital currently enjoys a very substantial share of the London market (60.9 per cent for 1996 and 58.1 per cent for the first half of 1997)[1] and that post-merger it is seeking to grow Virgin FM's share vigorously, we can well understand the concerns of the smaller stations. Advertising revenue is the lifeblood of a station and if the merger reduces the ability of the smaller stations to compete for revenue, then this would weaken them.

2.104. We believe one result of the merger would be to increase the relative attractiveness of the Capital/Virgin group of stations to advertisers. The three stations Capital FM, Capital

[1]Our figures are based on the latest RA and RAB data. We note that Capital has put forward lower forecasts for the whole of 1997, but we cannot corroborate these.

Gold and Virgin FM would, between them, provide by far the greatest access to important audience groups in London and thus it would be virtually essential for an advertiser seeking good radio coverage throughout London to use the Capital/Virgin stations. By contrast, the remaining non-Capital/Virgin stations will become of more marginal usefulness for major campaigns.

2.105. At present, advertisers have told us, it is possible to construct alternative advertising packages to Capital FM using combinations of Virgin FM, Kiss 100 FM, Heart and Melody. The ability to construct effective alternatives would be greatly reduced by the removal of an independent Virgin FM from the equation, since Capital would be in a position to offer combinations of stations covering particular types of audience which its competitors would be unable to match. We therefore consider that the change in the relative positions of the companies, if the merger were to go ahead, with Virgin FM moving from the non-Capital group of stations to the Capital group, would immediately put Capital in a dominant position for the supply of radio advertising. Capital expects the merged companies' market share to fall to [*] per cent by 2002, significantly below Capital's current share. However, we regard these projected market shares so far into the future as speculative. What matters more in this case for the purposes of competition analysis is the strength of the merged company in the period directly following the proposed merger.

2.106. We next look at the effect of the merged companies' dominance in the London market place on the price of radio advertising. From its business plan for the Virgin acquisition, it is clear that the viability of Capital's bid for Virgin depends upon the ability of the merged businesses to deliver an escalating revenue stream over the next few years (see paragraphs 3.45 to 3.57 and Table 3.11). This in turn is dependent upon growth in the overall size of the radio advertising market, and vigorous growth at Virgin FM. Capital forecasts that Virgin FM will increase its London audience share from the current [*] to [*] per cent by 2002. Much of this increased share will come from competing BBC stations. The percentage of potential advertising impacts sold (see Table 3.8) is projected to increase from [*] to [*] per cent over the same period and the CPT will rise progressively from £[*] to £[*] in nominal terms. The combined effect will be to grow Virgin's revenue by almost [*] per cent a year.

2.107. As far as Capital FM is concerned, Capital predicts a drop in audience share from around [*] to [*] per cent from 1997 to 2002. The percentage of potential impacts sold is projected to increase from 80 to almost [*] per cent and the average CPT from £[*] to £[*] (in nominal terms, equating to a [*] per cent increase over five years).

2.108. Capital's intentions are clear. For both Capital FM and Virgin FM it expects to be able to raise prices over five years by more than the current rate of inflation, whilst at the same time selling a greater proportion of its potential impacts. We are in no doubt that following the merger Capital would have the market power (for the reasons set out in paragraphs 2.103 to 2.105) to increase its prices by a greater amount than would have been possible in the absence of the merger. Many advertisers are not particularly sensitive to price fluctuations in radio advertising (see paragraph 2.67) and a steady real increase in prices will probably be sustainable. The ability of the merged company to sell more impacts while at the same time increasing prices reflects, in our view, its potential strength in the market place. Capital is already selling 80 per cent of its available advertising space. Given the unattractive nature of slots between midnight and 6.00 am, this suggests that Capital's current availability of prime slots (breakfast time and evening drive time) is probably already constrained.

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*Figures omitted. See note on page iv.

2.109. Finally, we look at the way in which Capital could behave following the merger and in particular we address a number of concerns expressed to us by Capital's competitors about the potential that would be created by the merger for Capital to use its dominant position to their disadvantage. One fear that was expressed was that Capital might take advantage of the broadly-framed promises of performance for the two FM stations specifically to target competitor stations in London. The RA has already recognized such concerns on the part of the newest entrant to the London market, Xfm. In giving its provisional public interest finding on the proposed merger, the RA informed Capital that Virgin FM would be required to reduce from 32 to 20 per cent the maximum amount of 'alternative rock' and eclectic music it could play.

2.110. We noted earlier that there is already a fair degree of overlap in listening between Capital FM and stations such as Heart, Melody and Kiss 100 FM. It would be possible for Capital to use one of its two FM stations after the merger to target one of these three stations or one of the other music stations playing in London. However, Capital's business plan suggests that it is looking for substantial growth in Virgin FM's share of listeners and that it expects to lose some audience from Capital FM because of competition in the market place and the growth of new entrants like Xfm and other stations like Heart. We do not think that growth in Virgin FM will be achieved by continually changing programmes to target specific offerings of competitors. Capital will be looking to build a consistent image for Virgin FM and to make only small adjustments to Capital FM to minimize any drop in listenership at what is already a very successful station.

2.111. Another scenario put to us by Capital's competitors was that the merged group could engage in selling practices which discriminate against its competitors. Capital told us that it had not undertaken conditional selling or insisted on exclusive dealing in the past and had no intention of dealing in this way in the future. Most advertising agencies which gave evidence to us were not concerned about these possibilities. The ISBA and the IPA, however, thought that the undertakings Capital had already given about its trading policies should be retained (see paragraphs 2.98 and 2.99). The RAB said that the major media buying points would not accept conditional selling in any form. We noted that both solus deals and conditional selling would probably be regarded as unduly discriminatory under the terms of the RA's Code of Practice on Advertising and Sponsorship. On the other hand, we also noted that the merger would give Capital a larger portfolio of stations that would include key London stations. With all its sales being handled in-house, it would have the opportunity to set prices that would give incentives to advertisers to take up packages covering both Capital and Virgin stations and also airtime that is otherwise hard to sell. Such pricing practices, which could have a similar effect to solus and conditional deals, would not be a problem in a fully competitive market. But in London, where Capital would have a dominant position following the merger, such behaviour would have a detrimental effect on Capital's weaker competitors, decreasing their attractiveness to advertisers, thus reducing their revenues to levels below those which would be achieved in the absence of the merger, and thereby reducing their ability to provide effective competition to Capital.

2.112. In paragraphs 2.102 to 2.111 we have described how we believe the merger would create a more powerful Capital/Virgin group which would have a detrimental effect on its weaker competitors. This could in time affect their ability to fund programmes and lead ultimately to less diversity as some radio stations found themselves unable to satisfy both their promises of performance and the requirements of the market place. In the extreme case it is possible that some stations might be unable to carry on broadcasting, and that new entrants might be unwilling to take up the vacant licences. We believe this extreme case is unlikely to occur; however, we note the possibility so that the RA may be aware of it when it completes its own assessment of Capital's proposed acquisition of Virgin's licences.

The UK radio advertising market

2.113. As set out in paragraph 2.76, the market with which we are concerned is also that for total UK advertising by national advertisers. In 1996 Capital's share of radio advertising revenue in the UK by national clients was 36.8 per cent, of which 13.5 per cent was attributable to Capital's non-London stations in MSM and 23.3 per cent to Capital's London stations. Following the proposed merger with Virgin, on the basis of 1996 data Capital's share will increase to 46 per cent. In considering Capital's share of this market we have excluded the revenues of stations which are not owned by Capital but use MSM as their sales house, since MSM is being disbanded regardless of this merger.

Views of Capital and Virgin

2.114. Both Capital and Virgin told us that the proposed merger would have benefits in the UK radio advertising market. First, Capital would be able to apply its expertise in programming to the national Virgin AM station, which would lead to it increasing its audiences, and hence the size of the UK radio advertising market. The investment required to split the Virgin stations would be significant. Not many people would be willing to take that risk, but Capital said that it had the scale and resources to commit to the investment and that the synergies that would result from the merger would reduce the risk. Secondly, through its acquisition of Virgin AM, Capital would be guaranteed a place on the national independent radio digital multiplex. Capital said that it was the only company with the commitment and management resources to launch a serious challenge to the BBC in the digital area.

Views of other parties

2.115. Most third parties which gave evidence to us were not concerned about the effects of the proposed merger on the UK market. However, Talk, Metro Networks (UK) Limited (Metro Networks), Heart and Melody put forward different views. Talk believed Capital and Virgin would control the London, and effectively the UK, market place. It would become almost impossible to buy around Capital and Virgin in London. As a result, Capital would dominate the London market place and effectively force the decision to buy UK coverage by adding its local stations outside London to advertising schedules. Capital would therefore control national advertising revenue to the detriment of Talk AM and other national stations. Metro Networks expressed concern that what it saw as Capital's very strong presence in the national advertising market, based on its strength in London, the southern counties and the Midlands, ownership of the INR station Virgin AM and representation of the Newslink and Pepsi Chart Show national sales packages, could lead to national advertisers using Capital exclusively. Heart pointed out that Capital would for the first time bring in-house the sale of its non-London stations' national airtime, achieving a degree of horizontal integration which would be reinforced by Capital's representation of national sales packages such as Newslink; and that the alleged benefits for advertisers resulting from the break-up of MSM were illusory, since the merger would also increase Capital's direct control of the key programming, marketing and sales levers in the London market. Melody thought the acquisition of the most popular national commercial format, Virgin AM, would allow the merged company to manipulate advertising rates at the national as well as the London level.

Our assessment

2.116. We noted the concerns (referred to in paragraph 2.115) made by some of Capital's competitors about the effect of the proposed merger on the UK radio advertising market. After the merger, based on 1996 data this market will include independent radio groups (and their national sales houses) such as GWR ([*] per cent), EMAP ([*] per cent) and SRH ([*] per cent). Although none of these players would have a market share close to that of Capital's (46 per cent), all are strong, well-established and have successful stations located around the UK (see Table 4.13). GWR owns Classic FM as well as over 30 local licences in the Midlands, East Anglia and central and southern England. In Newcastle, Manchester and Liverpool, EMAP stations have more than half the commercial audience, and in both Glasgow and Edinburgh SRH has a commercial audience share of over 60 per cent. National advertisers will be able to choose between these suppliers and the merged Capital/Virgin group when they are seeking to cover the regions of the UK outside London in their advertising campaigns.

2.117. However, national advertisers generally also seek to buy airtime from London stations as part of national advertising campaigns and we are concerned that the proposed merger will create conditions in which Capital would be able to use its dominance in the London market place to strengthen its position across the UK as a whole. We have already noted how difficult the merger will make it for advertisers to buy around Capital FM, Virgin FM and Capital Gold in London. Post-merger, Capital would be able to offer national advertisers packages involving both its London and non-London stations and incentives to buy airtime from its less popular non-London stations. This effect, which may be expected to result from Capital's dominance in the London market, would further enhance its strength in the UK market and its ability to raise prices.

Benefits of the merger

2.118. As far as the benefits of the proposed merger are concerned, whilst we agree that there are few players in the UK market which could bring to Virgin the level of professionalism and programming expertise of Capital, there are others which could develop Virgin AM and Virgin FM as specifically UK and London-focused stations.

2.119. DAB is likely to take some years to become established in the UK and we think that the backing of strong and committed players will be necessary to instil confidence in the technology. If Capital owns and operates Virgin AM it would have a guaranteed place on the national commercial multiplex. Provided that it takes up this place, which it is likely to do, Capital would then have a considerable incentive, in the form of an additional eight-year analogue licence term for Virgin AM, to invest in a substantial way in the development of DAB. We believe the development of DAB in the UK would be more assured if Capital owns and operates Virgin AM.

2.120. The proposed merger will result in relatively small cost savings. There will be a net reduction of [*] sales and administrative staff. There will be annual savings of £380,000 (including £150,000 annual savings from moving the Virgin business to Capital's new premises in Leicester Square) and savings in legal and professional costs. Capital told us that it would hire new disc jockeys as necessary for the formats it proposed, in particular its separate AM national output, but expected such costs to be offset by increased income.

Conclusions on the public interest

2.121. Within the London market, we find that the increased market share that Capital will gain from the merger may be expected to increase Capital's already strong position in that market and to diminish competition. We expect this to be characterized by a reduction in the ability of advertisers to assemble effective packages of radio advertising which do not include the Capital and Virgin stations; a weakening of the ability of other stations to compete for

*Figures omitted. See note on page iv.

revenue; and increased opportunities for Capital to adopt sales practices which may be expected to have detrimental effects on its competitors. As a result, prices may be expected to rise higher than they would in the absence of the merger.

2.122. We also think that Capital's resulting dominance in the London market would enable it to offer wide-ranging packages of advertising which would strengthen its position in the UK radio advertising market, thereby reducing the ability of advertisers to buy around Capital. As a result, prices may be expected to rise higher than they would in the absence of the merger.

2.123. We have noted the possibility that a weakening of the ability of other stations to secure advertising revenue could mean that the merger might have an effect on diversity of output in London. However, we think it is unlikely in the foreseeable future that other radio stations in London will be unable to carry on broadcasting or that new entrants to the market will be discouraged as a result of the increased ability of Capital to attract advertising revenue away from them. In the light of this, and given the undertakings and requirements which the RA has already obtained from, and imposed on, Capital (see paragraph 2.30) concerning changes to the programming of Virgin FM and retaining separate news broadcasts for the Capital and Virgin stations, we do not find that the proposed merger would have any adverse effect for the listener in terms of diversity of output. No other public interest issue concerning listeners was brought to our attention during our inquiry or appeared to us to be relevant.

2.124. There are three benefits of the merger: first, the development of Virgin AM as a UK-wide station and of Virgin FM as a London-focused station; secondly, increased professionalism and financial strength in the management of Virgin; and thirdly, a greater commitment by Capital to the development of DAB. The first two of these benefits could largely be achieved in the absence of the merger, for example through a greater commitment by Virgin to secure improvements in its management and programming or by the takeover of Virgin by another party. However, we believe the development of DAB in the UK would be more assured as a result of the merger (see paragraph 2.119). Overall, we consider that the benefits are not sufficient to outweigh the detriments we have specified.

2.125. We conclude therefore that the merger situation qualifying for investigation which has been created by the proposed acquisition of Virgin Holdings by Capital may be expected to operate against the public interest with the particular adverse effects specified in paragraphs 2.121 and 2.122.

Remedies

2.126. Under the terms of the Fair Trading Act we are required to consider what action (if any) should be taken to remedy or prevent the adverse effects which we have specified with regard to the proposed merger and, if we think fit, to include in our report recommendations as to such action.

2.127. We looked first at a number of undertakings which were offered to us by Capital as potential remedies. These included:

(a) an undertaking not to engage in conditional selling on any of its stations;

(b) an undertaking not to engage in solus deals, ie deals in which the advertiser is required not to place business with any or certain other radio stations in return for more favour-

able treatment than would normally be applied to those which place advertisements in similar circumstances;

(c) the provision of audited pricing data to the OFT on a regular three-monthly basis, so as to enable the OFT to form a view on whether Capital was abusing its position either to raise prices unjustifiably to its customers or to lower the advertising rates on Virgin FM or another station to the detriment of its competitors. The data would relate to Capital FM, Capital Gold, Virgin AM and Virgin FM and to three separate customer groups: national advertisers, local advertisers which use advertising agencies and direct local advertisers. For each customer group price data would set out:

— the overall average CPT;

— the average CPT for the top ten advertisers; and

— the average CPT for the bottom ten advertisers; and

(d) the contracting out for five years of the airtime sales of Capital Gold to an independent third party which would have complete control over the sales process, including the setting of prices.

2.128. We discussed these possible undertakings at second and third hearings with Capital. As far as *(a)* and *(b)* were concerned, Capital made clear to us that it had no intention of engaging in any form of anti-competitive behaviour or price manipulation if the merger were allowed to go ahead. However, Capital recognized the concerns that had been raised during the course of the inquiry and was prepared to give undertakings to the effect set out in paragraph 2.127*(a)* and *(b)* if this was thought necessary.

2.129. Our concern in this case is the strengthening of Capital to a position of dominance. As we have said in paragraph 2.121, we think this would result in prices rising higher than would otherwise be the case. In our view, the prevention of this adverse effect would not be ensured by behavioural undertakings of the type mentioned in paragraph 2.127*(a)* and *(b)*.

2.130. Regarding the provision of audited price data (undertaking *(c)*), Capital stressed that it did not have the ability to raise prices without justification because its customers would seek out other radio stations or media. Nor would it be in its interest to reduce prices on Virgin FM with a view to undercutting the competition. Capital believed such a course would ultimately harm its business beyond repair.

2.131. We have serious reservations about the effectiveness of monitoring price movements and of interpretation of the results. Analysis would be difficult and probably lengthy. By the time it had been completed it is theoretically possible that Capital could have spent several months applying what was later adjudged to have been an anti-competitive pricing strategy. In the meantime considerable damage could have been done to weaker competitors or to small, financially weak advertisers. We therefore reject undertaking *(c)* as ineffective.

2.132. We are also doubtful about the effectiveness of the fourth undertaking, namely contracting out the airtime sales of Capital Gold (see paragraph 2.127*(d)*). We think it is unrealistic to imagine that airtime sales can be kept completely separate from the day-to-day management of the station. Capital told us that whilst it would not set the prices of airtime, it would probably have weekly meetings with the sales house to ensure that sales targets were met. Moreover, it said that revenue earned from sponsorship and promotions would not be divorced from programming and there would be a necessary degree of editorial control over those matters by Capital’s programmers. In these circumstances we do not think an arm’s length relationship can be achieved.

2.133. We consider, therefore, that in the circumstances of this case, the various undertakings proposed by Capital are unsuitable and ineffective to remedy the adverse effects we have identified in the radio advertising market.

2.134. We now turn to consider structural remedies. In our view, these could comprise a prohibition on the acquisition of Virgin FM or the divestment of one of the two Capital radio stations providing coverage in London or the prohibition of the merger. Structural remedies have the advantage that once in place the market can work freely without the intervention of the authorities. As regards a prohibition on the acquisition of Virgin FM, Capital told us that Virgin FM was such a key part of the portfolio of the merged company that it could not contemplate acquiring Virgin AM alone. [

Details omitted. See note on page iv.

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2.135. As far as Virgin FM was concerned, Virgin said that the station had always been jointly operated with Virgin AM and that the two stations bore the same brand name. As such they were inextricably linked. Virgin told us that Virgin Holdings would not sell the two licences separately from each other as to do so would damage the integrity of the Virgin brand. In any event, Virgin doubted whether Capital would wish to proceed with the merger if it could own only one of the two Virgin stations.

2.136. The adverse effects which we have specified (see paragraphs 2.121 and 2.122) all stem from the dominance which the merged company would have in the London market place. If Capital Gold were to be divested, the merged group would lose a London-based ILR station (Capital Gold) which, in the second quarter of 1997, had more listeners than the station it would acquire (Virgin FM). As far as advertising revenue is concerned, the divestment would reduce the merged group's market share in London by 7.8 percentage points (1996 figures) to a level close to that of the Capital group stations pre-merger (see Table 4.11).

2.137. Disregarding Virgin AM, which has less than 2 per cent of the London market, the effect of this remedy would effectively be to exchange Virgin FM for Capital Gold in the package of stations which Capital currently offers. In terms of numbers of listeners in the different age groups shown in Figure 4.2, there is very little difference between Capital Gold and Virgin FM except for listeners aged 45 and over where Capital Gold is far more popular. We have been told that through combinations of Virgin FM, Heart, Kiss 100 FM and Melody it is currently possible to target broadly similar sectors of the London audience as can be reached through Capital FM and Capital Gold. Virgin FM would attract a slightly younger audience (25- to 44-year-olds) than Capital Gold (30- to 54-year-olds), with a greater proportion of men. But if the audiences of Kiss 100 FM (which has the greatest proportion of its listeners in the 15 to 24 age group) and Heart (which has the greatest proportion of its listeners in the 25 to 34 age group) were combined with those of Capital Gold (as shown in Table 4.4), then it would still be possible for advertisers effectively to target the same demographic group as Capital FM and Virgin FM's combined audiences would provide. With the addition of the recently launched Xfm, which will target the younger end (15- to 34-year-olds) of the Virgin FM audience, to the non-Capital package of stations, we think advertisers would have as much choice as they had pre-merger.

2.138. With this degree of choice available to radio advertisers as a result of the divestment of Capital Gold, we believe the merged group's strength post-merger would be sufficiently reduced in the London market to restrain it, first, from raising prices to levels higher than would otherwise be the case in the absence of the merger as proposed; secondly, from weakening the ability of other stations to compete for revenue; and thirdly, from adopting sales practices which would have detrimental effects on its competitors.

2.139. An alternative remedy to the divestment of Capital Gold would be to prohibit Capital from acquiring Virgin FM. In this case, and again disregarding Virgin AM, the position in London post-merger would be identical to that pre-merger and, in our view, should be sufficient to prevent the adverse effects of the proposed merger. [*Details omitted. See note on page iv.*]

2.140. As far as the UK radio advertising market is concerned, if Capital were prohibited from acquiring Virgin FM or were required to divest Capital Gold, Capital would still be better placed to offer advertising packages than it was pre-merger, but, in our view, there would be sufficient competing packages available for those national advertisers seeking to target UK and London audiences.

2.141. Finally, we note that a prohibition on the acquisition of Virgin FM or the divestment of Capital Gold would not preclude Capital from developing Virgin AM as a UK-wide station and from participating fully in the development of DAB in the UK.

Recommendation

2.142. We recommend that the proposed merger of Capital and Virgin Holdings should only be allowed to proceed if either:

(a) Capital is required to divest that part of its undertaking relating to Capital Gold in such a way that the divested business can continue to operate effectively in its present form. The divestment should take place prior to completion of the merger to a buyer unconnected with Capital and approved by the OFT and the RA; or

(b) Capital is prohibited from acquiring Virgin FM.

If Capital is not prepared to accept these conditions then we recommend that the proposed merger be prohibited.