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Keynote address

In a period of rapid and momentous change for UK media, it's perhaps not surprising that an individual milestone should risk going largely unnoticed.

But 2009 looks set to be a watershed year for one particular aspect of the way people in the UK choose to consume media. Twenty years after Sky's launch, the percentage of households which choose to subscribe to a pay TV service is likely to pass 50% this year. So if the theme of this conference is to identify what is working in today's media landscape, pay TV definitely falls into that category.

Of course the free-to-air offering has continued to expand over the same period. It's well established that if you want more variety than just five channels, you can get it without paying a subscription. Yet, despite the early success of Freeview and the arrival of Freesat, thousands of consumers continue to take up a pay TV service every week.

That's quite an achievement. It means that pay TV has grown steadily from a standing start to reach more than 12.5 million homes. Few would have believed it possible back in 1989, or even much more recently.

So this morning I'd like to consider:

- why the breadth and the durability of pay TV's appeal have proven to be so much greater than many people expected
- why we at Sky are confident that there remains substantial headroom for further growth
- and why the sustained growth of pay TV can hold lessons for the broadcasters, politicians and regulators who are currently scratching their heads over the state of public service broadcasting.

20 years on…

It's easy to forget just how much things have changed. For UK television viewers, life in 1989 was very different.

They had the choice of four channels showing a limited range of programmes. There were a handful of news bulletins at set times, the occasional film, a smattering of kids' programming and every now and again some live sports coverage.

Today, there has been an explosion of choice in what we can watch. There are over 500 channels on the Sky platform alone, and a vast amount of video content available online.

Viewers use PVRs, like Sky+, and on-demand services to decide for themselves what to watch and when.

The range and depth of content has exploded too. Channels dedicated to the arts, history, wildlife and religion. More movies, sooner after their theatrical release. Sport, finally given the exposure and quality of coverage it had cried out for over many years. 15 dedicated news channels offering different perspectives. And plenty more besides.

UK audiences have never had so much to choose from. And they've responded, leaving behind the limited opportunities of the analogue world and embracing the richer choice available from pay TV.

Things have changed within the industry as well. Three of those four channels in 1989 were owned by the state, which meant the UK's commercial broadcasting industry consisted of just one channel. Today we have a large and successful multi-channel sector. That, in turn, has created new opportunities and new jobs for independent producers, facilities houses and so on.

All of this is to be celebrated. Choice is fundamentally a good thing. At Sky, we're proud to have played our part in that revolution.

Sustained growth

Let's consider the reasons why the number of people choosing to pay for TV has surpassed expectations over so many years.

As far as Sky is concerned, I believe the key reason why we've been able to continue to keep growing over time is that we've never forgotten that our customers have a choice.

The blunt truth is that taking Sky, like any other form of pay TV, is a discretionary item. We recognise that no one is forced to buy our product and there have always been other options available to consumers, more so today than ever.

That recognition has tangible consequences in two hallmarks of our approach to building our business for the long term.

Firstly, we can never stand still. Our basic assumption is that customer expectations are always moving forward, and so must we. By embracing change, we've been able repeatedly to evolve our product offering to meet consumers' changing needs.

This has meant some big changes in our business over the years:

- Leaving behind a profitable analogue business in order to lead the transition to digital.
- Backing a belief in the potential of personal video recorders and using Sky+ to establish a new product category in the UK - now in more than half of our customers' homes.
- Entering the broadband marketplace and challenging the established providers with the superior quality and value that has made Sky the UK's fastest growing ISP.

- Committing to high definition long before anyone else – and taking a clear leadership position that now allows us to push harder to bring HD to many more families.

Of those changes, the latter two have come in the last three years. We are moving faster because that is the nature of the world we live in. When the pace of change is accelerating around you, any company that does not develop a culture of adaptation and continuous improvement is going to find itself either left behind or at the mercy of events beyond its control.

Alongside those fundamental shifts, we're continuously making make lots of smaller changes to our products and services. Like launching a second Sky Arts channel in high definition last week, or putting our full electronic programme guide on the internet so that customers can plan their viewing and book Sky+ recordings remotely.

The reason for all of this is quite simple. What we've learned is that that continuous change and innovation helps to keep existing customers satisfied, and also unlocks new pockets of demand from people who hadn't previously been persuaded to join us. We see HD as the latest big opportunity and I'll speak about it in more detail later on.

A second consequence of the need to persuade people to improve their TV experience is our belief in the importance of sustained investment in content. We know that we need to offer each and every one of our customers something that they really love but can't get enough of on free-to-air TV.

Over the last 20 years, pay TV has responded to gaps in provision by free-to-air broadcasters by offering additional content that viewers value and are willing to pay for. In the early days, we began by filling the gaps in the limited provision of news, movies and sport by the terrestrial broadcasters. Over time, we've broadened our offering substantially to include, for example, more UK-produced drama, entertainment and arts programming, as well as a much greater breadth of sports coverage all year round.

Today we invest around £1.3 billion a year on programming for our own channels, more than any other British broadcaster apart from the BBC. Of this almost £1 billion is spent in the UK. And our on-screen investment has increased steadily year-on-year, more than doubling over the past decade. In addition, we support channel partners such as UKTV, Discovery and National Geographic with further investment of around £300 million a year.

At a time when free-to-air broadcasters are cutting back their programme budgets, we are committed to increasing investment in differentiated content. This is fundamental to the way in which we intend to keep creating new reasons for people to join Sky.

Substantial headroom

As I said earlier, we are confident that pay TV penetration still has a long way to go. With half of the families in the UK yet to choose a pay TV service, we and other providers have significant headroom for growth. If we can evolve and communicate our offering in a way that persuades even a small minority of those families to join us, the effect on our business will be substantial.

One thing that's been remarkably consistent over the years is the number of people who have said that pay TV was about to hit a plateau. Despite the evidence of the last 20 years, some people still take the view that almost everyone who's ever going to be interested in pay TV has already signed up. They are the people who believe that remaining free-to-air households form a nucleus of committed objectors, the so-called "refuseniks".

In response, let me highlight just three of the factors that will support continued growth in pay TV penetration.

The first of those is the relative resilience of the subscription model.

No consumer business can claim to be immune from the recession, but it remains the case that home entertainment and communications are very important in people's lives. Although we will have to remain flexible going forwards, our experience so far is that we've performed well in increasingly challenging conditions.

Taking a longer view, we believe that the ability of pay TV broadcasters to invest in quality content will continue to grow. In contrast, the advertising-funded model faced significant challenges even before the current cyclical downturn and, as we have seen from ITV's announcement of budget cuts, the pressures will be felt on screen.

Of course, the free-to–air networks will continue to provide a wealth of quality content, but the gap between what's available free, and what more you can get if you choose to subscribe to a pay TV service will keep growing. And as a result, over time, even fewer families will choose to rely on free-to-air as their sole source of television.

Put simply, we believe more people will be prepared to pay for quality, choice and service. And we intend to keep investing to drive continual improvement in the content and products that we offer.

The second factor is value. At a time when people are cutting back on going out and spending more time at home, investing in home entertainment for the whole family is a sensible choice. And Sky is not expensive relative to other choices that people make on a daily basis. Today, for example, you can choose one of our TV packages for as little as 56p per day. That's less than the price of a can of Coke. Even our top-tier package costs less for a whole month than the price of taking the family out to the cinema. Or even, dare I say, buying a copy of the FT over the course of a month!

But the real game-changer for our value proposition has been the investment in broadband and telephony. For millions of existing customers, it means we can put money back in their pockets when they switch to Sky for communications as well as TV. For new customers, it means they can save up to £230 a year on their existing broadband and phone bills when they join Sky. For someone with Freeview, that could mean being able to upgrade your TV to Sky and still save money overall.

The trend for consumers to choose a single supplier for a bundle of entertainment and communications services is only going to continue. That's great news for us. Right now, only around 13% of our customers take the combination of Sky TV, broadband and talk from us. That's encouraging after less than three years but there's much more to come.

The third factor is the power of innovation. Just as we've always done, we will continue to look for new ways to engage consumers who might previously have thought that Sky was not for them.

Sometimes this means a major new product such as Sky+, whose success has been driven above all by existing customers telling friends and family about the way it transforms the TV experience. Sometimes it might be a new piece of content, such as the opportunity to watch opera in peak time on Sky Arts, or the first high definition coverage of an overseas England cricket tour on Sky Sports.

Another example is our Sky Player service, which allows customers to subscribe to pay TV on their PC or Mac, without the need for a dish or even a TV set. We know that there is a small but growing segment of customers who prefer to watch TV online and this is a way for us to cater to their needs.

Sky Player already includes a dozen channels such as Sky Sports and Sky Movies, and there are thousands of hours of on-demand TV programmes and hundreds of movies to download as well. Importantly, it's not just Sky channels. MTV One, Nickelodeon, National Geographic and British Eurosport are all featured on Sky Player and last week we announced a deal with UKTV to add two of their channels – G.O.L.D. and Eden – to the line-up as well.

We know from experience that consumer preferences develop and change over time. Each time we innovate, each time we broaden our product offering, we create a new reason for somebody to reappraise whether now is the time to get Sky.

And the latest phase of this evolution is the move to make HD accessible to everyone.

Leading the UK into the HD era

Over the past few years we've steadily positioned our business to take advantage of the emerging opportunity in high definition.

We moved early into HD at a time when some were questioning whether there was really any need for it, or whether consumers would show any interest. Well, by the end of last year around 800,000 customers had subscribed to Sky+HD, representing incremental annual revenue of around £80 million. And this is just the beginning.

With Sky+HD, we have built the UK's best HD content offering by far: 11,000 hours of quality content a month across 32 HD channels spanning sport, movies, entertainment, documentaries and the arts.

And now we're ready to extend that leadership further, as the evidence suggests that more consumers than ever are ready to embrace HD.

We've seen that in our own business, with sales of Sky+HD doubling in the last quarter – and growing fivefold from the quarter before.

There are more than seven million HD Ready TV sets in UK homes today and that number is expected to almost double by the end of the decade. There is growing awareness also in the wider marketplace of the benefits of HD and increasing penetration of HD enabled devices - from BluRay DVD players to PS3 games consoles.

So now is the right time for us to push harder. We've just made our HD offer even more compelling for customers with a new, everyday box price of just £49, passing on savings that we have made in our supply chain through the acquisition of Amstrad.

Those boxes provide us with an ongoing opportunity for future innovation. In the near term this includes our new EPG, in the medium term a deeper VOD offering, and longer term the potential to offer exciting new services such as 3D TV, which we have already begun experimenting with.

It is our belief that HD will become a new standard for TV. And we have the infrastructure, the content offering and the business model to lead the UK into the HD era.

Digital Britain

Our push into HD demonstrates how private enterprise can deliver good outcomes for consumers. It is just the latest example of the way that risk-taking and investment by the commercial sector has transformed the consumer experience for the better.

Sky's story over the last 20 years, growing from a standing start to reach more than one in three UK homes, has contributed to this transformation. So too have the investments made by a variety of other commercial players in the pay TV sector.

This brings me to a note of caution about the direction of the current Digital Britain review.

First of all, let me say clearly that we wholeheartedly agree with the aims of the review. A more connected society with a flourishing communications industry, providing more people with more access to a wider range of content from diverse sources is something that we should all work towards. In fact, I believe that Sky has done as much as any organisation to help deliver this goal over the last two decades.

But if the goals of Digital Britain are to be applauded, some of the means under consideration are another matter entirely.

In particular, we are concerned that the incentives for private investment may be undermined by a possible increase in public intervention to support the UK's public service broadcasting institutions. Such structural remedies, usually involving an arranged marriage for Channel 4, have all too quickly become the focus of debate.

Sacred cows

For a process that claims to champion radical thinking, it is particularly disappointing that Digital Britain continues to cling to two of the most sacred cows of broadcasting policy: namely that only the existing PSB institutions should rightfully be considered as sources of public service content; and that only advertising funding should be considered as a suitable model for the provision of public service content beyond the BBC.

It is possible that the fixation with the free-to-air, advertising-funded model was appropriate for an analogue world with just a handful of channels. But that world ended, or began to end, two decades ago. It is time to move on.

This means taking a more holistic view of the full range of high-quality content available to consumers: whether funded by licence fee, advertising or subscription; and, increasingly, whether accessed on television or online. All of these sources make a valuable contribution to the day-to-day experience of viewers. And all should be recognised and encouraged to play the fullest possible part in the future.

After all, broadcasting policy is out of step here with other areas of cultural activity. The existence of a paid-for model where customers choose what they want to consume doesn't stop books, newspapers, cinema or theatre from making a positive contribution to life in the UK. And no one seems to think that paying for a broadband subscription is a bad idea, even when it's used to watch the BBC iPlayer. In fact, Digital Britain wants – quite rightly - to encourage even more of us to pay for broadband. But in the world of television, the dogma that public service must mean free has been remarkably impervious to change.

It is clear to see that this rigid mindset has had destructive consequences. It has limited the room to manoeuvre of the commercial PSBs as they face the structural changes sweeping across the industry. It has driven their programming further towards a narrow mainstream as they seek to maximise audiences. And it has left them exposed to the full force of the cyclical advertising downturn.

An alternative approach

To judge by the current direction of travel, there is a real risk that the policy response will be in the form of further public intervention. Instead of diversifying revenues, the solutions being discussed, such as a merger between Channel 4, BBC Worldwide and/or Five, are inward-looking. The danger is that they would simply transfer value between existing organisations and further entrench reliance on advertising revenue. They could also distort competition and undermine private investment in content that meets public purposes.

We believe that such elaborate structural solutions should only be considered as a last resort. The first priority should be to consider how the existing institutions can be modernised for the digital age. This means clear prioritisation to maximise the distinctiveness of core public service output. And diversification to avoid reliance on a single, highly cyclical source of revenue.

Subscription has long since overtaken advertising to become the largest single source of revenue in UK television. Instead of ignoring pay TV, Digital Britain could take the opportunity to use that strong momentum to support the continued provision of high-quality UK content.

There are three steps that are needed for this to happen.

The first is to recognise fully the market's existing contribution to public purposes. Without any form of public subsidy or obligation, Sky is already a significant contributor to the provision of high quality UK content. We do so for purely commercial reasons – because that's what our customers want.

Our business has been built on identifying gaps in provision by the public service broadcasters, and responding by providing customers with content that they value. We saw an opportunity in the arts, for example, and today we have a suite of dedicated Sky Arts channels offering everything from Italian opera to the Rolling Stones. In addition to Sky, other pay TV broadcasters, such as National Geographic, History Channel and Nickelodeon, are also increasing investment in original UK programmes.

If policymakers started to look at the provision of public service content in the round, instead of focusing on particular institutions, they would get a very different picture of the diverse range of high quality and engaging content available to British viewers – on TV and, increasingly, online.

The second step is to ensure that public intervention does not have the unintended consequence of undermining incentives for commercial investment. There can be no benefit to viewers if public resources are used in a way that weakens the provision of public service content by other broadcasters.

And the third opportunity is for the PSBs to support investment in their core, free-to-air networks by developing new revenue streams in pay TV. This would allow them to participate in the growth of the sector, cushion the impact of a cyclical downturn in advertising and mitigate against any structural decline.

The BBC, to its credit, has already adopted this approach with significant success. We have a long-standing and mutually beneficial relationship with UKTV based around a suite of attractive pay TV channels, which delivers value back to the licence fee payer via its shareholder BBC Worldwide. There is no reason why we could not develop similar partnerships with Channel 4, ITV or Five.

Together, these three steps would represent a significant and positive development for the sustainable provision of PSB content. The market, including the pay TV sector, is capable of supplementing the output of the core PSB channels. It is delivering for viewers today and, given the right incentives, it will deliver even more tomorrow.

Conclusion

From our beginnings as a start-up, Sky's contribution has developed and grown over the last 20 years. I have no doubt that it will continue to grow over the next 20.

As a business, we are fundamentally optimistic. We always try to see opportunities, we invest, we change, and we grow.

It is an approach based on finding tailwinds in the marketplace.

That means identifying the structural trends that will develop over time. Looking at them as opportunities and not as threats to defend against. Investing to nurture and build momentum. And participating in that growth over the long term.

History tells you that is the only way to build sustainable success.

Thank you.