

## ERICSSON/CREATIVE MERGER INQUIRY

### **Summary of hearing with Encompass held on Wednesday 13 November 2013**

#### **Background**

1. Encompass was a leader in digital media services, which owned and operated what it considered to be state-of-the-art broadcast facilities throughout the USA, Latin America, UK and Asia. The company's mission-critical media services provided broadcasters, cable networks, corporations and government entities with customized solutions for the management and distribution of content. It acquired Ascent Media in February 2011.

#### **The tender process**

2. New contracts were tendered for via Request for Quotation (RFQ) and Request for Proposal (RFP) processes. The RFQ was sometimes preceded by a market sounding exercise or could itself act as a sounding. The processes were formal, with a significant volume of formal documentation and information exchanged covered by non-disclosure agreements.
3. Encompass was invited to most tender processes. If it became aware of a tender process to which it had not been invited, it would inquire why but was unlikely to request to be invited.
4. As one of its clients, [X], was approaching the end of its contract, it ran a market sounding exercise via an RFQ in January 2012 involving only competitors and excluding Encompass as incumbent. This prompted a negotiation based on information gathered from the market sounding exercise. [X].
5. In most cases there was no incumbent advantage from existing equipment at the end of a contract as providers needed to undertake a technology refresh incurring capital spend. There was an advantage in the knowledge and the working processes as these differed for most customers all over the world.
6. A typical tender process would follow a broadly standard process, though it varied on the basis of the customer's requirements and the levels of professionalism and process governance. Documentation was issued via a website or email which set out the requirements and deadline in a standard format. Sometimes there were follow-up questions. A similar process was then repeated at the RFP stage.
7. Where customers had included innovation in their requirements, a proof of concept stage would follow where suppliers demonstrated their proposed solution. The RFP would then either be revised or follow-up questions would be asked, and then the suppliers were asked to submit their RFP. Suppliers either submitted tenders in hard copy or via email or e-procurement websites.
8. A number of stages followed to consider commercial and legal issues, and there was a process of elimination using a scoring matrix. The customer would then engage the preferred bidder to agree commercial terms.
9. Encompass had no visibility of other competitors in the typical procurement process, although the industry was small so there was some speculation. It would ask who it

was bidding against so it could calculate its chance of winning and to know if the customer was genuinely tendering or undertaking a market sounding exercise. However, customers tended not to disclose this information. [☒].

10. Encompass recalled one tender where the customer attended its premises to explore its proposed technical solution. The customer informed Encompass it was twice as expensive as other competitors due to level of staffing. Encompass considered the resource necessary to fulfilling the customer's requirements. It needed to maintain high standards and, whilst customers had different price expectations, it was customers' service expectations that drove the price. The customer revealed Encompass had proposed by far the best solution and technology.
11. Bidding for business absorbed a lot of time and a large effort for the business. Recently it had been contacted by a market research house which said it was conducting an RFP on behalf of a customer. Encompass concluded no customer had such wide-ranging requirements as requested and declined.
12. [☒]
13. Encompass did not know the process by which it acquired the channels 5\* and 5 USA in 2010 as this was prior to Encompass acquiring the playout operations of London-based Ascent Media that handled those channels and EDML staff involved in the process were no longer at Encompass.

## **Selection criteria**

14. The service quality and technology solution were more important than price at the short-listing stage of a tender. The price had to be in the right ball park but most customers expected there to be price negotiation in the process. Other key criteria included service level agreements (SLAs) and penalty regimes relating to incidents, contract length which ranged from three to five years, and the approach to handling change requests. Customers asked for detailed business and financial information including how the organization was structured and managed, and where it was based.
15. Some customers would stipulate staff-to-channel monitoring ratios, whereas some would specify only the SLA. Important issues included project implementation, engineering support, and shift management. Reputation, management and track record played a role in the scoring of bids though bidders rarely had the opportunity to submit specifically on this issue. Companies without a track record would rely on proof of concepts to demonstrate ability.

## **Pricing**

16. Encompass put bids together on a cost plus margin basis, taking into account capital requirements, length of contract term, staffing levels, cost of borrowing, and what the overall payback would be. It would use a model to derive a starting point price to offer the services required.
17. Competitive bids drove prices down, and at the beginning of the tender process, service levels and pricing were the most important factors, followed by perception of reputation and credibility.
18. Some customers would request bidders to broaden their service offering so the customer could leverage its buying power. However, other customers were interested

in best of breed services. It was possible to pre-agree pricing for additional channels which was a form of volume discounting.

## **Technology**

19. The bigger the playout supplier, the more buying power it had with the vendors of technology. Not everyone used the same technology, and Encompass used various key technologies across the world as a result of acquisitions. Aligning technology would incur huge capex costs. Whilst it aimed to innovate and differentiate, the opportunity to do so purely on equipment was limited.
20. Some customers had strong views on particular technology, and bidders could be discounted for proposing a particular technology. These types of customers perceived their requirements as more complex than others and perceived that only certain technologies could be trusted to deliver their requirements.
21. There was a trade off between sticking with technology that worked and working with suppliers on technological innovation to deliver efficiencies. Encompass had a broader view of the capabilities of different technologies than its clients because it had several clients across different technological solutions.
22. For example, a customer might perceive the only way to achieve its graphics brand was to use one specific existing device. Encompass would propose more cost- and workflow-efficient solutions to achieve the same output though the client would often still prefer to use the existing device.
23. Sometimes the customer would specify a particular brand of technology, including the configuration. Customers usually specified whether they wanted a specific solution or to see innovation. It might pitch alternatives to a specified solution as an option. It was harder to compete when the solution was specified by the customer as bidders were competing primarily on the construction of the service and the workflows.
24. Having the right technology designed up front was important. Having the right training and experience of staff to work in that reactive environment was absolutely critical. It bid on the combination of the technological and operational solution.
25. The quality and quantity of staffing was driven by the customer's SLAs. Cutting people would leave you short of out-of-hours support or transmission and it knew the appropriate level from experience.

## **Availability of skilled resource**

26. There was sufficient skilled staff in the market, and staff moved from one supplier to another, including from Encompass to competitors and vice versa. The staffing challenge was a large upscale in staff for a customer, although in most cases TUPE would apply to staff already working on the contract with another provider. Where TUPE applied, it would not know the detail until later in the process so would assume a staff cost and reserve the right to revise their quote.
27. Encompass was well practised in launching new services and it used both internal and freelance project management and service integrator services. Preparation for launch could be staffed by flexible deployment of existing staff. For more complex reactive channels, it would use both existing staff on overtime and the freelance

market. However, it would prioritize using existing staff to retain knowledge of the customer's specific brand, operations and ways of working.

28. Encompass said that tenders often required transition plans and interim operating models, though it was not discussed until the short-list stage.
29. Encompass had staff in the USA, Latin America and Asia that could potentially be deployed throughout the global business, although this was more common with senior staff who were up to date with the latest technology. [☒].

### In-house

30. Encompass did not recall a process where the option to take it in-house was evident as part of the selection process.
31. Customers' ability to bring playout services in-house depended on the customer. Some organizations with history of in-house playout might have the potential capability to bring it in-house, though there were other customers for whom this would require time to design a solution, funds to invest in infrastructure, and experience to develop the capability.
32. [☒]
33. [☒] had in-sourced all of its playout business as it had critical mass of relevant operations.
34. Encompass did not recall the process by which it lost the playout services contract for Discovery in 2009, which took the services back in-house, as this was pre the Encompass purchase of Ascent.

### Complexity

35. The most complex customers were those with channel interactivity which required understanding of the nature and characteristics of the channel and brand. It viewed Channel 5 (C5), which it supplied, as one of the most complicated channels as it included live news interaction and commercial regions.
36. Encompass defined 'interaction' in terms of the ability to deal with switching into live programming, at national and regional levels, and manage potential compliance issues. This was different to a multi-channel environment where the operator was primarily checking that video and audio were playing. Contingency schedules for unpredictable live content were a key part of complexity. All of these factors impacted on both the technology, but also the operation of that technology, requiring a close relationship with the customer. These more complex areas were complex day to day, not just when incidents occurred. It made the incidents more complex to resolve.
37. The contingency parameters were set by the customer and the playout provider was responsible for execution of the appropriate actions. It was rare that any unscheduled actions would be taken without the involvement of the customer. Relevant incidents could occur several times a month on average, although the high-profile incidents were much less common.
38. Encompass was ultimately responsible to Channel 5 for ensuring that their playout was compliant with Ofcom rules, including advertising.

- 39. There were different levels of intervention, though operators were unlikely to take decisions that would impact the service without discussing with at least their supervisor, who might contact the client. The exception would be if a channel went 'black to air' which was extremely rare.
- 40. C5 was the most complex channel it currently serviced in the UK.
- 41. ITV was the most complex channel. It was similar to C5, though it had several micro and macro regions for commercials and programming which made it more complex. Encompass would need to scale up to be able to deliver playout for ITV. It would also need to deal with the live source switching particularly around the regional news. The rest of the change was just adjusting to a larger-scale operation.
- 42. Encompass would use C5 experience to demonstrate its ability to deliver for ITV and it would leverage its international experience.
- 43. Encompass considered the BBC to be similar in complexity to ITV. It did not have the commercial advertising aspects though the nations could be opted out from the network for long and different periods of time running their own live schedules. The BBC was more complex in respect of the network to nations to regions interactivity, though less complex as it did not have regional commercial advertising.
- 44. Channel 4 (C4) appeared to be less complex with a lot lower regional commitment. C4 appeared to be similar in complexity to C5.
- 45. BT Sport and Eurosport were less complex still, although the challenge was getting live content to air and having the necessary backup plans to deal with over and under runs. The live content did not have to interact as much with scheduled pre-recorded material so it was less complex. The sports model was largely about provisioning the live content feeds from studios/providers and putting in place contingency plans.
- 46. For live programming, there would be a pre-agreed advertising break pattern that complied with Ofcom rules. The complexity was in working with the sports production companies to identify the appropriate point in the sports event to trigger the commercials. Operationally, sport was quite simple, though it presented very high risk.

## **Bundling of services**

- 47. Bundling, such as creative services and playout, gave a supplier an advantage, although it depended on the customer's requirements. Encompass did not offer creative services and would need to partner with another company to offer those services.
- 48. It was common to explore partnerships with other companies to offer a holistic solution to the customer, though the customer might want two separate contracts to ensure accountability by contracting directly with the provider.
- 49. The prestige of a brand, for example the BBC, might give that customer negotiating strength with bidders. A company would gain kudos if it was able to provide one big company, for example [X], with its global playout services requirements. These were both forms of credibility.
- 50. Encompass had proposed a disaster recovery (DR) solution to C5 though Red Bee Media currently maintained DR services. DR could be done on a number of levels,

for example where the service was protected by diversified technology across multiple sites, as well as engaging a completely independent company.

51. [☒].
52. The transmission chain for C5\* and USA was relatively complex as it had more discrete devices for the operator to monitor.
53. Encompass did not recall any procurement process raising any incidents formally. It might instead draw on the value of having learned from various incidents in demonstrating the robustness of its proposed solution.

## **Competitors**

54. Red Bee Media had great Public Service Broadcaster (PSB) experience, and its huge strength was creative services, and reactive playout ability. It saw its weaknesses as being costly, with a large structure and multiple legacy issues.
55. Technicolor had good experience and reactive playout ability. It saw its weaknesses as its lack of creative services, inflexibility and fixed costs. Encompass viewed Ericsson, post-merger, as a formidable competitor for highly reactive customers. However, Encompass did not perceive itself to be at a disadvantage when bidding for customers with multi-channel requirements.
56. Encompass considered Red Bee Media to be its main competitor for the reactive customers, followed by Arqiva and Globecast which both had less experience and a bias towards distribution rather than channel origination. Both Arqiva and Globecast did not have the track record in serving complex reactive clients such as ITV and BBC.

## **Entry**

57. BBC and ITV had more complex requirements than anyone else. When ITV outsourced, many of its engineers and operators went to Technicolor which made it difficult for other providers to match that level of expertise. The rewards of serving BBC and ITV would be sufficient for it to bid to win an opportunity that came up.
58. The UK PSB market was different to the rest of the world, in particular, for example, the commercial nature of the PSBs was very different to the networks in the USA. The UK was different in terms of channels. There were some similarities in regulation, for example Turkey. It considered ITV to be probably unique as a commercial and public service broadcaster in the world.

## **Effects of the merger**

59. Encompass's ability to compete in the reactive channel environment would be significantly reduced. Customers would have less choice, though it recognized that with the merged entity, customers would have to take other suppliers more seriously. It was not confident that it could compete commercially with an entity with such significant reactive capability and existing infrastructure.
60. The merger would also make it more difficult for it to win middle-ground operators such as C4 and C5 as the merged entity would have economies of scale in infrastructure and the bundling of creative services.

61. The merger was unlikely to affect it in the multi-channel environment.
62. The merged entity might also be able to bundle services, such as creative and playout, which might make it more difficult for playout providers to compete on a level playing field.
63. Encompass was confident that it could demonstrate the ability to meet complex customers' requirements, though this would require a lot of new investment which might disadvantage it compared with an incumbent.