# 2011/12 Annual Plan & Budget

**A Statement by PhonepayPlus following its consultation published on 3 December 2010**

**Issued by PhonepayPlus on 29 March 2011**

## 1. STATEMENT ON BUSINESS PLAN AND BUDGET 2011/12

PhonepayPlus regulates premium rate telephone services (PRS) in the UK. These are the premium rate goods and services that you can buy by charging the cost to your phone bill or pre-pay account.

PhonepayPlus issued a public consultation on its Business Plan & Budget for 2011/12 on 3 December 2010, with a closing date for responses of 17 January 2011. Four responses from stakeholders were received and a meeting of the Industry Liaison Panel (ILP) was also held to discuss the proposals.

A summary of the responses is set out in this document along with our comments on the issues raised; the full responses can be found on the PhonepayPlus website[1].

Following consideration of the consultation responses and the ILP discussion, PhonepayPlus submitted the Business Plan & Budget 2011/12 to Ofcom for approval without alteration. Following a period of scrutiny, Ofcom approved the Business Plan & Budget in February 2011.

Given the imminent introduction of a new Code of Practice and industry Registration Scheme, the Business Plan for 2011/12 primarily focuses on ensuring that the new regulatory framework for PRS is implemented successfully. Alongside the external changes to regulation, PhonepayPlus is in the process of a significant internal restructure to better align teams and operations to effectively support this programme of implementation. Overall, 2011/12 will see a major transformation in PhonepayPlus' operation and therefore it is appropriate that delivering this change is our key concern, particularly given this will happen at a time of reducing resources.

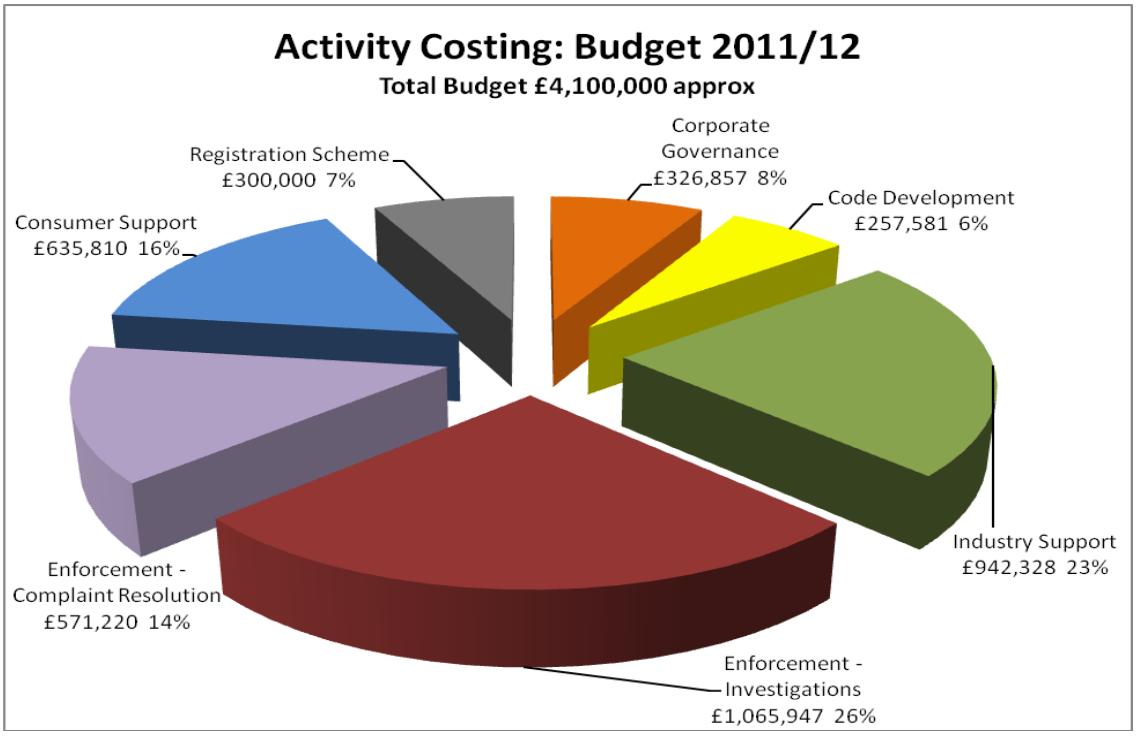
Other key priorities for PhonepayPlus in 2011/12:

- Supporting delivery of Ofcom's review of Non-Geographic Calls Services, in particular focusing on proposals to improve pricing transparency for PRS consumers;
- Launching the improved Number Checker service for consumers with a campaign aimed at providing information at the point of need (e.g. on phone bills, in directories);
- Working with the industry to develop appropriate guidance for emerging services in the mobile and internet sectors, including for in-app billing, virtual currencies and the use of PRS on social networking sites;
- Reviewing the success of regulation of 0871/2/3 and the measures brought in under the Mobile Review in 2009; and
- Continuing to drive efficiencies across the organisation, including a refresh of KPIs and processes related to the introduction of the new Code and Registration Scheme.

[1] http://www.phonepayplus.org.uk/output/Responses-PhonepayPlus-Business-Plan-Budget-2011-2012.aspx

Total cost of PRS regulation in 2011/12

We expect the total cost of PRS regulation in 2011/12, covering PhonepayPlus' core activity and the new Registration Scheme, to be approximately £4,100,000. The split of this cost across activity is shown in the chart below.




The proposed PhonepayPlus budget for levy-funded activity in 2011/12 is £3,799,743. This is a **real terms decrease of 13.2%** on 2010/11[2]. In cash terms, the budget is 10% lower than the current year. Following budget reductions in the previous two years, by the end of the next Financial Year PhonepayPlus will have **reduced its like-for-like costs by 20% in real terms since 2008/9**. This reduction reflects efficiency savings across the organisation as a result of a significant fall in consumer harm in the PRS market.

As registration is a new activity in this business year and as it is a fixed cost, funded separately through fees, we will not include registration in our calculations of like-for-like costs of our levy-funded activity going forward. This means that next year's business planning cycle will show a total cost of PRS regulation, including registration. We will then separately show the cost of our levy-funded activity, against which we will continue to seek efficiency savings through the implementation of the new Code of Practice. An update on the final figures will be issued once the costs of the Registration Scheme build are settled.

[2] This figure includes CPI inflation, so that the real impact of rising costs can be seen on any proposed budget increases or decreases. CPI was 3.2% in October 2010 and we are using this figure to represent our budget proposals for 2011/12.

Registration Scheme

PhonepayPlus is due to launch its new industry Registration Scheme in April 2011. The work on developing the Scheme has been ongoing through 2010 and it was agreed that the initial funding to cover the costs of introducing the Scheme would be met through applying some of the cash reserves PhonepayPlus holds as a result of surplus income (e.g. collected fines). The costs of the Registration Scheme would then be met through the collection of fees, with a view that the fees would be set at a level that would see the initial investment repaid over a period of five years. This initial industry investment would then be returned to the industry as part of the annual adjustment of the industry levy.

As we near completion of this project, it is our intention that the costs of registration are incorporated into our Annual Report and business planning going forward. This will enable us to show the total cost of regulation for PRS, although it is important to remember that registration will have a different funding stream from other PhonepayPlus activity.

Until the project is completed and the system is finally accepted by PhonepayPlus, we cannot confirm costs, so the figures below are the latest estimates. We expect these will be close to the final figures, given the project is in its final stages, and these will be confirmed in our Annual Report for 2010/11, due for publication in July.

The total build costs for the Registration Scheme are currently forecast to be around £600,000. Operational running costs will be in the region of £185,000 per annum, which cover the hosting, licensing, maintenance and operation of the Scheme. Capitalising the build costs over five years means that we expect the total cost of the Registration Scheme to be around £300,000 per annum for the next five years.

We have set the registration fee at £100 plus VAT for the financial year 2011/12 and we are forecasting 3,500 registrants, which would give us a break even at the five-year point. If the number of actual registrants is significantly over or under 3,500, we will need to reassess the level of fees charged. We will report on the number of actual registrants and forecast the impact on registration fees as part of the next annual planning process in late 2011.

Market Report

Alongside this statement, we are publishing our latest report on the current and future market for premium rate services[3]. The report estimates that premium rate revenues, excluding VAT, totalled £816.2 million in 2010, a 0.8% increase compared to the 2009 equivalent of £810.1 million. We set out further key themes emerging from the report later in this document (see section 3).

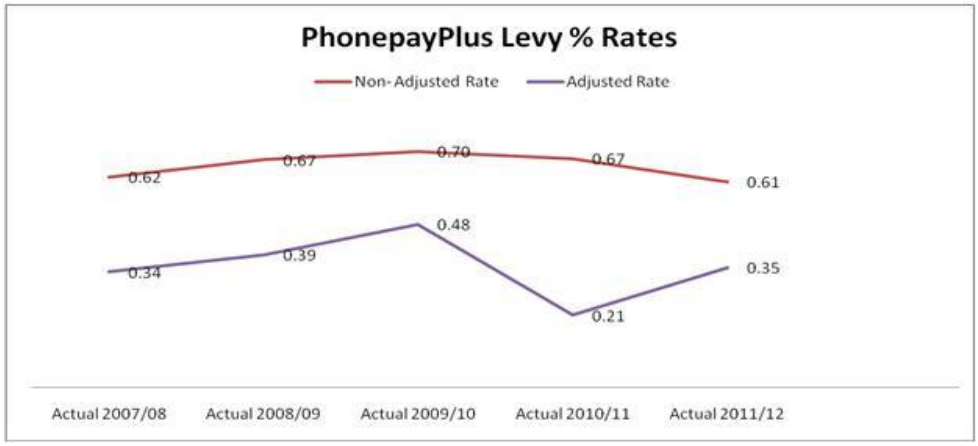
Industry levy

PhonepayPlus has announced that its adjusted industry levy for 2011/12 will be 0.35%. The adjusted levy applies to all outpayments payable by network operators to service providers in respect of revenue generated by premium rate services. The levy is

[3] http://www.phonepayplus.org.uk/upload/2011-Current-and-emerging-trends-in-the-UK-PRS-market-2010-Analysys-Mason-report.pdf

calculated as a proportion of every outpayment to ensure that PhonepayPlus continues to receive adequate funding to carry out its activities, as required by Section 121 of the Communications Act 2003.

The graph below shows the non-adjusted levy requirement for the last few years. This non-adjusted rate would be the levy PhonepayPlus would need to raise if it did not receive any other income (such as fines, administration charges or bank interest). Owing to the significant fall in PhonepayPlus' budget for 2011/12 and a relatively stable market, the non-adjusted levy has fallen from 0.67% in 2010/11 to 0.61% for the coming year.




The adjusted rate is the amount PhonepayPlus is required to levy once the costs of regulation are offset by other income. As this amount is subject to great variation, the actual rate levied can appear to change dramatically from year to year. Further information on how the PhonepayPlus levy is calculated can be found in our consultation document on our Business Plan & Budget[4].

Despite the non-adjusted levy falling this year, the amount we need to collect from industry through the adjusted levy is slightly up on last year's rate of 0.21%; we alerted the industry to the likelihood that the levy would rise in our statement last year. In 2010/11, PhonepayPlus returned a significant cash surplus to the industry derived from an exceptional level of fines in 2009/10, meaning the levy was heavily discounted. When setting the levy last year, we discussed with our Industry Liaison Panel (ILP) whether it would be better to return this surplus over a number of years, in effect smoothing the levy, or to discount heavily in 2010/11 on the understanding that the levy would likely increase in 2011/12. The ILP consensus was to return the money to industry in one year, which is why the levy has increased this year despite the significant fall in PhonepayPlus' budget.

[4] http://www.phonepayplus.org.uk/upload/2011-Business-Plan-and-Budget.pdf
This consultation has now closed.

## 2. SUMMARY OF RESPONSES TO THE CONSULTATION

We received four formal responses to the consultation on the PhonepayPlus Business Plan and Budget for 2011/12.

This section summarises the responses received to the questions set out in the consultation, with our response where appropriate.

**Consultation Questions**

*Q1. What information or evidence do you have about market trends and about the overall size of the phone-paid services market in 2010/11?*

AIME: Anecdotal evidence suggests that the market trend is much as described last year with the only moderate growth areas being the interactive broadcast sector and 087 services. Consequently we believe the likely PRS consumer billings outcome for financial year ending 2011 to be of the order £0.8 bn.

BT: We agree with the widely reported contraction of the PRS market.

MBG: From a mobile perspective, albeit without firm evidence either way, the view of the majority is that premium SMS will continue to decline in the coming year, though perhaps more slowly than in the previous two years. Thus, if this is not reflected in PhonepayPlus' assessment that the overall market will be static in the coming year, the MBG would conclude that the regulator is being a bit optimistic. Although the overall value added market on mobile has increased dramatically (led by third party App stores), there is also increasing competition in payment methods, where PRS has a very much more prescriptive regime and this has an impact on the potential for market growth.

PRA: It is clear the market place needs new ideas and a confidence in regulation to drive forward the entrepreneurs and also consumer confidence to increase spending this will be difficult however with price increases due to VAT increases and a the bad debt levy.

*Our response:*

After several years of decline, it is encouraging to see the UK PRS market return to growth in 2010, albeit only a slight improvement (see section 3 of this statement). The continuing challenging economic circumstances will certainly be holding back growth, but it is clear that innovation, particularly in virtual goods and the charity sector, is behind increasing consumer engagement with PRS.

PhonepayPlus notes comments about the different regime for PRS as opposed to other micropayment mechanisms, such as credit card. We believe it will be important for Government, the industry and regulators to consider an appropriate regulatory regime for all micropayments in the mobile and internet sectors as part of the process of developing a new Communications Act, with the focus on a proportionate regime that protects consumers, encourages innovation and creates a level playing field for industry.

*Q2. What information or evidence do you have about any specific segments or content areas and their potential for real growth or decline over 2010/11?*

AIME: We do not see any specific segments or content areas as having potential for significant real growth or decline during 2010. The threat of BT succeeding in their attempt to increase the PRS Bad Debt surcharge from 3.03% to 9.7% appears to have been successfully challenged and the most recent proposition of 5.24% is still under examination. However, while 5.24% represents a significant reduction over 9.7% any increase to this surcharge will have an adverse effect on the PRS market.

MBG: It should be noted that Ofcom will shortly be carrying out their review of CPRS, including Payforit, and the outcome is likely to fall within 2011/12. This adds a factor of uncertainty around the scope of leviable outpayments.

*Our response:*

As noted in our Market Report for 2010 (see section 3), social networking and mobile internet services offer the most potential for growth in the short-term. Traditional PRS revenues remain stable, which suggests the industry is struggling to attract new consumers to its products, or that business models remain under threat from "free" services on the internet. Realising the potential for PRS as a mobile/internet payment mechanism is likely to be key to arresting the decline in traditional PRS.

The setting of the bad debt surcharge for PRS is a matter for Ofcom, although we recognise the challenges that increased costs here, and with the recent VAT increase, place on the industry.

In terms of the outcome of the current review by Ofcom into the scope of controlled PRS, neither of the services under review represents a significant proportion of levy income, so we believe we can adjust to any changes in income arising from Ofcom's proposals.

*Q3. How do you see the phone-paid services market developing in 2011/12? In particular, do you have any insight into how PRS might develop on social media or smartphones?*

AIME: We will see micro payments facilities being utilised in support of the emerging applications (Apps) market and PRS will clearly be one of the options but we do not have any specific or formal information to support this view. AIME would expect to share information of this nature with PP+ through our regular meetings forum.

MBG: PhonepayPlus is correct to mention the topic of 'In-App' billing and virtual currencies. The MBG is pleased to note that the regulator will be responding to comments made at the Industry Liaison Panel on this subject by consulting on guidance.

PRA: Certainly new applications and new entrants into the market place (such as Android) will drive forward consumer friendly applications and consumer demand although budgetary constraints will be the test as to whether great applications will lead to low value high demand purchases.

*Our response:*

We are committed to working with the industry through the ILP to share information on market developments and to manage emerging market and consumer risks through appropriate guidance and advice.

*Q4. What comments do you have on the priorities for 2011/12? Are there other projects or issues that you think PhonepayPlus should consider for the coming year?*

AIME: Clearly the priorities for 2011/12 are the successful implementation of the new Code and associated Registration scheme and AIME will continue to offer its support to achieve this goal.

BT: We believe that the priorities for 2011/12 are broadly correct provided the reductions do not undermine the ability of PhonepayPlus to regulate the market effectively or push the burden of enforcing the code onto industry.

The need for the successful launch and implementation of the new code and registration scheme is clearly important. PPP needs to be clear about how they propose to measure this success. We support the move to either pre-empt non-compliance or deal with appropriate non-compliance in an informal manner.

We believe that PPP should concentrate promotional / educational activity and spend on PRS users and adult PRS and non-PRS users rather than on school children. Given the change in regulatory responsibility in the 12th Code, there needs to be significant effort in educating the new L2 organisations on their responsibilities. Given the reduction in the Code Compliance and Development budget from 2010/11, PPP need to ensure that the communication is effective.

We believe that PPP should support the creation of a level playing field in UK PRS as envisaged in a number of the proposals in the current Ofcom Non-geographic Services Consultation.

PRA: It remains to be seen as to whether your new registration scheme will in fact get all SP's IPS and others involved in PRS to register. We believe your priority should be to regulate fairly, evenly and with true independence at all times.

*Our response:*

As noted in the statement (see section 1), successfully implementing the new Code of Practice and Registration Scheme will be our primary focus in this business year. However, we will support the important Ofcom review into Non-Geographic Call Services, particularly to ensure improvements are made to pricing transparency for PRS consumers. In terms of our consumer literacy work, we will continue with our youth-oriented campaign, PhoneBrain, for another year. Our other significant campaign, launching the new improved Number Checker service, will be targeted at PRS consumers more broadly.

*Q5. Do you support our proposed budget changes for 2011/12, having regard to the activities and strategy that drives the changes? If not, please explain why.*

AIME: AIME is broadly supportive of the budget proposals subject to the individual concerns raised.

BT: We support the reduction in the overall budget reflecting the reduction in the size of the market. The split of Enforcement into Complaint Resolution and Investigation will be useful in reflecting the priority of the activities and focus the different behaviours appropriate to the different areas. It is important that both these areas are effective.

As above the reduction in the Code Development budget needs to allow for sufficient communication of the new Code and its implications to encourage and enable widespread compliance among Network Operators, L1s and L2s.

MBG: While the MBG welcomes the fact that PhoneypayPlus has prepared a draft budget that entails cuts in expenditure, we feel that it does not yet go far enough. Government bodies and private businesses under pressure, including those engaged in the declining PRS market, have been able to achieve greater cuts than what is proposed here. For example, PhonepayPlus is budgeting to spend £540,000 on Communications, External expertise, legal costs and intelligence, which appears excessive. There are other cuts that could be made that, while yielding savings that are small relative to the overall budget, are nevertheless important for instilling a mindset of maximising value for money. Stakeholders could forego lunch at the PhonepayPlus Forum, as an example.

The MBG has one final point on cost recovery from administrative charges. The budget document is not clear on the balance between costs and income. We see that £1.066m will be spent on formal enforcement. It would be helpful to see that administrative charges for enforcement are levied at the right level to cover the costs of at least those cases that are taken forward to Tribunal. If not, then PhonepayPlus needs to consider reviewing the level of administrative charges. If stakeholders had access to last year's enforcement and CCP budget as against last year's invoiced administrative charges, with an estimate of split between the cost of cases closed after formal investigation and the cost of investigations taken to Tribunal, it should be possible to give clarity on this point.

PRA: We support effective use of industries money and by more industry focused and lead activity there seem to have been improvements as evidenced by a reduction in fines. However it also seems out of kilter that any industry which was worth £1.2 billion had a regulator costing the industry "just" £2.2million and last year you cost £4.2 million with an industry worth £900 million. This year you will cost £3.7 million with an industry worth £800 million. Therefore whilst you state a reduction in cost of 13.2% on reflection this would appear to show a market decrease not a budgetary one.

We note the reduction in cost for staff, legal, publications and external audits, but the note the large increase in website costs and telecoms. Where is the budget for the registration scheme database development?

We note and encourage the ongoing development of working relationships with other regulatory bodies as highlighted at the ILP in the hope that regulation and responsibilities will be clear and regulation will not be over burdening.

The main risk for PPP is that it does not focus on its core activity which is to work with industry to establish a fit regulation model along with a workable code. PPP needs to work continue to work with and be clear with the industry.

*Our response:*

PhonepayPlus has driven down costs across the organisation in 2011/12, with all teams seeing a reduction in non-staff costs, alongside an 11% decrease in headcount. For example, our non-staff communications budget has decreased by 17% this year[5]. As we have stated previously, this year's budget is not the first year that PhonepayPlus has delivered savings to industry, but in combination with the preceding two years, we will have delivered savings of a fifth in real-terms by March 2012. We recognise the continuing challenging economic circumstances and take seriously our commitment to delivering further efficiencies in future years.

In terms of our administration charges, enforcement is not limited to those cases subject to formal breaches, but rather covers a broader range of activity. Where cases are upheld, the direct costs associated with investigation and adjudication are partially, or fully, recovered. The collection rate for administrative charges is in line with those for fine collection and is reported on a quarterly basis against a KPI target of 80%.

[5] The reason this is not reflected in the accounts shown at Annex A is due to a revision of where certain costs are recorded in the budget to better reflect functions. Non-staff costs for communications were budgeted at £175,100 in 2010/11 and £144,910 in 2011/12.

## 3. 2010 PRS MARKET REPORT

PhonepayPlus commissioned Analysys Mason to carry out a review of the current and future market for premium rate services in the UK. Analysys Mason has delivered its report, *Current and Emerging Trends in the UK Premium Rate Services Market*. This section includes key findings from the full report, which is published today[6].

One objective of the PRS market report is to assess the commercial health of the market and its constituent service areas and to gauge the likely market developments in the short to medium term. We believe this information is critical to PhonepayPlus, as it provides an indication of the impact that regulation and other factors have had on the PRS market, or a particular sector, which then informs our regulatory activity.

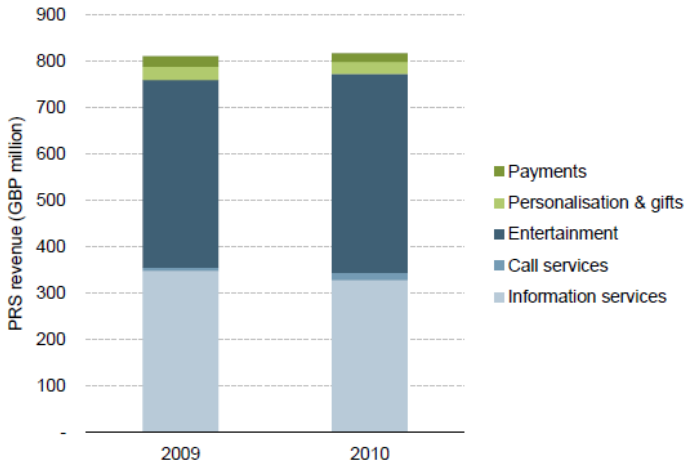
The other key objective is to gain an understanding of developments in consumers' behaviours and attitudes to the PRS market, which is critical to ensure our Code of Practice and consumer support work is delivering an effective and proportionate regulatory regime. For that reason, we commissioned Analysys Mason to carry out a quantitative study of 5,000 consumers to inform the report.

*Stakeholders should note that the opinions and statistics set out in this section are those of Analysys Mason. PhonepayPlus will consider the findings of this report alongside feedback and other evidence from stakeholders when developing policy and deciding on priorities for its work regulating premium rate services.*

### *The PRS Market*

In 2010, the premium rate industry in the UK was worth an estimated GBP 816.2 million excluding VAT, up 0.8% from GBP810.1 million in 2009[7].

The figure below shows the breakdown of revenue from the high-level categories of premium rate services.




[6] http://www.phonepayplus.org.uk/upload/2011-Current-and-emerging-trends-in-the-UK-PRS-market-2010-Analysys-Mason-report.pdf
[7] All market size figures in this report refer to revenue ex-VAT, unless otherwise specified.

Of the major PRS categories, the largest in terms of revenue is Entertainment, followed by Information services (the majority of which is accounted for by Directory enquiries).

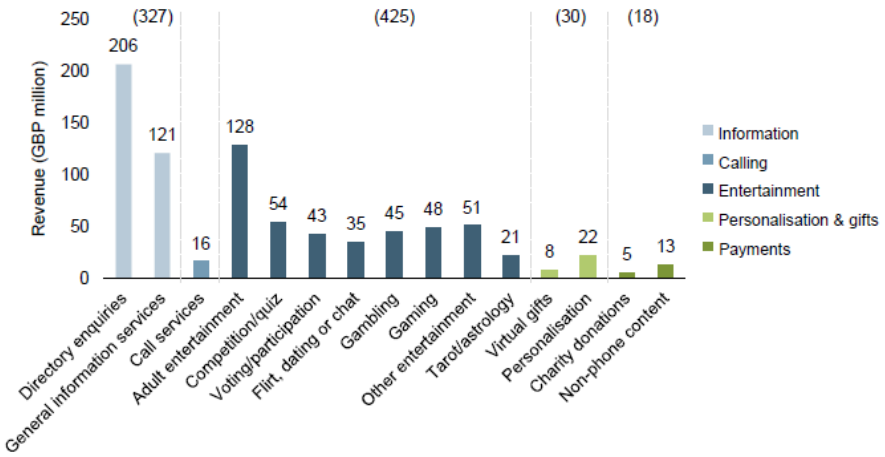
**Entertainment** PRS were worth GBP 428.6 million in 2010 (52.51% of the total phone-paid services market). The Entertainment category saw revenue growth over the year, up 6.1% from GBP 404.1 million in 2009. This was mainly driven by growth in gambling, participation TV and flirt chatlines. However, the remainder of the product segments declined marginally or at best remained stable.

These declines reflect changing consumer spend and purchase habits, rather than a decline in consumer appetite for paid-for entertainment services.

A number of key factors are driving this shift (many of which impact other areas of the PRS market as well, although less dramatically):

- **Entertainment services are increasingly going digital** and being delivered across a wide variety of platforms which may not necessarily be within the control of, or linked to, the consumer's telephony provider;
- The trend towards **greater availability of free information and content** is continuing;
- **Internet access from the mobile and the use of mobile applications** for accessing entertainment and other information services are displacing opportunities for phone-paid services;
- Consumption of entertainment services is increasingly centred on **social networks**, which could present growth opportunities for PRS if the right partnerships are developed;
- Content and service providers are providing consumers with **a wider range of payment options than in the past**, which compete with PRS.

The figure below shows 2010 Phone-paid services revenue by service sub-category.



The largest individual phone-paid service sub-category in terms of revenues generated is Directory enquiries (part of the Information services category in the figure above), which was worth an estimated GBP 206.4 million in 2010 (25.3% of the overall PRS market). Directory enquiries also showed high penetration levels in 2010 – it was the second-most-commonly used PRS service, with 23% of survey respondents reporting they had accessed Directory enquiries PRS one or more times in the past three months.

The most widely-used PRS service last year was Competitions and quizzes (a sub-category of Entertainment), which 26% of survey respondents reported accessing.

Adult entertainment services (a sub-category of Entertainment) also constitutes a significant proportion of the phone-paid market, worth an estimated GBP 129.4 million in 2010 (15.9% of total PRS revenue), but unsurprisingly was not used by as wide a group of consumers (6.3%).

While Directory enquiries and Adult entertainment services remain the two largest contributors to the PRS market, as they were in 2009, markets for both have shrunk in the past year (Directory enquiries services by 6.4% and Adult content by 1.3%). The most important factor in both declines is increasing competition from free information and adult content, as well as the increasing diversity of means to pay for, and consume, such services.

### *Trends Impacting the PRS Market*

Analysys Mason identified a number of key trends in information and entertainment delivery and consumption which are impacting the PRS market.

*Entertainment services are increasingly going digital*

The main context for the ongoing shifts in the PRS market lies in the digitalisation of content and entertainment services, as these are increasingly being made available to consumers via IP networks and the internet. Entertainment and information services are already being delivered across a wide variety of platforms, which may not necessarily be within the control of, or linked to, the consumer's telephony provider, including delivery to the TV via the set top box, to the games console via the internet, and to the mobile phone via third-party content and applications providers.

At the same time, many players in the content and entertainment world are stretching beyond their traditional places in the value-chain, in the search for additional revenue and control of the customer relationship. Device manufacturer Apple has become the world's most influential distributor of digital content. Internet search provider Google is offering everything from free information services to IP-based voice telephony.

The relationship between the consumer and the communications services provider is being displaced by these new players. While this is a threat to PRS services, it also creates potential new opportunities for those PRS providers who are flexible enough to develop new partnerships and consider alternative business models.

*Greater availability of free information and content is displacing paid-for options and limiting PRS growth*

The trend towards **greater availability of free information and content** is continuing, with significant implications for the future of the PRS market. There is significant growth in the creation and availability of user-generated content (the creation of which is of growing interest for users of social networks and other consumers of internet video).

Ad-subsidised and sponsored or promotional content is increasingly accessible on fixed and mobile platforms, and competes with paid-for offerings which are offered via PRS. Such content may range from ad-subsidised Directory enquiries to promotional mobile apps developed by companies looking to build brands or to pull users in initially with the ultimate goal of moving them onto paid-for services.

As discussed above, the growing availability of free content is a major factor in the declining revenue from both Information services and Adult content services. For Adult services, industry sources explain that user-generated free content is a major competitor to paid-for content. The growing prevalence of "Adult 2.0" – including adult "tube" sites (which offer access to user-created adult video and images) – is reducing consumer willingness to use phone-paid adult content. For Information services, the ability to "just Google" any business with an internet presence is now displacing not only Directory enquiries calls from the home, but also those made on the move, as growing numbers of mobile subscribers take advantage of smartphone capabilities and mobile data plans.

The proliferation of free mobile content and applications, rather than via charging the consumer directly, is impacting consumer perception of value and limiting what consumers are prepared to pay for; however, content and service providers still need to monetise their offerings. Striking a balance between the interests of consumers and providers, **"freemium"** application business models are becoming more prevalent on the mobile as well as the online platform, particularly for game applications. Freemium games allow the user free access to basic content, but charge for premium services, be they access to additional levels within the game, or content, such as virtual gifts, accessories, weapons and power-ups. While these premium services are normally billed in-app, the requirement for micropayments (especially in the mobile environment) potentially offers new opportunities for phone payments. At present, however, most apps bill via non-PRS payment mechanisms, for example credit/debit cards, PayPal and, increasingly, virtual currencies.

*Smartphones are becoming more prevalent, enabling both mobile internet access and the use of mobile applications*

As **smartphones** become more prevalent among consumers, the ability to access Entertainment and other Information services directly, using mobile data services, is displacing opportunities for traditional phone-paid services, while potentially also creating new opportunities for PRS service providers.

The availability of **devices with enhanced connectivity**, and more effective User Interfaces and Operating Systems is increasing, enabling more sophisticated mobile content and applications and increasing the size of the addressable market. Flat-rate data plans and sender-pays schemes are reducing the cost of using paid-for mobile Entertainment services for consumers.

**App stores** have significantly altered the landscape for paid-for content and services, affecting the business models for content providers and other players in the market, and impacting the way services are monetised and billed. Apple has led the way with its iTunes store, which moved from online to mobile with great success as the sole source of applications for the popular iPhone, and is now being extended to offer applications for the iPad. Many of these applications are free, either because they are being offered to consumers for marketing purposes, because they are ad-subsidised, or because they are gateways to "hook" users into an app with the goal of then up-selling them with in-app virtual goods or premium game levels and the like.

Initially, many app stores were looking to mobile operators to provide the billing for app purchases, creating phone-paid service opportunities, but there is an increasing shift to alternative payment mechanisms within the mobile app environment.

*Social networks are becoming a central feature of consumer entertainment and information sharing and may significantly impact PRS opportunities*

Consumption of entertainment services (and discovery of information, content and applications in general) is increasingly centred on **social networks**, which are creating new addressable markets for social games and applications that could present growth opportunities for PRS, if the right partnerships are developed. However, at present, social network services are primarily monetised by non-phone-paid payment mechanisms, including credit/debit cards, PayPal and, increasingly, **virtual currencies**. The consumer survey revealed that on average 9.5% of survey respondents had purchased one or more items of digital content through phone paid mechanisms over the past six months, whilst in a social network.

For service providers, social networks are offering a **new marketing channel**. Premium rate services are now being advertised on social networks such as Facebook, MySpace and Twitter, with some positive results, particularly for certain categories such as virtual gifts. Along with direct advertising, the marketing agencies who work with PRS service providers have opened up opportunities for viral marketing.

*Consumers have an ever-widening range of payment options for content and entertainment services*

Payment processes and mechanisms continue to fragment across platforms, as a result of **consumer preference for choice** and as **new players enter the market** seeking to differentiate their propositions. While phone-paid services benefited from something of a first mover advantage as a payment mechanism for digital content, the spread of new platforms and the development of new business models for the provision of digital goods and services are resulting in an increasingly diverse marketplace.

**Virtual currencies** and "credits" are also becoming a more established means of making micropayments within certain types of online, mobile and gaming environments. Virtual currencies have long been employed within the online gaming space as a convenient solution for consumers and an inexpensive way for service providers to monetise small items of content, by cutting out the credit card companies in particular. They are increasingly being employed by social networks and other large online communities to support transactions within applications hosted by and for the social network. Leading social network Facebook recently launched its own virtual currency

intended for use across the multitude of popular social games and other applications which it hosts.

Virtual currency purchases potentially create new opportunities for phone-paid billing, at least at the point where the consumer purchases the virtual currency itself, as well as competing with PRS billing. Many of these services are however, currently being monetised by non-phone-paid payment mechanisms.

***Discovery and perception of phone-paid services***

As part of this year's study, Analysys Mason surveyed consumers about how they discover, and perceive, phone-paid services.

In terms of discovery, **adverts on TV or radio** were the most likely means for consumers to discover a given phone-paid service. 47.3% of respondents who had purchased a phone-paid service stated that a TV or radio advert had been their call to action.

However, new platforms are becoming an important means of discovery for certain types of phone-paid services. **Web advertising** was cited as the most common discovery mechanism for three individual service types: phone-paid flirt/date/chat services, phone-paid music/video services and phone-paid virtual gifts. Web advertising plays an important role for discovery of all types of PRS services – it was among the top three discovery mechanisms for PRS overall.

**Mobile application stores** are a relatively new advertising mechanism for PRS and offer a variety of discovery options. PRS may be advertised directly within the mobile app store. Alternatively, the user may find an advertisement for a PRS within an app that they have purchased from an app store. Thirdly, the user may discover a PRS related to an app which they have already purchased, for example, an opportunity to purchase virtual currency. Mobile application stores were the most common discovery mechanism for phone-paid games. Mobile app stores ranked either second or third among discovery mechanisms for four other individual phone-paid service types: phone-paid adult content, music/video services, virtual gifts and personalisation services.

**QR codes** are another emerging means of discovering PRS services. QR codes are two-dimensional barcodes which are used as a call-to-action by advertisers, who invite consumers to "read" the code via a cameraphone, after which it is processed by an application which provides access to a particular service, coupon or piece of digital content. They are widely used for consumer advertising in Japan, but are a relatively new concept in the UK. Once QR codes become more established, we anticipate that they will be a growth driver for a range of real-world and virtual purchases, particularly if payment providers can successfully integrate a (phone-paid) purchase option.

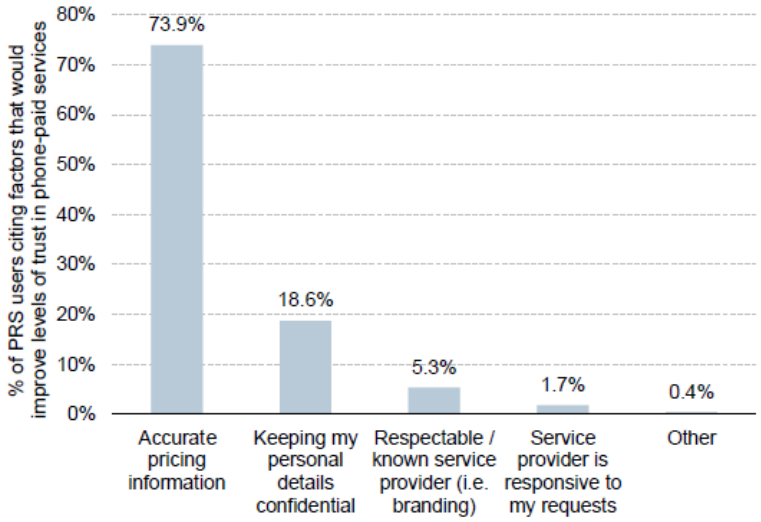
**Social networks are offering a new discovery and advertising channel for PRS**. Premium rate services are increasingly being marketed on social networks such as Facebook, MySpace and Twitter. 4.3% of PRS users we surveyed had discovered the phone-paid services that they used in the past six months via a social network or internet forum, although for some phone-paid services, such as virtual gifts, the proportion was significantly higher (13.7%).

***Consumer perspectives on phone-paid services***

For users of phone-paid services, accurate pricing information is the single most important factor that will help to improve trust, with just under three quarters (73.9%) of phone-paid service users citing this as a factor.

Privacy issues were also seen as important to respondents, with 18.6% of respondents believing "keeping my personal details confidential" would improve their levels of trust in phone-paid services.

This figure shows factors that would help improve the level of trust users have in phone-paid services.




Around half of phone-paid service users (45%-55% depending on the specific PRS service type) believed that their current PRS usage level would stay the same over the coming year. Across the board, however, more consumers believed their usage would decrease than believed it would increase, over the coming 12 months:

- This difference was especially marked for Mobile personalisation services (16.2% difference in favour of decreasing usage), Competitions/quizzes (12.3% difference) and Call services (12% difference).

- Non-phone content, Charity donations, music/TV/video services, and Tarot services had the most equal ratio of users believing their usage would decrease and those that believed it would increase, indicating the most stable usage levels.

- **"Lack of interest"** was the most common reason cited by consumers for non-usage of phone-paid services. The fact that mobile applications have seen significant traction in the past 12-18 months, however, suggests that there may be potential for further growth in phone-paid services if the services are able to

offer the same information or entertainment content as mobile applications (or indeed serve as billing mechanisms for mobile applications), at a similar price point.

- **Cost** is also a deciding factor: 28.3% of non-users cited cost as a reason for not using phone-paid services.

***Outlook for 2011***

The micropayments ecosystem (of which PRS is a part) is evolving rapidly. Premium rate services are subject to competitive pressure from a growing number of sources. The trend towards greater availability of free information and content, the wide range of payment options now available to content providers and consumers, and the high revenue-share payments from PRS content providers to the service providers (notably mobile operators) are all dampening the growth prospects for PRS in the UK.

This year's study has, however, provided some compelling evidence that the PRS industry is moving in the right direction. Most industry stakeholders interviewed as part of the study agreed that regulation introduced in the last couple of years in the UK has helped "clean up" the PRS industry and improved its functioning.

This is reinforced by the findings from the consumer research: only 3% of current phone-paid service users cited "lack of trust of the companies offering these services" as the reason they weren't interested in using additional types of phone-paid services. This compares favourably with the 2009 survey, in which 4% of *non-users* of PRS cited their reason for non-use as a lack of trust in the companies advertising PRS; and with a figure from the 2008 Market Review which showed that, on average, 20% of non-users of any given PRS service cited lack of trust in *the service* as a reason for not using it. This suggests that there has been a significant reduction in the prevalence of issues caused by less scrupulous PRS providers.

The research has also identified a number of potential growth areas for PRS, notably around social media and mobile applications. For example, Virtual goods purchases may offer new growth opportunities for PRS services providers, as could billing opportunities for mobile applications and purchases within applications.

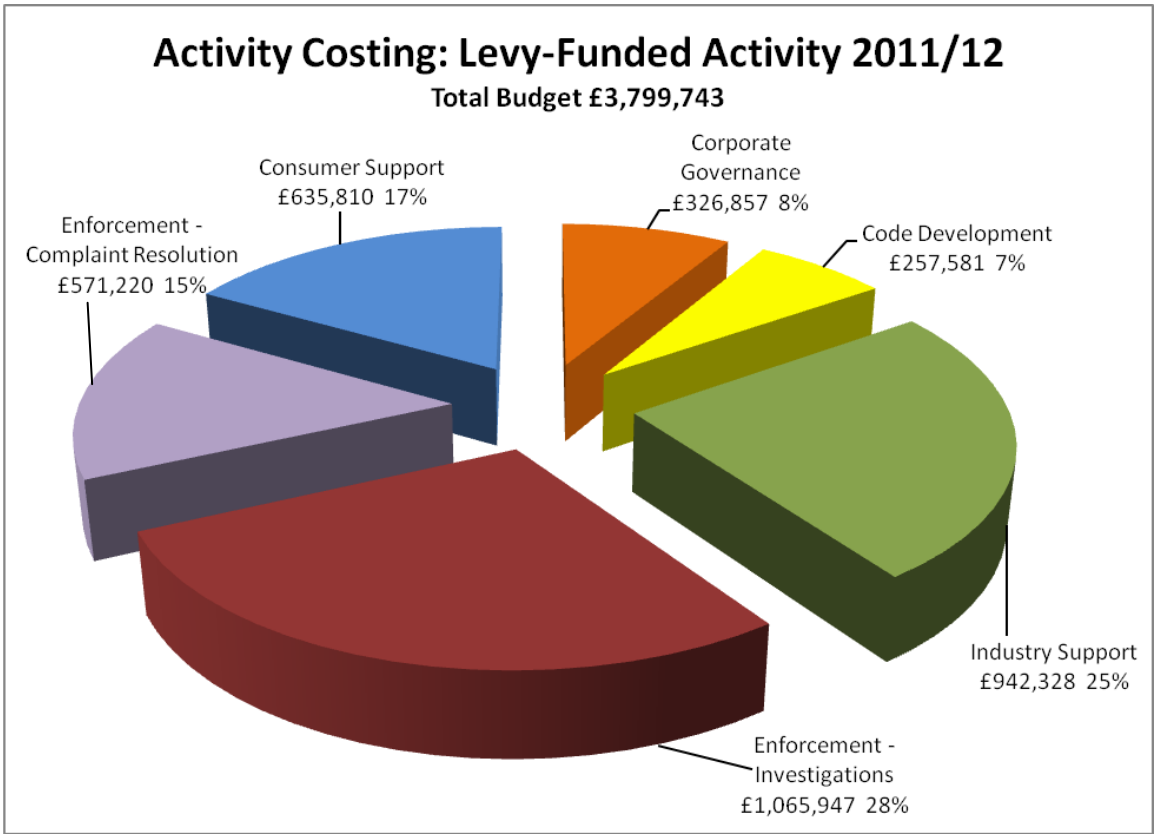
However, PRS providers must be adaptable in considering new partnering and revenue-share models if they wish to make the most of these opportunities, and should work proactively with mobile operators in particular to demonstrate the benefits of a more flexible approach in targeting these new markets. Industry stakeholder interviews suggest that communications providers (and mobile operators, in particular) are reviewing their current revenue-share agreements with PRS service providers and that these may become more favourable to PRS providers in the course of the coming year. Along with improving revenue-share agreements, exploring new partnerships and alternative business models will be a key element of any successful PRS growth market strategy.

**Appendix A – Summary Budget of levy-funded activity (excl. Registration Scheme)**

**Table of Expenditure 2011/12**

| | **Budget 2011/12 £** | | **Budget 2010/11 £** | | **Variance (Inc) / Dec** | **% Change** |
|---|---|---|---|---|---|---|
| | | | | | | |
| Staff (note 1) | **2,366,891** | | 2,512,578 | | 145,687 | -5.8% |
| Communications (note 2) | **138,150** | | 115,000 | | (23,150) | 20.1% |
| External expertise (note 3) | **155,000** | | 159,938 | | 4,938 | -3.1% |
| Legal (note 4) | **97,000** | | 155,000 | | 58,000 | -37.4% |
| Intelligence (note 5) | **150,000** | | 170,000 | | 20,000 | -11.8% |
| External audit (note 6) | **17,750** | | 36,140 | | 18,390 | -50.9% |
| Overheads (note 7) | **290,375** | | 316,149 | | 25,774 | -8.2% |
| Premises (note 8) | **325,433** | | 412,191 | | 86,759 | -21.0% |
| Publications (note 9) | **11,315** | | 43,000 | | 31,685 | -73.7% |
| Telecoms (note 10) | **43,463** | | 69,072 | | 25,609 | -37.1% |
| Website (note 11) | **51,000** | | 82,000 | | 31,000 | -37.8% |
| Depreciation (note 12) | **153,367** | | 150,781 | | (2,586) | 1.7% |
| | | | | | | |
| TOTAL | **3,799,743** | | 4,221,850 | | 422,107 | -10.0% |
| | | | | | | |

This levy-funded activity expenditure budget is presented in traditional accounting style to allow stakeholders to compare proposed spending in 2011/12 with previous years. The presentation by function below splits these costs proportionately to the different activities PhonepayPlus carries out.




Notes:

1. PhonepayPlus is consulting with staff on a headcount reduction from 50.3 FTEs to 44.8 FTEs for 2011/12. This restructuring is scheduled to be completed by 31 May.

2. Increase reflects restructuring of Communications budget and funds set aside to ensure successful communications campaign for the new Code of Practice and Registration Scheme. This heading was previously called Events, but has been changed to better reflect the actual activity.

3. This budget allows PhonepayPlus to bring in external expertise when needed, which keeps overall costs down by not requiring full-time specialists on staff. This also includes a provision to undertake expert external monitoring of the market. This heading was previously called Consultants, but has been changed to better reflect the actual activity.

4. The reduction reflects the expectation that we will use less external legal resource now the new Code of Practice is nearing completion.

5. This is primarily a cash reduction in the amount available for external market intelligence and research work. This heading was previously called Research, but has been changed to better reflect the actual activity.

6. We have allowed for less activity in external auditing for 2011/12. This heading was previously called Other, but has been changed to better reflect the actual activity.

7. Every non-staff budget has been scrutinised in an attempt to identify savings in necessary overheads, such as energy costs and stationery.

8. Reduction reflects successful renegotiation of lease on current premises.

9. Reduction reflects shift from printed publications to online documents, with the exceptions of the Annual Report and the Code of Practice where there will be limited print runs. This heading was previously called Printing, but has been changed to better reflect the actual activity.

10. This reduction reflects successful procurement of a more cost-effective supplier combined with a reconfiguration of our needs.

11. This reduction reflects planned changes to the hosting and management of the website.

12. This budget line reflects the need to properly account for and depreciate capital assets.

## Appendix B – Notes of the ILP meeting of 14 December 2010

**Present:**
Hamish MacLeod – MBG (Chair)
Jeremy Flynn – AIME
Anne Hoitink – Ofcom
Nik Hole – The Number
Justin Hornby – UKCTA
Andy Martin – FCS on behalf of Jacqui Brookes
Miranda Roberts – MEF

**PhonepayPlus**
Sir Alistair Graham
Paul Whiteing
Bradley Brady
Joanne Prowse
John O'Reilly– (minutes)
Stephanie Ratcliffe

**Apologies:**
Paul Berney – MMA
Suhail Bhat – MEF
Jacqui Brookes – FCS
Shawn Brown – MDA
Natalie Christian – BBC
Ann Cook – ITV
Suzanne Gillies – PRA
Jeremy Hallsworth – BT Agile Media
Mark Hawkins – MDA
Jeff Loan – Ofcom
Rory Maguire – H3G, MBG commercial
Marianne Pendray – ITV
Neil Pepin – Channel 4
Hannibal Latuff – BBC
Ritu Manhas - Ofcom
Graham Pottie – BT
Michael Traynor - BT
Wendy Ward – BT Agile Media

**Welcome:**

Hamish MacLeod welcomed representatives to the meeting and apologies were noted.

**1.0 Presentation on Business Plan and Budget 2011/12**

Paul Whiteing presented an overview of the PhonepayPlus Business Plan and Budget for 2011/12 and its driving principles. The significance of the coming year was expressed, with core challenges being overcome through the application of PhonepayPlus' (PpP's) core values in delivering a new regulatory regime over the coming three years.

PpP values were highlighted as critical in reducing the cost of effective regulation and guiding practices and processes.

The addition of '*collaborative'* to PpP core values has changed the regulator's relationship with the industry for the benefit of all parties, whilst *'independent'* remains a crucial linchpin of the regulatory framework.

Moving forward, the addition of two new PpP principles was highlighted:

- Efficiency
- Transparency

**2010: The Journey Towards A New Regulatory Regime**

Paul Whiteing highlighted the excellent cooperation and dialogue between the industry and PpP in the run-up to the era of the new Code and registration scheme.

Significant work has been undertaken and substantial changes made to complaints and their investigation. The establishment of the complaint resolution team, in resolving examples of lower-level consumer harm, has enabled more efficient and informal resolutions to be reached.

Industry engagement has lead to greater improvements in industry relations. The benefit of the ILP as a forum for market intelligence will furthermore enable the industry and PpP to work together and face day-to-day issues arising in the market.

The journey has furthermore led to a review of processes, updates as well as improvements to KPIs to enable the implementation of a successful three-year plan.

**2011: The New Regulatory Regime**

The launch and implementation of the new Code, supported by guidance, and aided by the registration scheme.

A pre-emptive and collaborative approach, which will encompass effective monitoring and service-testing, will allow intelligence to be shared with the industry and 'lessons learnt'. Costs may be further reduced by intelligence sharing of values and methods of best practice with similar bodies. Business processes will be examined and structural changes implemented to increase efficiency and effective regulation, within the context of the proposed reduced budget.

**Externalities & The PRS Market**

Quarterly information indicates the CPRS market to be in the region of £800 million for 2010-11. This figure refers to the retail value of the market, not outpayments. Further research will highlight the main driving forces and forthcoming changes to the market.

The VAT increase and subsequent consequences for providers were noted.

The growth in popularity of Smartphones, with an estimated 20% of adults possessing a Smartphone, presents an exciting new area for development and opportunity.

Another potential area for success in the PRS market lies with social media. Despite many opinions and suggestions expressed, social media is yet to be successfully monetised within PRS.

Methods of direct billing and new, smarter forms of billing are on the horizon. An in-depth understanding of micropayments, their scope and implications for the industry is still required to better understand the potential opportunities and threats.

**Budget & Reserves**

The following points were noted:-

- The proposal to reduce the budget by 13.2% in real terms (10% reduction in cash terms) and to continue trajectory of reduction and efficiency savings.
- A budget reduction to £3.7million for 2011/12 in comparison to £4.2 million in 2010/11.

- A 20% reduction in real terms costs since 2008/9, by the end of 2011/12.
- Registration Scheme costs are not included in the above proposal but are funded separately initially through existing reserves. The Scheme will be self funding overtime through the annual registration fee, with any surplus costs being returned to the industry.

**The Levy**

The rate at which the levy is set is affected by market size. The headline levy, representing the real cost of regulation, is forecast at 0.60% for 2011/12. Based on current projections, the discounted levy charged to industry (once income such as fines is taken into account) is expected to be between 0.28% and 0.35%.

The importance of the spike fund and reserves as well as the requirement to ensure these are readily available was discussed; should an emergency arise or where under certain circumstances the organisation would need to be wound-up.

The Executive advised that a more detailed explanation of administrative fees and fine split is illustrated in the published quarterly reports. These fees contribute to enforcement activity and partially cover the overhead investigation and Tribunal costs spent on investigating cases. The latest report showed that £214k is due in the recovery of administration charges as of the month-end date 31/12/2010.

Following Ofcom's approval of the budget, a better idea of levy setting will be obtained. The levy setting is expected to be finalised in March 2011 and further communication with the ILP will follow.

Paul Whiteing explained the proposed activities and cuts to be taken in 2011:-

1. Consumer Support

- Proposed budget decrease by 20% from previous year (from £798K to £636K).
- Contacts stabilisation and a decrease in complaints.
- Improvements in efficiency and processes made through the integration of consumer support and complaint resolution teams.
- Consumer literacy program – working groups and campaigns such as Number Checker and PhoneBrain to be launched, with a proposed 2% of the budget (£75K). The request was noted for PhoneBrain to remain within the PRS brief; to continue to focus on children and their use of PRS rather than move into the realm of online security.

The Executive confirmed action is being taken to establish links and relationships with other consumer institutions, such as CAB/moneysavingexpert.com to further assist in consumer awareness.

2. Industry Support & Intelligence

- Proposed budget increase of 8% (from £874K to £942K).
- New sanctions guide to be published for improved understanding of investigation processes.
- New regulatory regime is expected to breed further demand for industry affair resources, including compliance advice.
- Intelligence research to be evidence-based
- Intelligence monitoring and testing to evidence and raise compliance standards within the market.

The Executive agreed with the suggestion that further cost saving measures might be identified through increased collaboration and engagement with commercial and regulatory issues with parties across the value-chain.

Jeremy Flynn made note of AIME concerns around qualitative research and its cost to PpP. The Executive highlighted the continuous improvements of in-house monitoring and intelligence gathering which should ultimately reduce the reliance on external researchers.

The importance of PpP's independence was stressed, but it was still felt to be important that methods of sharing intelligence with the industry were explored, with these to be further facilitated by the new Code.

3. Regulatory Enforcement and Resolution

- Proposed budget will increase to £1.66m, but now including the new complaint resolution team. These costs will, in part, be recoverable
- Budget further split into formal procedures and informal resolutions.
- Improved pursuance of core values to pre-empt and prevent harm in the market, allowing industry relations to develop.

4. Code Compliance & Development

- Proposed budget decrease by 55% (from £575K to £258K), with most of the development costs already absorbed in 2010.
- Launch and implementation of the new Code and registration scheme with sufficient resources in hand to deal with daily operations.

5. Governance & Corporate

- Proposed budget decrease by 26% (from £442K to £327K).
- Improved drive to find greater efficiencies across all levels; overheads; freeze in staff wages and recruitment.
- Further streamlining and savings for IT, broadband and telecom provisions, improved contractual arrangements and review of third party suppliers.

The ILP noted that savings have been made across the organisation - from negotiation of lease, to efficiencies in business systems, with the Board making significant contribution to cost savings.

**2.0 Discussion on Business Plan and ILP Proposals**

Paul Whiteing advised the ILP of the joint understanding to seek ways to reduce costs, identify savings. Any further changes and restructuring to further reduce costs will be announced to the ILP.

Discussion followed, including additional factors to consider:-

- Improvements on pricing transparency through the current Ofcom review.
- Impact of the new Code and Registration Scheme along with confirmation of the annual registration fee.
- Recommendations made for consumer literacy projects and approach to industry research.
- Any potential changes to the overall staff structure of PpP are yet to be finalised.
- The accuracy of the estimated market size of £800million will need to be confirmed, with the budget projections factoring in a small decline in market size.
- Concerns around NGCS review, how call fees will be broken down into two parts (call and access charge), whether the result could lead to an increase in termination payment and its impact on the levy, were raised. The Executive stressed the current expectation is for out-payments to remain based on TCP outpayments, so the impact is not expected to be significant.
- The introduction of new number ranges into PRS and its potential to bring about new developments in the industry remains open for discussion.

- Registration Scheme costs and charges applicable to the industry; the exact figure is under review. However, once confirmed, total costs will be published with clarity and transparency. It is believed the benefit of the scheme will become apparent over the forthcoming years and will result in further cost savings.
- The MBG noted that the £115k spent on communications, external expertise and support still looked high. PpP advised this cost heading covered a number of communications related activities, including the need to run an extensive communications campaign for the new Code and Registration Scheme in 2011/12.

The ILP noted that the individual costs of the budget were well explained, however requested further clarity as to whether the total burden of costs to the industry, including registration, would be greater or lesser in 2011. The Executive confirmed these costs would be circulated as soon as figures had been calculated and confirmed.

The ILP members welcomed the business plan and budget 2011/12 presentation, were supportive of its recommendations and commended its detail and clarity.

## Appendix C – List of Respondents

PhonepayPlus' consultation on its proposed 2011/2012 Annual Plan & Budget generated the following responses:

Association for Interactive Media & Entertainment (AIME) (Trade association)

British Telecom (BT) (Industry stakeholder)

Mobile Broadband Group (MBG) (Trade association)

Premium Rate Association (PRA) (Industry stakeholder)