



National Audit Office

Report

by the Comptroller
and Auditor General

BBC

The BBC's commercial
activities: a landscape review

Key facts

4

main commercial subsidiaries in the BBC Group, as at December 2017

£1.2bn

revenue generated from the BBC's commercial activities in 2016-17

£312m

total dividend paid from 2012-13 to 2016-17 by BBC Commercial Holdings to the BBC Group for use on public service broadcasting

4,900

staff employed by the BBC's main commercial subsidiaries in April 2017

16

countries in which the BBC has registered subsidiaries

110

subsidiaries owned by the BBC and undertaking commercial activities, as at July 2017, including the four main subsidiaries

£450 million

in financial contributions by BBC Worldwide to programmes shown on the BBC's public service broadcasting channels and services between 2012-13 and 2016-17 (in addition to dividend payments)

1 April 2017

was the date on which BBC Studios became a commercial subsidiary of the BBC, having previously been a division of its public service broadcasting operations

1 April 2018

is the planned date on which BBC Studios and BBC Worldwide will merge to create a new commercial entity, also to be called BBC Studios

Summary

1 This report is about the commercial activities of the BBC. The BBC's Royal Charter permits it to undertake commercial activities, provided these activities fit with its mission and public purposes, are not funded through licence fee income, and are undertaken with a view to generating a profit.

2 The BBC cannot undertake commercial activities directly, but must do so through commercial subsidiaries. In 2017-18, the BBC has four main commercial subsidiaries of varying size and complexity to manage its commercial activities:

- BBC Worldwide (Worldwide) accounted for approximately 90% of the BBC's commercial revenue in 2016-17, mainly from the sale and distribution of TV content and formats internationally and in the UK. In 2016-17, it generated the largest turnover of any UK media distribution company.
- BBC Studios (Studios), the BBC's newest commercial subsidiary, established as a company in April 2017, creates and produces content, principally TV programmes, for the BBC and other clients.
- BBC Global News (Global News) provides English-language news services overseas via the BBC World News TV channel and the BBC's international website, BBC.com.
- BBC Studioworks (Studioworks) provides TV production facilities, equipment and crews, and post-production services for the BBC and other clients, with bases in Elstree and London's White City.

3 In November 2017, the BBC announced that it intended to merge Worldwide and Studios from 1 April 2018. This will create a new commercial entity, to be called BBC Studios, which will unite the BBC's commercial production and distribution arms as is the case among many of its competitors. As at February 2018, the merger was still subject to regulatory review. Throughout this report, all references to Studios refer to the subsidiary that was established in April 2017 unless otherwise stated.

Scope and approach

4 Under the BBC's December 2016 Royal Charter, we were granted access for the purposes of audit to the BBC's commercial activities for the first time, starting in April 2017. This report, our first on this subject, examines:

- how the BBC's commercial activities are organised, overseen and regulated;
- how the activities have fared in terms of their commercial performance and contribution to the BBC's public purposes; and
- how the BBC is responding to the opportunities and challenges its commercial activities face.

5 This report is a landscape review. We have not, therefore, drawn a value-for-money conclusion, but have made concluding remarks about some of the important issues the BBC needs to focus on in future.

Key findings

Scope and set-up of the commercial activities

6 The BBC has been undertaking commercial activities for a long time, but these activities have become increasingly important to its overall strategy. The BBC incorporated BBC Enterprises Limited, the forerunner of Worldwide, in 1979, with a focus on selling finished BBC programmes to other countries. Since then, the BBC's commercial activities have expanded considerably so that they now operate at significant scale. The commercial activities generated revenue of £1.2 billion in 2016-17, and employed 4,900 staff in April 2017.¹ The most recent major expansion in the BBC's commercial activities, in April 2017, occurred when the BBC moved a large part of its public service broadcasting (PSB) production operations into a new company, BBC Studios. The BBC's latest overall strategy identifies several of the commercial activities as fundamental to the BBC's overall future vision and ambitions (paragraphs 1.4, 1.5 and 3.6).

7 Including its four main subsidiaries, at July 2017 the BBC had 110 subsidiaries of different types undertaking commercial activities, with Worldwide accounting for 93 of these. We have not examined the specific purpose of all the BBC's subsidiaries. However, a large number exist to facilitate commercial operations in financial, legal and regulatory ways that are normal for international media organisations. At a high level, we found the number of BBC companies to be in line with other international media groups operating in the UK, with the number falling by 23% since March 2012. For management purposes, the four main subsidiaries are run as individual consolidated businesses, irrespective of the number of subsidiaries they contain (paragraphs 1.8 and 1.9).

¹ The figure of £1.2 billion is distinct from the BBC's 2016-17 licence fee income of £3.8 billion, which it received to fund its public service broadcasting operations. The figure excludes the costs incurred by the commercial activities and relates to a period before the creation of Studios as a commercial company in April 2017.

8 Since April 2017, the BBC has made significant changes to the structure and oversight of its commercial activities, the full implications of which will take time to become apparent. Under the new Charter, responsibility for overseeing the BBC's commercial activities now rests with the new BBC Board. Between the BBC Board and the main subsidiaries, a holding company exists, BBC Commercial Holdings (Commercial Holdings), which now plays an important role in governance and oversight. In October 2017, the BBC expanded the membership of the Commercial Holdings Board, appointing non-executive members to it for the first time. The BBC plans for this Board to oversee the four main subsidiaries' operations and performance at a level of detail greater than the main BBC Board can provide. Although the BBC has agreed terms of reference for the enhanced Commercial Holdings Board, it is not yet clear how the various boards will interact in practice, particularly given the planned merger of Worldwide and Studios (paragraphs 1.10 to 1.13).

9 Ofcom has replaced the BBC Trust as the BBC's regulator, with responsibility for regulating aspects of the commercial activities. A principal focus for Ofcom will be the relationship between the BBC's licence fee-funded PSB divisions and its commercial subsidiaries. Ofcom has set requirements on the BBC to ensure that the commercial activities do not, as a result of their relationship with the UK PSB divisions, distort the market or gain an unfair competitive advantage. Ofcom's new requirements include one for the BBC to notify it if any commercial line of business is not making a commercial rate of return. Ofcom also has to decide by April 2019 whether to conduct a formal regulatory review of Studios' operations. It is not yet clear how the scope of any such review might be affected by the BBC's decision to merge Studios and Worldwide (paragraphs 1.14 to 1.18).

Performance of the commercial activities

10 The BBC's main commercial subsidiaries are significant businesses in their respective markets, creating important additional value for licence fee payers. Overall, the BBC's total revenue from its commercial subsidiaries was broadly stable at more than £1.1 billion in each of the five years from 2012-13 to 2016-17. Only Worldwide made profits throughout the five years. Its profit after tax, sometimes referred to as the bottom line, was 68% lower in 2016-17 than in 2012-13, £40.4 million compared to £127.6 million. This change mainly occurred in 2016-17 when Worldwide incurred two large one-off costs: a major change in the accounting treatment for distribution rights, worth £67.9 million, and a write-off of £12.5 million following the closure of BBC Store. Both Global News and Studioworks returned to profitability in 2016-17, making a profit after tax of £0.4 million and £2.8 million respectively. Similar data are not available for Studios as it did not become a commercial company until April 2017 (paragraphs 2.1, 2.3, 2.11, 2.13, and 2.15).

11 As with any company, high-level data on revenue and profits are not a straightforward guide to the subsidiaries' performance; context is required to interpret the data. This context includes the performance of the wider markets in which each subsidiary is active and the short- and long-term effects of major strategic decisions that the subsidiaries, and the BBC as a whole, have taken. We describe some of these factors in the body of the report, but we have not set out to evaluate as part of this landscape review the quality of the BBC's management of its subsidiaries or the relative importance that different factors have had on their performance. These are subjects to which we will return in later value-for-money reports (paragraphs 2.2 and 2.14 to 2.17).

12 Between 2012-13 and 2016-17, Worldwide paid dividends of £423 million. The BBC chose to use most of this money in its PSB divisions, but retained a significant minority in the commercial part of the BBC. Worldwide was the only main subsidiary to pay a cash dividend over the last five years. Of £423 million paid since 2012-13, £312 million (74%) has been used to supplement licence fee income in the BBC's PSB divisions. Commercial Holdings retained £111 million (26%) in its own reserves. The BBC then used these reserves to lend to the main commercial subsidiaries, including Worldwide. By lending from Commercial Holdings' reserves, rather than borrowing money from external lenders, the BBC has avoided incurring interest costs. Between 2012-13 and 2016-17, Commercial Holdings' lending to Worldwide more than doubled, from £79 million to £199 million, while its own borrowing from external lenders increased by just 7% to £201 million (paragraphs 2.9, 2.21 and 2.22).

13 Alongside any dividends, each of the main subsidiaries also contributes to the BBC's public purposes:

- Worldwide's key contribution takes the form of direct payments for programmes shown on the BBC's PSB channels and other PSB services. Between 2012-13 and 2016-17, these contributions, which reduced the cost of programme-making for licence fee payers, were worth £450 million. Each year in its Annual Review, Worldwide combines these payments with dividends and a number of other payments, and describes the resulting figure as its financial return to the BBC. This metric is unique to Worldwide and is not comparable with measures of financial performance used by other commercial media companies.
- Global News has provided independent news, and sought to reflect the UK and its values of accuracy, impartiality and fairness, to citizens of other countries; it has increased its audiences considerably over the last five years, for example reaching 450 million households with the World News TV channel in 2016-17, compared to 366 million in 2012-13.
- Studioworks provides the BBC and its programme makers with studio capacity in London and the South East of England, where many of its programmes are made, as well as providing capacity to third-party companies at a time when other studios in the area have closed either temporarily or permanently.

- Still in its first year of operations, the new Studios subsidiary is intended to provide a secure basis for the BBC to continue producing distinctive output, as well as creating new intellectual property (IP) for the BBC to exploit in future through its work for the BBC and others (paragraphs 2.23 to 2.26).

14 The new BBC Board receives regular updates on the performance of the main subsidiaries against a number of standard commercial metrics, but there is scope to improve the information it receives. The BBC Board receives reports on the performance of the main commercial subsidiaries in terms of their revenue, cash flow and profitability. However, up to February 2018, the BBC has used different measures of profit for each of the subsidiaries in these reports; it told us in February that it intends to introduce a standard set of measures shortly. In its reporting to the Board, the BBC has also not made regular use of other financial indicators that businesses commonly employ to assess commercial performance, such as margin and return on capital employed. Furthermore, in recent years, BBC management has commissioned benchmarking exercises to understand more about how Worldwide and Studios compare to other businesses in their respective markets. Management has used these exercises to inform business planning, but it has not, as a matter of course, shared the findings of the exercises with the Board. The Board is able to commission its own benchmarking if it considers this to be necessary (paragraphs 2.2, 2.18 and 2.19).

Opportunities and challenges

15 Like the wider sectors in which they operate, the BBC's main subsidiaries face important opportunities, challenges and risks in the immediate future.

Audiences, particularly younger people, are increasingly accessing content digitally, including via fast-growing global subscription video on demand (SVoD) services such as Netflix. These new entrants to the market have been willing to invest large amounts in creating new programmes, particularly drama, and in acquiring distribution rights. The BBC's commercial subsidiaries have benefited from these developments in a number of ways, but both they and other companies also face increased competition and costs to secure the valuable IP that underpins the contemporary media business model. In response, Worldwide has entered into more co-productions and partnerships with other international companies, bought stakes in independent production companies, and partnered with, or established its own, small regional production businesses. These actions have the potential to deliver greater financial rewards than more traditional lines of business in the changed commercial environment in which Worldwide now operates. However, they also entail greater risks. Simultaneous with these developments, advertisers in many countries are adapting to audience behaviour by spending more of their budgets online, putting pressure on the traditional business model for running TV channels, a development that affects both Worldwide and Global News (paragraphs 3.2 to 3.5 and 3.19 to 3.24).

16 The success of the BBC's commercial activities will be critical to the BBC as a whole, and therefore to licence fee payers, in the immediate years ahead.

The recently announced merger of Worldwide and Studios may lead to changes in the detail of the BBC's future plans for its commercial activities. However, the BBC expects many of these plans to remain unchanged, including the following:

- Increasing the financial returns to the BBC from the parts of the commercial activities currently known as Worldwide. In October 2015, the BBC set Worldwide a target to deliver £1.2 billion of financial returns between 2017-18 and 2021-22, a 21% increase on the previous five years. The BBC has great flexibility over how it builds up these returns, as it has not publicly specified the proportion that it aims to take as dividend payments or the proportion that will come in the form of contributions to BBC programme costs.
- Securing the success of Studios, in terms of its ability both to continue making a wide range of content for the BBC, at a time when more PSB commissions will be subject to competitive tender, and to win commissions from other national and international broadcasters.
- Putting Global News on a sustainable financial footing, in the light of risks to some of its existing sources of revenue, including through reducing costs and, potentially, alternative sources of income for some of its operations.
- Challenging Studioworks to make the most of its expanded capacity, following the reopening of studios in White City (paragraphs 3.12, 3.16, 3.17, and 3.24 to 3.26).

Concluding remarks

17 The BBC's commercial activities are undertaken on behalf of licence fee payers and exist to create value by exploiting the significant assets that licence fee payers have paid for. It is, therefore, a matter of public interest that these activities should be subject to independent scrutiny to help the BBC optimise the value for money it delivers.

18 The BBC has created value through its commercial activities to date, both in terms of dividends and other financial returns, and in terms of the contributions that these activities have made to its overarching public purposes. Commercial activities are of growing importance to the BBC's health and success, in part as a result of the BBC's most recent funding settlement with government and in part because of wider media trends and the BBC's strategic response to those trends.

19 As we begin our work auditing this part of the BBC's operations, it is already clear to us that the BBC faces a number of important challenges and risks. We will examine some of these in greater detail in future value-for-money reports. In particular, we note the following matters:

- a Developing new BBC-owned IP to drive growth.** Owning IP, primarily in the form of TV series and formats, is the cornerstone of the modern media industry. It has recently increased in importance relative to other parts of the media business, such as owning television channels or earning commissions from the sale of distribution rights. By creating Studios and through Worldwide's investment in independent production companies, the BBC has expanded its opportunities to create new IP to exploit. But both Studios and Worldwide (and, from April 2018, the new merged organisation) will need to manage risk carefully, and foster the right creative and commercial culture, to ensure that the funds they invest have the greatest impact possible in a crowded marketplace.
- b Setting meaningful targets to drive financial performance.** In October 2015, the Director-General set Worldwide a target to deliver £1.2 billion of financial returns to the BBC from 2017-18 to 2021-22. Since then, there have been continued changes to Worldwide's operating environment, and the BBC itself has made significant changes to the scope of both its PSB and commercial activities, in particular establishing Studios as a commercial subsidiary in April 2017 and proposing the merger of Studios and Worldwide from April 2018. The BBC may now wish to consider whether its financial returns target remains relevant or whether it could be improved, given both the changes that have occurred and the flexibility that currently exists to meet the target through a combination of contributions to BBC programmes (a cost to Worldwide that may or may not turn out to be profitable) and a share of profits.
- c Striking the right balance between paying dividends to PSB and increasing investment in the commercial activities.** In the coming years, the BBC and its Board will need to keep in view the relative merits of taking higher dividend payments to alleviate immediate financial constraints in PSB, and leaving more funding with the commercial subsidiaries where there is demonstrable potential to increase the value of BBC assets longer term. To allow it to assess retrospectively the impact of its choices, the BBC will need to keep a detailed account of its rationale for the level of dividend it takes.

- d Ensuring that the Board and others charged with oversight have meaningful and consistent information about commercial subsidiaries' performance at an appropriate level of detail.** The Board is not in the same position as a shareholder, but it is vital that in future it is able to think and act like a shareholder with regard to the commercial subsidiaries whenever necessary. It will need routine access to a wide range of commonly used commercial metrics and benchmarks, such as margin and return on capital employed, that provide the right level of detail to aid good decision-making and a good understanding of risk in commercial activities. As a minimum, the level of detail will need to be sufficient to meet Ofcom's requirement that the BBC inform it when a given line of business is not making an appropriate commercial rate of return. In taking decisions about the future of the commercial activities, the BBC will always have to consider financial data alongside evidence about the contribution an activity makes to the public purposes. It is important that the financial arguments in favour of, or against, a particular decision are always established separately from public purpose considerations, as far as possible.
- e Embedding a new culture of transparency in the commercial subsidiaries.** The Royal Charter has placed a greater expectation of transparency on the BBC's commercial activities than previously, including through our new audit rights and Ofcom's new regulatory role. This is fitting, especially given the expanded importance of commercial activities to the BBC as a whole. The BBC is putting significant corporate energy into adapting to these new demands and making the necessary cultural change. The Board will want to assure itself in the coming years that, across the subsidiaries and at BBC Group level, the BBC is taking a consistent approach to transparency, in line with the spirit of the new arrangements.