



National Audit Office

Report

by the Comptroller
and Auditor General

BBC

BBC Studios

Key facts

£1.2bn

BBC's target returns
for BBC Studios for the
five years to 2021-22

£243m

BBC Studios' cash returns
to the BBC in 2018-19

£1,373m

BBC Studios' revenue
in 2018-19 as a
merged business

- 1 April 2017** date BBC Studios was established as a commercial subsidiary
- 3 April 2018** date a single entity, BBC Studios, formed from a merger of BBC Studios and BBC Worldwide, began trading
- 4** number of BBC Studios' forecast 16 top revenue-generating in-house produced shows in 2019-20 first produced after 2010
- 13.4%** BBC Studios' profit margin in 2018-19 against a target of 9%–11% (£159 million)

Summary

1 The BBC is the UK's main public service broadcaster, providing a wide range of television, radio and digital services. In 2018-19 it received £3.7 billion of public funding from television licence fees to enable it to meet its public service broadcasting (PSB) commitments. The BBC also undertakes commercial activities, such as creating and selling television programmes, that generate income for it.

2 In May 2016, the BBC brought together in-house production teams from across its PSB operations to form BBC Studios as a separate division within PSB. It then established the division as a commercial subsidiary in April 2017 to create and produce content, principally TV programmes, for itself, and, crucially, for the first time for non-BBC clients. In April 2018 the BBC created the new BBC Studios as its largest commercial subsidiary following a merger of the existing BBC Studios and BBC Worldwide, its commercial distribution business.

3 Under the BBC's December 2016 Royal Charter, we were granted access to audit the BBC's commercial activities from April 2017. Our first report in March 2018 examined the landscape of the BBC's commercial activities. In July 2018, the Committee of Public Accounts recognised that the newly created BBC Studios would be crucial to the future success of the BBC as a whole and recommended the BBC set clear expectations for, and keep the BBC Board informed of, BBC Studios' performance.

4 Before the merger, the BBC faced strategic challenges from increased competition for content and the talent needed to create this content, and from a significant change in how audiences in the UK and globally were consuming this content, moving away from watching a traditional TV set to online viewing. These market changes increased the importance of owning the underlying ideas, or intellectual property (IP), of the content produced. Ownership of IP is valuable to the BBC as there are numerous ways in which it can generate financial returns from its content, for example selling rights to show programmes overseas. Since 1990, the BBC has not owned the IP for an increasing proportion of the programmes it showed as it has been required to put production of a significant proportion of these out to tender. Consequently, it was producing fewer programmes itself and therefore owned fewer of the associated IP rights.

5 According to the BBC, BBC Studios' success in creating and commercially exploiting new content and its associated IP will be critical in helping it meet its ongoing challenges. Given this, this report examines:

- the BBC's rationale for the creation of BBC Studios (Part One);
- implementation of the merger to create the new BBC Studios (Part Two); and
- the success of BBC Studios so far (Part Three).

Key findings

The BBC's rationale for the creation of BBC Studios

6 The BBC had a clear rationale for creating BBC Studios as a global, integrated business that is better able to compete in the market, and its action was consistent with market trends. In October 2017, the BBC Board approved the merger of the former BBC Studios and BBC Worldwide to create the new BBC Studios from April 2018. The BBC's strategic rationale was for the merged company to be a creator, producer, owner and distributor of IP serving customers all over the world. The BBC expected the merger to deliver a number of non-financial benefits, such as improving BBC Studios' ability to generate high-quality content and exploit the IP associated with it through improved collaboration between production and distribution. In merging the companies, the BBC followed media market trends where its major UK competitors operate integrated production-distribution businesses. The BBC considered that it would be disadvantaged in the wider market and less efficient in its operations had it not taken this decision (Paragraphs 1.4 and 1.12 to 1.14).

Implementation of the merger to create the new BBC Studios

7 The BBC's planning meant that, by April 2018, BBC Studios had put in place the major structural building blocks for a successful merger. Both the former BBC Studios and BBC Worldwide had undergone significant changes prior to the merger which facilitated this. For example, the establishment of BBC Studios as a commercial subsidiary in April 2017 had exposed it to the requirements and culture of operating commercially, while BBC Worldwide had been undertaking its own programme to improve business performance. By the merger go-live date of 3 April 2018, the new BBC Studios had completed its planned high-level merger activity of setting out a unified vision, strategy and target organisational culture; establishing a new management structure; and appointing its senior management team. In July 2018, it wound up its merger implementation team as it considered the remaining integration tasks were operational and could be undertaken by its managers. As at November 2019, integration work was ongoing and there was still significant operational separation across the business (Paragraphs 2.2 to 2.6).

8 Delivering crucial cultural change and new ways of working that are needed to realise the merger's expected benefits has been more challenging for BBC Studios. BBC Studios considers a single organisational culture and the introduction of new ways of working for staff are crucial if it is to realise the expected benefits of the merger. An April 2019 staff survey showed there was a difference in staff engagement scores for BBC Studios' two businesses with BBC Studios Productions scoring 55% compared with 64% for BBC Studios Distribution, indicating, according to the BBC, that a cultural gap still remained between the two. Embedding cultural change in an organisation is never easy. In April 2019, BBC Studios identified that it still had some way to go towards achieving a common culture and stepped up work to align people's behaviours to the intended culture. However, its latest plan for bringing about this cultural change did not identify what remained to be done to deliver change or spell out how its proposed actions would achieve this. The plan also did not include performance indicators for assessing the extent to which it was achieving this change or a timetable for delivery (Paragraphs 2.9, 2.10, 2.12 and 2.13).

9 While implementing the merger, BBC Studios has taken several strategic decisions which help the BBC respond to market changes. The market environment has advanced considerably since April 2018. Existing content providers, such as Disney and WarnerMedia, are setting up their own subscription video-on-demand (SVoD) services, while existing SVoD providers, such as Netflix and Amazon, are increasingly commissioning their own content in genres, such as natural history, where the BBC has traditionally been strong. BBC Studios has evolved to address these changes and help the BBC implement its 'Routes to Market strategy' – its strategy for increasing the BBC's control over how its content is delivered to audiences in the UK. In line with this strategy, in June 2019, BBC Studios bought seven of 10 UKTV channels from its then partner in UKTV, Discovery, at a cost of £173 million, while the BBC itself entered into partnership with ITV for a new online UK SVoD service, BritBox. The BBC also intends to increase the length of time its programmes are available on its online iPlayer service to 12 months. The impact these developments will have on BBC Studios' ability to generate commercial returns from BBC content is as yet unclear as their introduction is still at an early stage. The BBC considers that these developments should not adversely impact on these returns (Paragraphs 2.14 to 2.17).

10 The steps BBC Studios has taken to respond to the dynamic commercial environment have shifted the nature of the risks it faces. In late March 2019, BBC Studios entered into two 10-year agreements involving the licensing of the rights to the BBC's back catalogue of natural history programmes to Discovery and a partnership arrangement to develop new natural history content for Discovery. These two deals are estimated to be worth more than £300 million in total, and aim to secure the BBC's position in the profitable global SVoD market for high-quality natural history content in the face of competitors such as Netflix. The content development partnership with Discovery represents a simplification of BBC Studios' operations and increases certainty around its future income. However, there is a risk that, over time, its partners' interests may diverge from its own. BBC Studios therefore needs to manage carefully the increasing risk profile arising from its exposure to new risks and the strategic challenges posed by the fast-developing market (Paragraphs 2.15, 2.18 and 2.19).

11 The extent to which the merger is achieving expected non-financial benefits is uncertain. The BBC expected that the non-financial benefits anticipated from the merger (paragraph 6) would result in improved financial performance on the part of the new, merged business. Although BBC Studios has monitored its financial performance, assessing delivery of non-financial benefits is more difficult due to their nature, and neither the BBC nor BBC Studios set out metrics for assessing progress in achieving these benefits in the October 2017 merger business case. As a result, the BBC and BBC Studios cannot easily identify the extent to which these non-financial benefits have been delivered, and the extent to which the merger has impacted on BBC Studios' financial performance to date (Paragraph 2.20).

The success of BBC Studios so far

12 BBC Studios' financial performance in its first year has been boosted by its branded services and the Discovery content deals in late March 2019. In 2018-19, BBC Studios' profits increased by 51% to £159 million, above the expectation in its March 2018 business plan (£143 million). Its profit margin was 13.4%, above the target margin of 9%–11% set for it by the BBC Board in December 2018. In contrast, its 2018-19 headline sales of £1,373 million were 3% lower than the previous year, and 7% lower than March 2018 expectations. Profits were particularly boosted by the natural history back catalogue deal with Discovery, and because BBC Studios' branded services (channels and digital services, such as BBC America and UKTV, that are broadcast commercially) continued to perform well. In 2017-18 and 2018-19, branded services contributed 58% and 44% of total profits respectively, significant contributions which BBC Studios expects to continue for the next three years, notwithstanding the challenges posed by the SVoD market. In contrast, in 2018-19, BBC Studios wrote down the value of its consumer products business by £21.5 million in recognition of the continuing long-term fall in DVD sales (Paragraphs 3.3 to 3.7).

13 BBC Studios is increasing its investment in new content so that it is better able to financially exploit the related IP, but has so far been less successful than planned in winning new commissions. BBC Studios' strategy for 2018-19 contained objectives focusing on IP content creation and exploitation. In March 2019, it planned to increase significantly its spend on creating and acquiring new content over the next five years, from £154 million annually to more than £200 million. It is keen to generate new formats and brands to sustain its long-term performance as only four of its forecast 16 top revenue-generating in-house produced shows in 2019-20 were first produced after 2010. However, investing in content can be highly speculative as BBC Studios is seeking to identify successful shows in advance and faces stiff competition for the creative talent behind this content. BBC Studios monitors the performance of its content investments, but the lengthy timing of associated returns means that its monitoring data often involve a combination of returns achieved to date and forecasts. To date, BBC Studios has been more successful than planned in retaining existing BBC work, for which it does not own the IP, but it has been less successful in winning new commissions from the BBC and third parties to generate the IP which it can then exploit financially. It expects significant increases in work generating new IP from 2019-20 onwards (Paragraphs 3.13 to 3.18).

14 The BBC has changed how it judges the contribution made by BBC Studios to the overall BBC organisation. In October 2015, the BBC set BBC Worldwide a target to deliver £1.2 billion of financial returns between 2017-18 and 2021-22, and now applies this target to BBC Studios following the merger. So far, returns of £453 million (38%) have been delivered, including £243 million in 2018-19, meaning that BBC Studios must deliver record returns each year to achieve the target by 2021-22. The returns measure is unique to the BBC as it combines two things – the value that BBC Studios delivers as the BBC’s main producer and distributor of content, such as upfront contributions to the financing of BBC programmes, and the value that the BBC receives as BBC Studios’ owner via dividend payments. The BBC does not report publicly on the composition of this target or of the returns delivered. This lack of disclosure and the measure’s unique nature make it difficult to assess the level of performance that the £1.2 billion target or the returns delivered represents. The BBC itself considers the measure to be a legacy metric and now focuses on sales, profit and cash flow performance when assessing BBC Studios’ contribution to the BBC as a whole (Paragraphs 3.19 to 3.21).

15 BBC Studios’ reporting to BBC boards has focused on financial performance but the BBC now plans to improve the reporting of BBC Studios’ non-financial performance. BBC Studios regularly reports to the BBC Commercial Holdings Board and main BBC Board on its financial performance. In comparison, there are gaps in its reporting of areas of non-financial performance which are key to its success. The Saul Review identified in January 2019 that key indicators for non-financial performance in areas such as customer diversification, margins and success in winning business were lacking, and should be developed. In our opinion, these gaps have meant that the boards have had insufficient oversight over key drivers of performance and the rising risk profile BBC Studios faces from increased competition and changing audience demand. In November 2019 the BBC included in its report to the BBC Commercial Holdings Board proposed measures for reporting key aspects of BBC Studios’ non-financial performance, intending to agree the final set of such measures early in 2020. These improvements should result in this Board being better placed to form a clear view on the broader value the BBC receives from BBC Studios and to challenge management effectively. However, in our opinion, there are still areas for improvement in the proposed measures (Paragraphs 3.23 to 3.26).

16 The BBC has strengthened its governance overseeing BBC Studios, but we cannot yet tell how effective these changes will be. The BBC has restructured and strengthened the governance of its commercial activities to take account of the merger. For example, in September 2017 it expanded the membership and remit of its Commercial Holdings Board, and, in April 2019, increased the number of non-executive members on this Board from two to four, with one of them becoming its chair. In September 2019, it amended relevant terms of reference to reflect the roles of the main BBC Board, BBC Commercial Holdings Board and the Commercial Group strategy sub-committee of the executive team in reviewing and approving the strategic objectives of the commercial subsidiaries, including BBC Studios. However, it is too early to tell how effective the changes to terms of reference and the April 2019 improvements to governance will be in practice (Paragraphs 3.27 to 3.29).

Conclusion on value for money

17 The April 2018 merger of the BBC's production and distribution businesses to create the new BBC Studios was supported by a clear strategic rationale and the BBC planned well to get the merger off to a good start. However, it is still too early to tell if the merger is delivering sustainable value for money as delivering the associated changes in organisational culture takes time. BBC Studios still has work to do to align the differing cultures and processes in its production and distribution arms, but lacks performance indicators for assessing the extent to which it is achieving this alignment. Also, the BBC and BBC Studios cannot easily identify the extent to which the non-financial benefits expected from the merger have been delivered, and the extent to which the merger has impacted on BBC Studios' financial performance to date.

18 In its first full year, 2018-19, BBC Studios met the overall profitability target set for it by the BBC Board, despite lower than expected sales. Beneath this top-level performance, it faces wide differences in profitability within business areas, and its continued profitability remains dependent on parts of its business performing well. Faced with a highly dynamic and competitive market for ownership of intellectual property (IP), from which it can generate profitability and returns to the BBC, BBC Studios faces a rising risk profile in its business. It is therefore crucial that the oversight of the BBC Board and the BBC Commercial Holdings Board is informed by a sound understanding of where weaknesses lie across BBC Studios' full range of activities. This includes clarity about the extent to which BBC Studios is winning new business and generating valuable IP against its plans, and how far its investments, particularly in some of the new, more complex deals, are leading to sustainable margins and returns. Since April 2019, the BBC has strengthened governance over BBC Studios and taken steps in November 2019 to improve reporting of BBC Studios' performance to the BBC Commercial Holdings Board. However, it is too early to tell how effective these changes will be in practice, and there is still scope for improving the reporting to the Board of BBC Studios' non-financial performance.

Recommendations

19 The BBC should:

- a** **develop a clear plan for closing the cultural gap between the production and distribution arms of BBC Studios**, including milestones and indicators for measuring its progress in achieving this.
- b** **review the effectiveness of recent improvements to governance over BBC Studios**, including whether the September 2019 changes to relevant terms of references have successfully clarified the respective roles of the main BBC Board, BBC Commercial Holdings Board and the Commercial Group strategy sub-committee in setting BBC Studios' strategic objectives and the BBC's commercial strategy, and in holding the BBC and BBC Studios to account for the delivery of these.

- c finalise the performance indicators for the regular reporting to the BBC's boards of BBC Studios' non-financial performance in early 2020** as planned, while ensuring that this set includes adequate measures to enable board monitoring of:
- BBC Studios' performance in winning new work and creating new IP against what it expected;
 - the size and strength of BBC Studios' content delivery pipeline;
 - the management of significant risks to BBC Studios achieving sustainable margins and returns; and
 - BBC Studios' management of its staff, development of organisational capacity and delivery of cultural change.