



National Audit Office

Report

by the Comptroller
and Auditor General

BBC

BBC Studios

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Gareth Davies
Comptroller and Auditor General
National Audit Office

18 December 2019

This report examines whether the BBC is well placed to realise the strategic objectives of its commercial activities, following the integration of its commercial production and distribution businesses to create a new company called BBC Studios.

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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.

Part One

The rationale for the creation of BBC Studios

1.1 The BBC is the UK's main public service broadcaster and is responsible for serving audiences with impartial, high-quality, distinctive services that inform, educate and entertain. Its total income in 2018-19 was £4.9 billion, of which £3.7 billion was derived from the television licence fee. The BBC uses its funding to meet its public service broadcasting (PSB) commitments and deliver a range of television, radio and digital services in the UK and internationally.

1.2 The basis of the BBC's activities is a Royal Charter establishing its independence, primary mission and public purposes. The Charter also permits the BBC to undertake commercial activities through commercial subsidiaries, provided these activities:

- fit the BBC's mission and public purposes;
- are not funded through licence fee income; and
- are undertaken with a view to generating profit.

1.3 The BBC's commercial activities include creating and selling television programmes and formats (known as 'content') internationally, providing English-language news services overseas, and offering studio and post-production facilities, equipment and crew for hire in the UK. In 2018-19, these commercial activities generated income of approximately £1.4 billion.

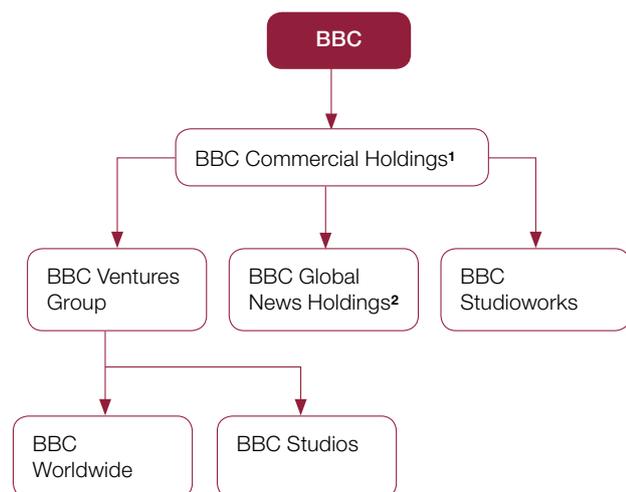
The merger of BBC Studios and BBC Worldwide

1.4 In April 2018, the BBC created its largest commercial subsidiary by merging its commercial production business, the former BBC Studios, with its commercial distribution business, BBC Worldwide. Although these two companies remain as separate legal entities for administrative purposes, with the former BBC Studios renamed as BBC Studios Productions, and BBC Worldwide as BBC Studios Distribution (**Figure 1**), their operation and management is integrated at the level of their parent holding company, BBC Studios Ltd. In this report, 'BBC Studios' refers to the merged entity established in April 2018, and 'the former BBC Studios' refers to the entity prior to this.

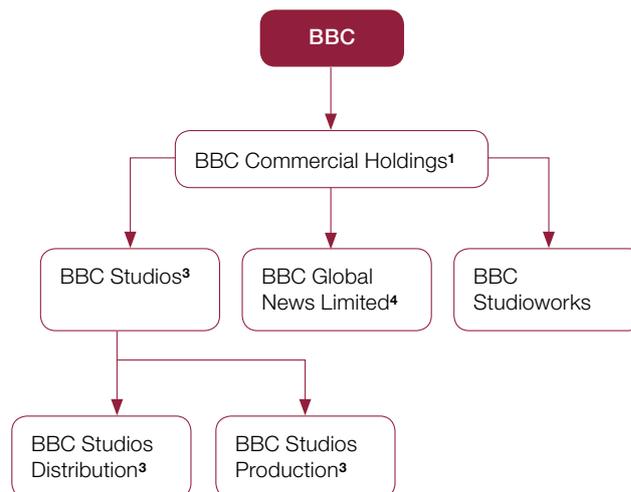
Figure 1
BBC's Commercial Group structure

The BBC amended the structure of its Commercial Group following the merger of BBC Studios and BBC Worldwide in April 2018

As at March 2018



From April 2018



Notes

- 1 BBC Commercial Holdings has two other direct subsidiaries that are not shown: BBC Store Limited and BBC Children's Productions Limited.
- 2 This was the holding company for the BBC Global News group of companies, including BBC.com Limited and BBC Global News Limited. The group is managed as a single business.
- 3 BBC Studios operates as a single entity.
- 4 BBC Global News operations were restructured at the start of 2018-19.

Source: National Audit Office analysis of BBC documents

1.5 We published a landscape review on the BBC's commercial activities in March 2018.¹ In July 2018, the Committee of Public Accounts recognised that the newly created BBC Studios would be critical to the future success of the BBC as a whole.² The Committee noted significant risks to future performance arising from changing audience behaviour and the challenges of operating in an increasingly competitive market. It recommended that the BBC should set clear performance expectations and act decisively if the new company underperformed, and that the BBC Board should be kept informed of variations in profitability within and between the new company's individual lines of business.

1 Comptroller and Auditor General, *The BBC's commercial activities: a landscape review*, Session 2017–2019, HC 721, National Audit Office, March 2018.

2 HC Committee of Public Accounts, *BBC commercial activities*, Fifty-first Report of Session 2017–2019, HC 670, July 2018.

Strategic context

1.6 The BBC faced several strategic challenges preceding the merger. Firstly, it faced increased competition for content to broadcast and exploit commercially, and for the talent behind the creation of this content. The content production and distribution markets that the BBC operated in had changed dramatically due to the rise of global, well-funded subscription video-on-demand (SVoD) providers, such as Netflix and Amazon. While these new companies offer additional income opportunities as buyers of BBC content, they are also the BBC's competitors for content and the talent behind this. Their entry into the market has been cited as a key factor for the sudden and steep inflation in content creation and talent costs in some genres such as high-end drama, which the BBC has struggled to match and which has impacted on its ability to fund and produce content that meets its public purpose obligations. Therefore, like other broadcasters, the BBC has increased its reliance on the co-funding of productions whereby other bodies contribute to the funding of these in return for a share of financial returns generated.

1.7 Secondly, there has been a significant change in how UK audiences consume content. The rise of the new global SVoD providers has prompted audiences to move away from watching linear television (that is, programmes viewed at the time of broadcast) and purchasing DVDs, traditionally a significant source of income for BBC Worldwide, towards streaming and online viewing, on demand. The percentage of people in the UK with access to an SVoD service increased from 18% in 2014 to 48% in 2018. This shift has been particularly marked for those aged 16–34, a long-standing priority demographic for the BBC.

1.8 These market changes have increased the importance of media companies owning the underlying intellectual property (IP) rights to content. IP rights are the rights given to persons over the creations of their minds, and creators are able to sell or licence these rights to others, usually in return for a financial payment. Since the Communications Act 2003, ownership of IP rights for TV programmes has resided with the production company that makes the programmes, not the organisation commissioning the programmes for broadcast. Typically, after the initial broadcast by the programme commissioner, production companies seek to commercially exploit their IP rights to content by selling or licensing their rights to distribution companies, such as BBC Worldwide, who would then sell the content overseas. With the emergence of the new global SVoD providers, who have been willing to pay more to secure global rights, distribution companies have faced increased competition for TV content.

1.9 Ownership of IP is valuable to the BBC as there are numerous ways it can generate financial returns from its content (**Figure 2** overleaf). Since 1990 the BBC has not owned the IP for an increasing proportion of the programmes it shows as it has been producing fewer of these programmes itself. Under the Broadcasting Act 1990, the BBC was required to commission 25% of its TV content from external production companies only. It was then required under its 2006 Royal Charter to open up another 25% of content to competition from its in-house production teams and external companies. Increasingly, this 25% was won by external companies so that, by 2016-17, these companies were winning 80% of this contested content, with in-house production winning no commissions for drama, for example.

1.10 The BBC was, to a certain extent, still protected as there was a guarantee that its in-house production units would make the remaining 50% of the relevant TV content without competition. However, this guarantee is being phased out under the BBC's December 2016 Charter, which requires the BBC to open up to full competition 40% of its network TV drama, comedy, entertainment, factual and daytime hours previously subject to the in-house guarantee by December 2018, with the remainder opened to full competition by 2027.

1.11 Before the merger, the BBC had acted to address these challenges. In May 2016, it brought together in-house production teams from across its PSB operations to form BBC Studios as a separate division within PSB. It then established this division as a commercial subsidiary in April 2017, requiring it to operate commercially. The BBC believed that BBC Studios would be better able to compete for BBC work, as it was put out to tender, and attract the creative talent needed to create high-quality and exploitable content, than if it remained as part of PSB. Commercial status would also allow it to bid for work from non-BBC sources to replace BBC work it lost. BBC Studios would have more opportunity to retain the IP resulting from any new content it created, which could then be commercially exploited globally by distributors, including BBC Worldwide. BBC Worldwide had also taken steps to improve performance in response to market changes. From 2017, it had embarked on a programme to transform its business performance by reducing costs, increasing sales and improving profit margins. The programme included projects to reform its finance and sales functions and to rationalise its portfolio of overseas TV channels.

The strategic rationale for the merger

1.12 In October 2017, the BBC Board approved the merger of the former BBC Studios and BBC Worldwide. The strategic rationale for this was for the merged company to be a creator, producer, owner and distributor of IP, primarily based in the UK but serving customers all over the world. This rationale reflected the BBC's belief that control over the production, ownership and exploitation of IP across its full life-cycle, from production of content for initial broadcast to its sale to other organisations, would be the main source of competitive success and commercial advantage in future years in light of the strategic challenges it faced.

Figure 2
BBC’s exploitation of its Intellectual Property (IP) rights to TV content

The BBC can exploit its IP rights to content to generate financial returns in a number of different ways

Route to market	Summary	Example
Broadcast revenue	Content is broadcast on primary UK channels (eg. BBC One) during its first window. After the first window BBC Studios can sell the content overseas (for example, to ABC in the USA) as well as to secondary UK channels and subscription video-on-demand services.	<i>Doctor Who</i> debuts on BBC One during its primary window. Secondary UK window rights, and back catalogue, are sold to other broadcasters (eg. UKTV). The BBC previously sold <i>Doctor Who</i> to PBS in the USA. In 2009, BBC America bought the rights, with earlier seasons accessible on BBC Studios’ BritBox US service.
Format sales	BBC Studios generates revenue selling the format of proven successful UK shows to overseas broadcasters who want to produce their own local version.	BBC Studios sold the <i>Strictly Come Dancing</i> format to ABC in the USA under the title <i>Dancing with the Stars</i> . Format sales can be paired with production services below.
Overseas production	Overseas broadcasters who have bought the format of a show may commission BBC Studios to produce the content for them as they already have the relevant expertise and knowledge to produce the show to a high standard.	BBC Studios produces <i>Dancing with the Stars</i> and, in 2018-19, <i>Dancing with the Stars: Juniors</i> , for ABC in the USA.
Consumer products	BBC Studios sells physical products for content with wide appeal, which can be in the form of DVD sales or merchandising products. Consumer products may also include live events for popular broadcast shows.	Consumer products generated £108 million revenue for BBC Studios in 2018-19. This revenue has been in decline in recent years due to the structural decline in the physical media market, primarily DVD sales.
Miscellaneous	BBC Studios generates revenue by selling experiences to fans of content such as rides and attractions overseas.	<i>Top Gear</i> and other IP-led experiences (eg. <i>BBC Earth</i>) are in development at theme parks across China (both pop-up and fixed), which are expected to open in 2020.

Source: National Audit Office analysis of BBC documents

1.13 In merging its production and distribution businesses, the BBC followed recent media market trends where major UK competitors, such as ITV, All3Media and EndemolShine, were increasingly operating integrated production-distribution businesses. The BBC identified in 2017 that integrated producer-distributor companies accounted for more than 50% of the UK production market, with the top five distributors accounting for more than 80% of distribution revenues.

1.14 In its October 2017 business case, the BBC identified a number of non-financial benefits arising from the merger. It expected the merger to: improve the merged BBC Studios' ability to generate high-quality content and exploit the associated IP; increase the efficiency and effectiveness of content creation and its exploitation; and support growth by creating a business of global scale. A single merged company was expected to encourage more collaboration between production and distribution, rationalise and simplify complicated working relationships that existed between the two parts, and bring about a common unified culture cutting across business boundaries. Such a company would also present a single face to the market and be better able to agree deals with customers which combined elements of production and distribution. The BBC considered that, had it not decided to merge, it would have been at risk of being disadvantaged in the wider market and of operating less efficiently.

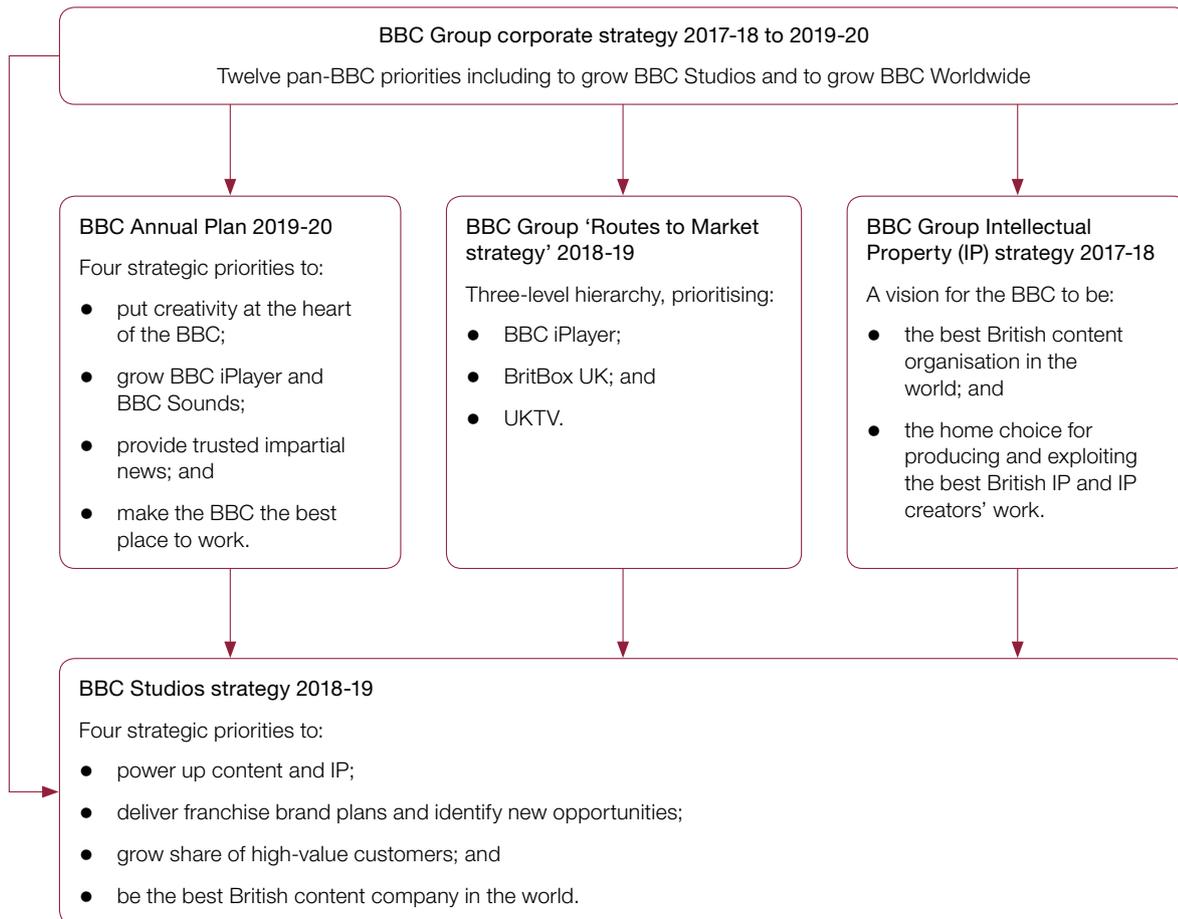
1.15 In its October 2017 business case, the BBC expected that delivery of these non-financial benefits would result in improvements to the financial performance of the new, merged business. However, it was not until March 2018 that BBC Studios had a business plan which took full account of the merger's impact on financial performance. This plan forecast revenues that were around £100 million a year higher from 2019-20 onwards than the forecasts in the October 2017 business case.

1.16 The BBC did not have, as at November 2019, a separate commercial strategy covering the activities of its commercial subsidiaries as a whole. Instead, it has a corporate strategy and annual plans that cover all of the BBC, including its main commercial subsidiaries such as BBC Studios. The BBC Board approves separate strategies for each main subsidiary in line with this corporate strategy. The Board set the current corporate strategy in October 2017 and this has driven the BBC's strategic commercial aims, with BBC Studios' 2018-19 strategy being consistent with these aims (**Figure 3** overleaf).

1.17 The BBC Annual Plan 2019-20 notes that BBC Studios' commercial exploitation of new content and its associated IP will be critical to helping the BBC meet ongoing challenges. BBC Studios also has a key role in delivering the BBC-wide 'Routes to Market strategy', which seeks to address the shift to online viewing (paragraph 1.7) by increasing the BBC's control over how its content is delivered to audiences in the UK, particularly via the various video-on-demand options open to it.

Figure 3
Summary of the BBC’s strategic framework

BBC Studios’ strategy is consistent with wider BBC Group strategies



Source: National Audit Office analysis of BBC information

1.18 Having established strategies for each of its commercial subsidiaries, in July 2019 the BBC Board decided to put in place arrangements to draw up a BBC Group commercial strategy for the first time, drawing on these strategies, given the importance of the commercial sector to the BBC as a whole. The Board recognised the major strategic developments for the BBC since 2016 in the commercial sphere in terms of creating and owning IP, securing greater control of IP in the BBC’s secondary markets (Figure 2), and growing the BBC’s direct reach with audiences. It also recognised that BBC Studios had played a crucial role in all these areas, and would continue to do so. The new arrangements include the establishment of a sub-committee of the BBC executive team to develop and oversee the implementation of the BBC Group commercial strategy.

Part Two

Implementation of the merger

2.1 This part of the report sets out the progress in delivering the structural and cultural changes needed to implement the merger between the former BBC Studios and BBC Worldwide, and to integrate the two businesses as they continued to operate in a rapidly changing market.

Delivering structural change

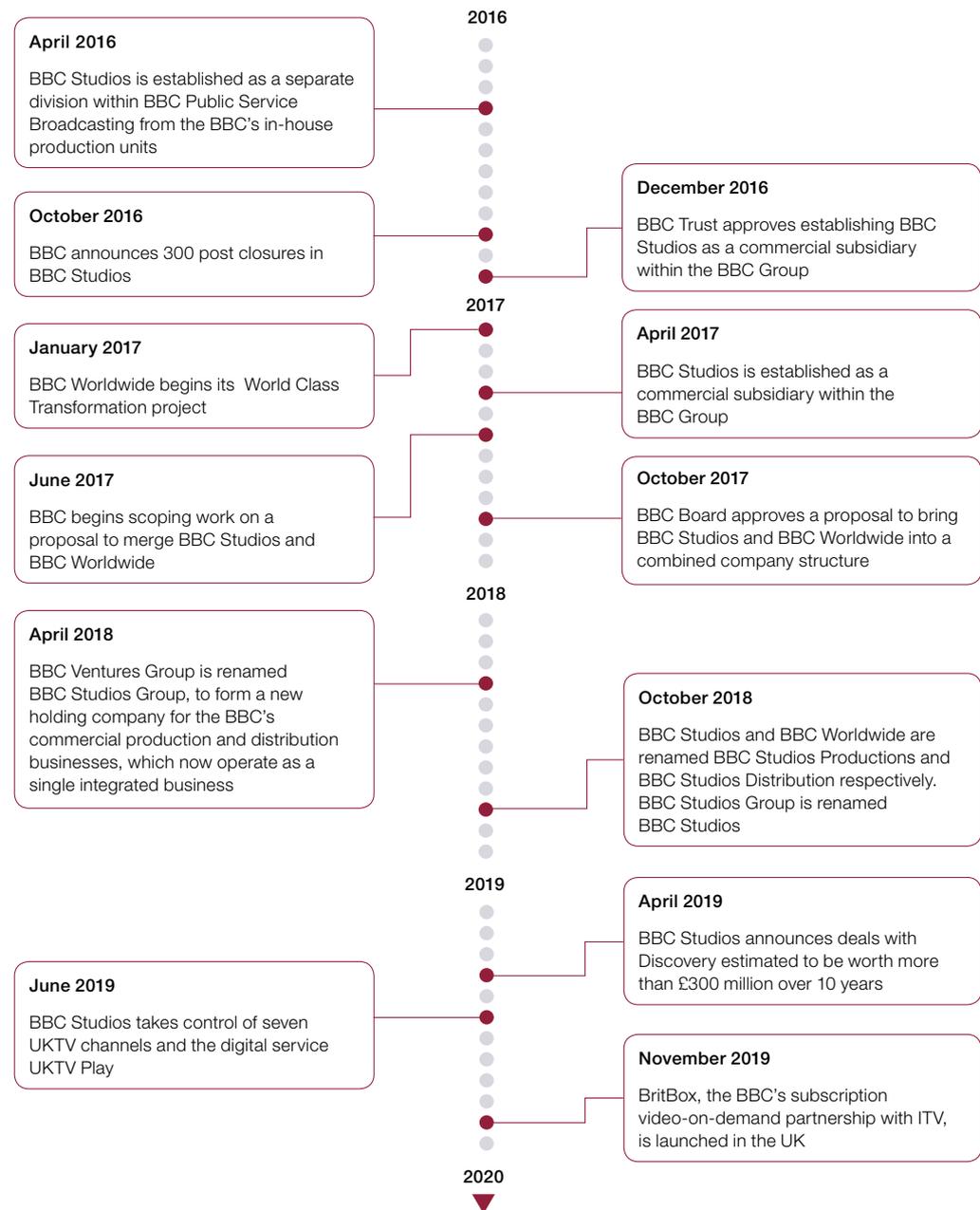
2.2 Both the former BBC Studios and BBC Worldwide had undergone significant changes before the merger. The BBC established the former BBC Studios as a separate division within its public service broadcasting (PSB) operations in 2016, and as a commercial subsidiary in April 2017, requiring it to operate commercially (paragraph 1.11 and **Figure 4** overleaf). In preparation for its commercialisation, in October 2016 the former BBC Studios announced the shedding of 300 staff posts. For its part, since 2017, BBC Worldwide had been undertaking a significant transformation programme to improve business performance (paragraph 1.11).

2.3 The BBC planned to implement the merger in five stages (**Figure 5** on page 21), overseen by a working group of senior executives from both organisations and managed by a dedicated implementation team. Implementation of the merger was facilitated by the two companies already being part of the same BBC business and sharing some common purposes, such as operating commercially while having to meet the BBC's public purposes. They also operated in different fields, the former BBC Studios in production and BBC Worldwide in distribution, with little overlapping activity other than some support services such as HR. This meant that there was no need for large-scale redundancies among staff.

2.4 By 3 April 2018, the merger go-live date, BBC Studios had put in place the major structural building blocks for a successful merger. It had established its organisational structure and appointed its central senior management team to take an end-to-end view across the business from content creation and production to its distribution. It had agreed a unified vision and strategy for the merged business and set a five-year business plan. It had also agreed a new organisational culture, extending the organisational values of BBC Worldwide.

Figure 4
Timeline of actions, 2016 to 2019

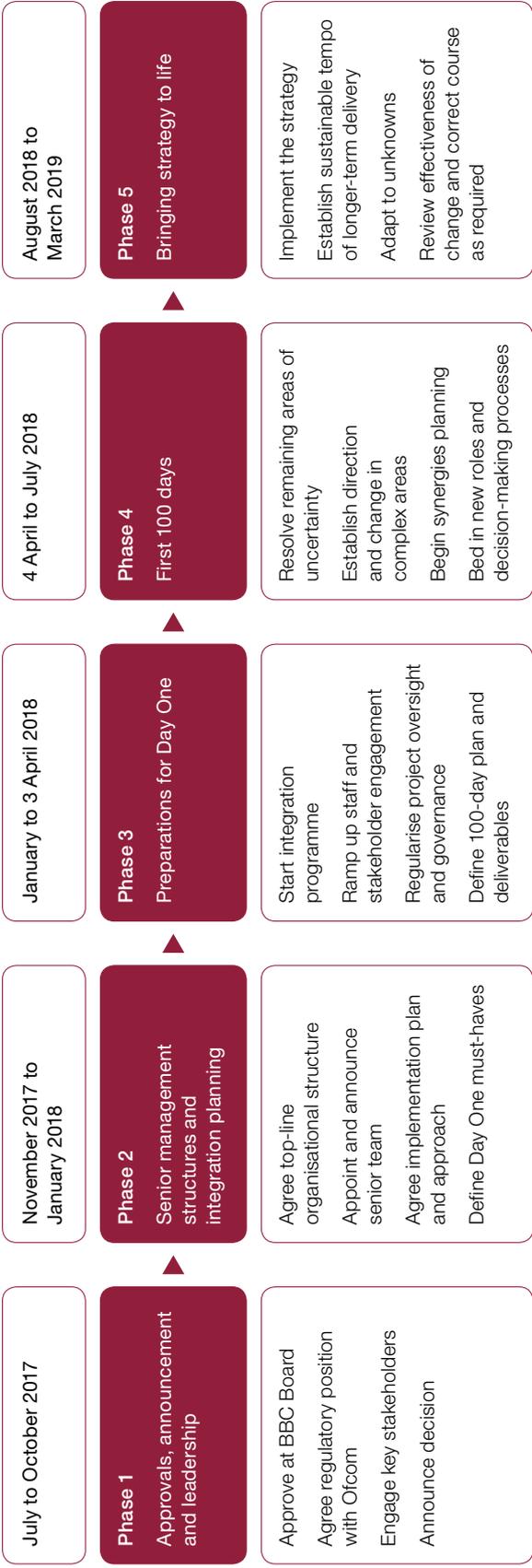
Significant developments have taken place in BBC Studios since 2016



Source: National Audit Office analysis of BBC documents

Figure 5 Implementation stages for the merger of the former BBC Studios and BBC Worldwide

The BBC planned to deliver the merger in five stages



Source: National Audit Office analysis of BBC documents

2.5 In the first 100 days after the merger went live, BBC Studios began work on the more detailed structural changes, including setting the priorities for each division in line with the agreed business strategy, integrating its business support functions and agreeing the new internal trading relationship between its production and distribution businesses. In July 2018, on completion of this first 100 days, BBC Studios wound up the dedicated merger implementation team as it considered that the remaining merger tasks were operational and could be undertaken by its managers. The working group of senior executives continued to receive regular progress reports on the remaining merger workstreams.

2.6 Implementing the merger cost BBC Studios £4.3 million against a budget of £5.7 million. As at November 2019, integration work remained ongoing and there was still significant operational separation across the business. BBC Studios still had duplicate policies, systems and procedures in place in some areas, such as HR, although it expects integration of these by March 2021. BBC Studios is still working on harmonising staff terms and conditions across the organisation and with the rest of BBC Group, and has yet to integrate the financial systems and processes for its production and distribution businesses, despite completing in November 2019 a legacy BBC Worldwide efficiency project, Finance Transformation, which aimed to increase the automation of finance activities for its distribution business.

2.7 The delivery of cost savings was not one of the primary reasons for the merger as both the former BBC Studios and BBC Worldwide were already implementing significant cost reduction programmes. The former BBC Studios had already made 300 staff redundant in 2016-17 (paragraph 2.2) and was expected to make ongoing efficiencies of £2 million a year to offset inflation, while BBC Worldwide had a target of delivering savings of £38 million a year by 2021-22 under its change programme (paragraph 2.2) and had delivered £20 million of these by 2017-18. The two businesses were also complementary, limiting the overlap between their functions and therefore the scope for savings.

2.8 Despite this, in October 2017, the BBC identified that there was scope for the merger to produce savings from greater economies of scale and the reduction of interfaces between, and overlapping of, operations and functions. It set a target for merger savings of £5 million a year by 2021-22. As at March 2019, BBC Studios expected to deliver by 2019-20 £2.1 million of the £5 million due.

Delivering cultural change

2.9 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 merger's expected benefits. The behavioural changes needed of staff under the new culture include learning how to pitch to win commissions for new content, setting out to create content which is specifically designed to have a high sale value across the world, and increased joined-up working between the production and distribution businesses.

2.10 BBC Studios agreed the new organisational culture for the merged organisation before the merger went live in April 2018 (paragraph 2.4). Embedding a new culture is never straightforward. Although the establishment of the former BBC Studios as a commercial subsidiary in April 2017 meant that its staff had already started to get used to a more commercial culture, the introduction of this culture was still ongoing at the time of the merger, and the former BBC Studios was still a relatively immature organisation at that point. For BBC Worldwide, the presence of its staff across the globe makes ensuring a consistent culture across the organisation difficult.

2.11 The merged BBC Studios took a number of steps to embed its new organisational culture. Before April 2018, the leadership of the new organisation identified the 100 managers within the organisation whose support for the merger would be crucial and held briefings with these to secure their buy-in to the cultural changes needed. It then did the same with staff, holding a series of events, including conferences, briefings and roadshows. It introduced common branding and co-located all London-based production staff with their distribution colleagues at Television Centre in White City.

2.12 An April 2019 staff survey shows that the staff engagement score for BBC Studios Productions was 55%, below that for BBC Studios Distribution (64%). According to the BBC, this difference in scores indicates the cultural gap remaining between the two and arises, in part, from BBC Studios Productions' greater use of fixed-term contractors.

2.13 In April 2019, BBC Studios identified that it had still got some way to go towards achieving a common culture across the whole organisation. It therefore introduced a new action plan to align people's behaviours to the intended culture over the coming six months so that, for example, working together became second nature across the business. Actions included regular conferences for the key 100 managers and new training programmes. However, the plan did not identify what remained to be done to bring about the required cultural change or spell out how the actions it contained would achieve this. The plan also did not include performance indicators for assessing the extent to which it had succeeded in achieving cultural change, or a timetable for delivery of this change.

Meeting market changes

2.14 During the merger's implementation, BBC Studios has continued to operate as normal, making around 2,000 hours of programmes in the UK, working with other content providers to co-fund programmes, and trading in more than 200 different territories across the world. It has also taken some strategically important decisions, which reflect an evolution of its business strategy and build on existing relationships, in response to the rapidly changing market.

2.15 Since BBC Studios began trading as an integrated business in April 2018, the strategic challenges facing both it and the BBC (paragraphs 1.6 to 1.8) have intensified as competition for content and the talent behind it has increased further. 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.

2.16 In response, in June 2019, BBC Studios bought seven of 10 UKTV channels, and UKTV's digital service, UKTV Play, from its partner in UKTV, Discovery, for £173 million, including a significant amount in respect of BBC Studios' payment of its share of UKTV's debt. Previously both had held a 50% stake in UKTV. In February 2019, the BBC took a 10% stake in BritBox, a partnership with ITV for a UK SVoD service, which launched in November 2019. This builds on an existing BBC Studios partnership with ITV for an overseas BritBox service in the USA and Canada. The BBC sees the UKTV and BritBox deals as key to increasing its control over its intellectual property (IP) rights and how its content is distributed in the UK in line with its 'Routes to Market strategy' (paragraph 1.17 and **Figure 6**).

2.17 The BBC also intends to increase the length of time its programmes are available on BBC iPlayer to 12 months in line with its 'Routes to Market strategy'. It is as yet unclear what impact this development, and the new BritBox service, will have on BBC Studios' ability to generate commercial returns from these programmes once their availability on iPlayer finishes.³ The introduction of these developments is still at an early stage, although the BBC considers that these developments should not adversely impact on these returns. The BBC has put in place new governance arrangements to determine where the BBC will make content available after iPlayer (paragraph 1.18).

2.18 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 whereby BBC Studios develops new natural history content for Discovery's new SVoD service. Together, these agreements are estimated to be worth more than £300 million to BBC Studios over 10 years (**Figure 7** on page 26). These deals aim to secure the BBC's position in the profitable global SVoD market for high-quality natural history content, and increase certainty around BBC Studios' future income.

³ The potential impact of iPlayer on the ability of the BBC to exploit commercially its content was also recognised in the report from the HC Committee of Public Accounts, *BBC Commercial Activities*, Fifty-first Report of Session 2017–2019, HC 670, July 2018.

Figure 6

The BBC's routes to market

The BBC has sought to increase control over its intellectual property rights in the UK secondary market

Market	Prior to implementation of 'Routes to Market strategy'	After implementation of 'Routes to Market strategy'
UK primary television	BBC linear programmes and content were free-to-air and viewed live as they were broadcast.	BBC linear programmes and content are free-to-air and viewed live as they are broadcast.
UK secondary television	BBC Studios owned half of UKTV in a joint venture with Discovery Channels Interactive; UKTV operated 10 channels.	BBC Studios owns 100% of seven UKTV channels out of 10 that it deems to be editorially important – Gold, W, Alibi, Yesterday, Dave, Eden and Drama.
UK primary online	Programmes were available to view on BBC iPlayer for 30 days after initial broadcast on BBC linear channels.	Programmes are generally available to view on BBC iPlayer for 12 months after initial broadcast on BBC linear channels. Certain programmes and genres are available for longer, including multi-series box sets and iPlayer exclusives.
UK secondary online	BBC Studios sold and licensed content to third-party subscription video-on-demand (SVoD) providers, such as Netflix and Amazon.	BBC makes some content available on the new BritBox SVoD service, in which BBC Commercial Holdings has a 10% stake. BBC Studios sells and licenses some content to other parties, eg. Netflix.

Notes

- 1 UK primary television refers to public service broadcasting television services in the UK.
- 2 UK secondary television refers to non-public service broadcasting television services in the UK.
- 3 UK primary online refers to online services in the UK provided by the BBC itself.
- 4 UK secondary online refers to BBC content made available online in the UK by non-BBC providers.

Source: National Audit Office analysis of BBC documents

Figure 7 BBC Studios' Discovery deals

BBC Studios entered into two long-term content deals with Discovery

Discovery plans to launch a new global premium factual subscription video-on-demand (SVoD) service in 2020. In late March 2019, BBC Studios signed two 10-year agreements with Discovery to provide the new service with content. Under these agreements, BBC Studios will:

- provide Discovery with existing BBC landmark natural history programmes, such as *Planet Earth* and *Blue Planet*, and with any future such programmes commissioned by the BBC from BBC Studios; and
- develop landmark factual programmes specifically for Discovery for linear and digital distribution.

These deals cover all territories apart from the UK, Ireland and China, and are estimated to be worth more than £300 million in total. As well as being financially advantageous for BBC Studios, these deals bring strategic benefits, including:

- helping the BBC to secure its position in the profitable global SVoD market for high-quality natural history content in the face of competitors such as Netflix;
- facilitating the implementation of the BBC's 'Routes to Market strategy', which aims to give the BBC greater control over its video-on-demand content (Figure 6); and
- simplifying BBC Studios' business as it seeks to agree individual global deals for content in place of a series of smaller, regional deals.

Source: National Audit Office analysis of BBC documents

2.19 Through the Discovery and BritBox deals, BBC Studios has entered into long-term partnerships with third parties. Although such arrangements represent a simplification of BBC Studios' operations in that, previously, it would have had to enter into a number of deals to generate the income arising from these two partnerships, as highlighted by the Committee of Public Accounts, there is a risk that, over time, the various partners' interests will diverge.⁴ BBC Studios will need to ensure that it manages its relationships with its partners effectively to deliver long-term success and has adequate provisions for dissolving the partnership should the need occur. It will also need to address the legacy of prior content deals it made with SVoD providers such as Netflix where, in time, content will revert to BBC Studios and it will have to decide how to generate financial returns from this content.

4 HC Committee of Public Accounts, *BBC Commercial Activities*, Fifty-first Report of Session 2017–2019, HC 670, July 2018.

Monitoring the merger's impact

2.20 BBC Studios has monitored its financial performance against its March 2018 business plan as part of its normal business operations (paragraph 1.15). Assessing delivery of the non-financial benefits, which were expected to result in improvements in this performance, is more difficult due to their nature, and neither the BBC nor BBC Studios set out in the October 2017 merger business case metrics for assessing progress made in delivering these benefits. 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.

Part Three

The success of BBC Studios so far

3.1 This part of the report examines how BBC Studios has performed since the merger in delivering returns to the BBC while maintaining its financial sustainability, and in creating and acquiring the content for it to exploit commercially. It also examines the oversight and performance reporting arrangements in place for ensuring that BBC Studios performs successfully in future.

Maintaining financial sustainability

3.2 BBC Studios monitors three aspects of financial performance to ensure the sustainability of its business – profitability, sales and cash flow. The BBC Board has set a public target for one of these, profitability, with further financial targets agreed internally.

Profitability

3.3 In 2018-19, BBC Studios' profits, as measured by the BBC Board's chosen measure, EBITDA, increased 51% to £159 million from £105 million in 2017-18 (**Figure 8**), above the forecast of £143 million in the March 2018 business plan (paragraph 1.15).⁵ This represented a profit margin of 13.4%, exceeding the target range of 9%–11% set by the BBC Board in December 2018. In setting this target, the Board took account of benchmarking undertaken by consultants, EY, on its behalf. This showed that the average benchmark margin for similar companies was 13% with lower and upper quartile figures of 11% and 15% respectively.⁶ BBC Studios forecast in March 2019 that it would deliver margins of between approximately 11% and 13%, above the target range, each year from 2019-20 to 2022-23.

3.4 Profits increased in 2018-19 as they were underpinned by a higher contribution of in-house produced content to its global sales, the natural history back catalogue deal with Discovery (paragraph 2.18), and favourable foreign exchange rates. BBC Studios is recognising the sales income and profits from the back catalogue deal with Discovery over two years, 2018-19 and 2019-20, rather than 2018-19 only.

⁵ Earnings before interest, tax, depreciation and amortisation. To calculate EBITDA, the BBC takes BBC Studios' reported operating profit and adds back depreciation and most amortisation operating expenses, including any impairments or write-downs of the value of assets.

⁶ The Board's decision to set a lower target took account of factors specific to BBC Studios, such as its legacy BBC pension costs and the range of outputs it needed to deliver to meet BBC's public service broadcasting (PSB) requirements (some outputs generating low margins).

Figure 8

BBC Studios' financial performance 2017-18 to 2019-20

BBC Studios has forecast that it will meet its profit margin target of 9%–11% in 2018-19 and 2019-20

	2017-18 Outturn	2018-19 Outturn	2019-20 Budget
Headline sales (£m) ¹	1,411	1,373	1,434
Statutory sales (£m) ²	1,236	1,189	1,409
Profit (£m) ³	105	159	150
Profit margin (%) ⁴	8.5	13.4	10.6

Notes

- 1 Headline sales include BBC Studios' share of the revenue earned by its joint ventures.
- 2 Statutory sales exclude BBC Studios' share of the revenue earned by its joint ventures. From 2019-20, the figure includes UKTV revenue as BBC Studios is no longer in a joint venture for this after purchasing outright seven of UKTV's 10 channels (paragraph 2.16).
- 3 The BBC's chosen measure of profit, EBITDA (Earnings before interest, tax, deductions and amortisation).
- 4 Profit margin is EBITDA as a percentage of statutory sales.

Source: National Audit Office analysis of BBC data

3.5 Profits also increased because areas of the business with higher profit margins performed well. BBC Studios relies in particular on its branded services – the channels and digital services that are broadcast commercially, such as its share of BritBox US and Canada, UKTV and BBC America – as they deliver the best margins across its business (**Figure 9** overleaf). In 2017-18 and 2018-19 branded services contributed 58% and 44% of BBC Studios' total profits respectively, despite contributing only 23% and 24% of headline sales. BBC Studios expects to continue to rely on branded services to deliver profits over the next three years, particularly from UKTV, where, following its purchase of UKTV channels (paragraph 2.16), returns to BBC Studios are forecast to grow.

Sales

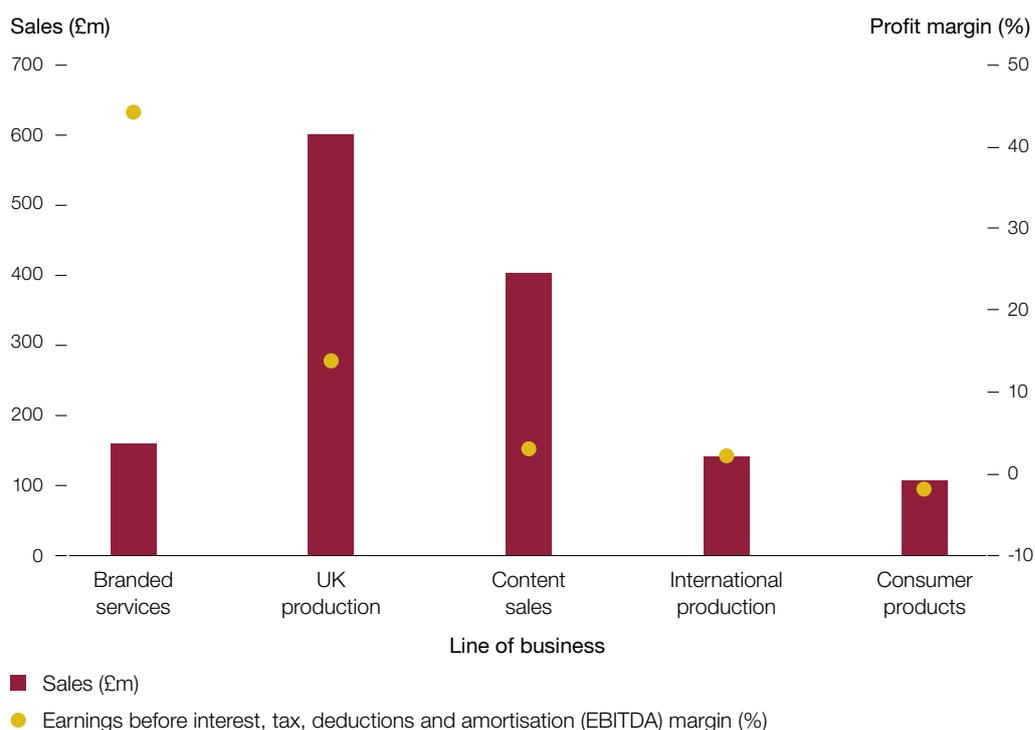
3.6 In 2018-19, BBC Studios' headline sales fell by 3% to £1,373 million from £1,411 million in 2017-18 (Figure 8), 7% lower than the £1,469 million forecast in its March 2018 business plan (paragraph 1.15).⁷ This lower performance was largely driven by delays in the production of key titles in the UK, the cancellation of some overseas titles and decline in the consumer products market.

⁷ The 2017-18 sales figure is the combined sales figures achieved by the former BBC Studios and BBC Worldwide in that year, adjusted to exclude sales between the two then separate companies.

Figure 9

Financial performance of BBC Studios' main lines of business in 2018-19

In 2018-19, BBC Studios' branded services delivered the highest profit margins

**Note**

1 Profit margin is EBITDA as a percentage of statutory sales.

Source: National Audit Office analysis of BBC Commercial Holdings and BBC Studios published accounts, 2018-19

3.7 Structural changes in the market continued to affect BBC Studios' financial performance. In 2018-19, it wrote down the value of its consumer products business by £21.5 million in recognition of the continuing long-term fall in DVD sales, once an important source of income.⁸ BBC Studios is also currently paid by the BBC to produce some existing long-running series which the BBC has yet to put out to competition. However, this income is at risk as the BBC moves to put the production of all such series out to competitive tender by 2027 (paragraph 1.10).

3.8 Despite these structural changes, BBC Studios has ambitious plans to increase its sales by approximately 20% from 2019-20 to 2022-23. However, there are uncertainties attached to the achievement of these plans. They include: the expiry of existing global content supply deals; the second and final year of income from its back catalogue deal with Discovery (paragraph 2.18); and a new deal with WarnerMedia HBO Max over rights to *Doctor Who* and other content. BBC Studios will need to deliver new deals to replace the income from these existing deals once they have been completely accounted for.

8 This accounting adjustment involved no expenditure of cash by BBC Studios.

Cash flow

3.9 BBC Studios monitors cash flow using two measures:

- Free Cash Flow, which measures the amount of cash generated by a business.⁹
- Net debt, which measures a business's total net amount of borrowing.¹⁰

3.10 BBC Studios is forecasting a large fall in Free Cash Flow in 2019-20 (**Figure 10**), due to increased investment in content for UKTV and in programmes in production in advance of their delivery from 2020-21 onwards, and due to an increase in amounts owed by BBC Studios' customers arising from new global deals. It is also forecasting a large increase in net debt in 2019-20, in part to fund the payments due under its deal to purchase UKTV. In 2018-19, the BBC increased the limit on the amount BBC Studios could borrow from its parent company, BBC Commercial Holdings, from £270 million to £300 million. It increased this by another £100 million in 2019-20 to reflect the impact of the new accounting standard for leases, IFRS16.¹¹

Figure 10

BBC Studios' cash flow 2017-18 to 2019-20

BBC Studios uses two measures to monitor its cash flow

	2017-18 Outturn (£m)	2018-19 Outturn (£m)	2019-20 Budget (£m)
Free Cash Flow	92	111	48
Net debt at financial year end ¹	127	46	266

Note

¹ Net debt figures exclude the effects of the new accounting standard for leases, IFRS16, which came into effect from January 2019. The new standard will increase the amount of net debt.

Source: National Audit Office analysis of BBC data

Content creation and exploitation

3.11 BBC Studios seeks to create content which it can then exploit commercially in three ways. It:

- produces content itself via BBC Studios Productions;
- acquires distribution rights to other companies' content; and
- acquires stakes in other production companies to share in the intellectual property (IP) they create.

⁹ Free Cash Flow is the amount of cash generated by a business after accounting for the cash outflows to support operations and non-current capital assets. It is therefore calculated after deducting working capital and capital expenditure and excludes interest and tax.

¹⁰ Net debt is defined as all borrowing less cash balances and the value of short-term investments.

¹¹ BBC Commercial Holdings was subject to a limit of £350 million, set by the Department for Digital, Culture, Media & Sport (DCMS), on the net commercial borrowing it can take out. It then allocated this total among its main commercial subsidiaries. In 2019-20, DCMS increased this limit to £500 million to reflect the impact of IFRS16.

3.12 Since the merger, BBC Studios has acted to strengthen its content creation and exploitation capability, in line with its strategic rationale (paragraph 1.12). It reinvented its company-wide Content Partnership function, which is responsible for allocating BBC Studios' investment in content between BBC Studios Productions and the other production companies in which BBC Studios has a stake, and for overseeing the performance of these in delivering that content. In April 2019, it produced a new company-wide content strategy, prioritising, by each genre, the annual spend and the returns it expected to generate from new content.

3.13 BBC Studios' strategy for 2018-19 sought to improve its content creation and exploitation capability by strengthening the links between the production and distribution sides of its business so that, for example, the sales and distribution teams are better able to provide the production teams with intelligence on customer requirements. It has introduced new arrangements to enable its production businesses to benefit in full from the returns generated through BBC Studios Distribution selling the content they produce. BBC Studios Distribution's sales division has also improved how it maps customer needs and has enhanced its relationships with key strategic customers.

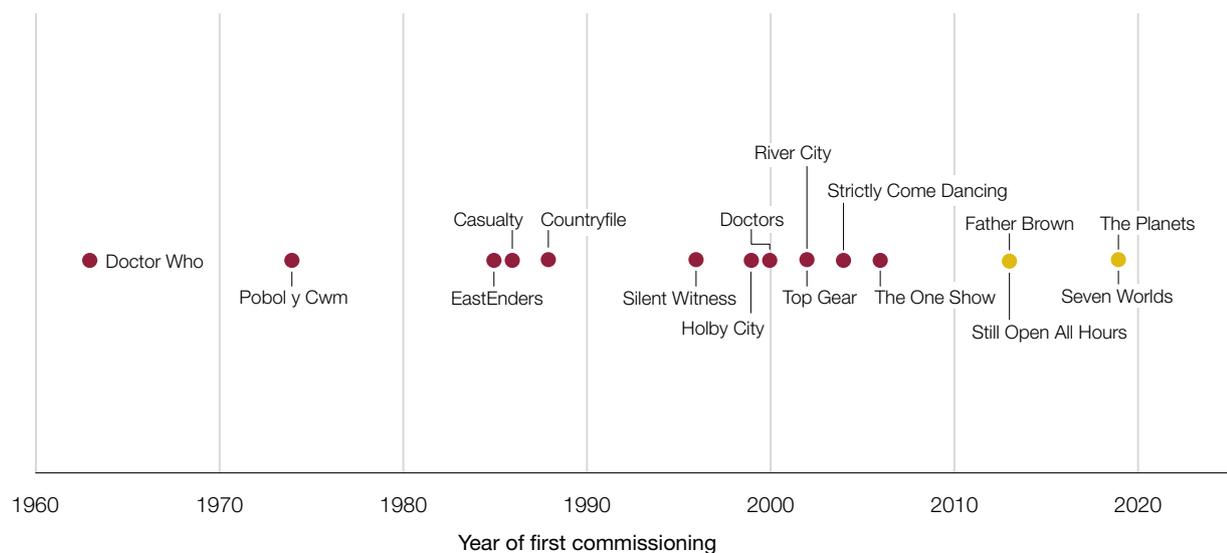
3.14 BBC Studios is increasing its expenditure on creating and acquiring new content and IP. In March 2019 it planned to increase significantly its annual spend on content over the next five years from £154 million to more than £200 million. In line with this, in 2018-19 it increased its distribution rights spending by 45% to £171 million from £118 million in 2017-18 as it spent more on acquiring third-party IP. Identifying the total income generated by content is difficult as content can generate income over many years. Thus, although BBC Studios monitors the performance of its content investments, the timing of returns means that its monitoring often involves a combination of returns achieved to date and forecast future returns, with BBC Studios unable to formally assess the actual total returns achieved against its original investment.

3.15 Investing in content can be highly speculative as BBC Studios is seeking to identify in advance those new shows which will be successful. BBC Studios is keen to generate new formats and long-term brands to sustain its long-term performance. Its current performance relies significantly on some long-standing brands, such as *Doctor Who* and *Top Gear*, with only four of its forecast top 16 revenue-generating in-house produced shows in 2019-20 dating from after 2010 (**Figure 11**). However, investing in new series or franchises which last for a number of years can be expensive, exposing BBC Studios to high levels of risk. For example, it is investing a record amount in co-funding the production of two series of *His Dark Materials* in return for ownership of the global distribution rights, committing to series two in advance of any indication of whether series one has proved successful.

Figure 11

Age of BBC Studios' top income-generating in-house produced programmes in the UK

Only four programmes, produced by BBC Studios' in-house production arm, BBC Studios Productions, and forecast to be among BBC Studios' top 16 revenue-generating shows in 2019-20, were first produced after 2010¹

**Note**

¹ Yellow dots represent the four shows produced after 2010.

Source: National Audit Office analysis of BBC data

3.16 BBC Studios has continued to acquire stakes in production companies, although in lower numbers than previously. In 2018-19, it acquired new stakes in two companies, Moonage Pictures and Firebird Pictures, and increased its stake in Lookout Point Limited to 100%, at a total cost of £16.5 million.¹² In contrast, BBC Worldwide spent more than £21 million in 2016-17 on acquiring such stakes. BBC Studios regularly monitors the financial performance of these companies, and acts to address any concerns identified.

3.17 BBC Studios recognises that it must attract and retain the talent needed to generate new IP with a high global appeal and high commercial value. It has enhanced the role of its Chief Creative Officer and, since autumn 2018, has sought to recruit more creative talent to the leadership of its genre teams. However, it faces stiff competition for such talent from other players, such as Netflix, who are able to pay more than it can. BBC Studios has therefore identified the attraction and retention of talent as one of its top three key strategic risks.

¹² Cash payments of £13.7 million in 2018-19 and consideration of £2.8 million in future years.

3.18 To date, BBC Studios has been more successful than planned in retaining existing BBC work, earning £406 million from such work in 2018-19 (**Figure 12**). This was, in part, due to the BBC commissioning a larger volume of returning titles than expected. Since April 2017 BBC Studios has won seven out of the 10 existing programmes the BBC has put out to tender, losing *Songs of Praise*, *The Proms* and *Mastermind*. The IP related to these programmes resides with the BBC, not BBC Studios. This higher rate of BBC commissioning of existing programmes by the BBC has left less scope for new content. BBC Studios has been less successful than planned in winning new commissions from the BBC and third parties to generate the IP which it can then exploit financially. In 2018-19, it generated production revenue of only £28 million from such commissions, and its successful non-BBC commissions tended to be for small, one-off factual programmes, rather than large drama series. BBC Studios expects significant increases in work generating new IP from 2019-20 onwards.

Generating financial returns

3.19 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 the BBC continued to apply this target to the merged BBC Studios.¹³ In July 2019, BBC Studios reported that it had delivered returns of £243 million in 2018-19, representing, together with 2017-18's returns, 38% (£453 million) of the £1.2 billion target (**Figure 13** on page 36). It also forecast in December 2018 that it would exceed the target and deliver returns over the period of £1.37 billion. To do this, it will need to deliver higher levels of returns between 2019-20 and 2021-22 than in previous years.

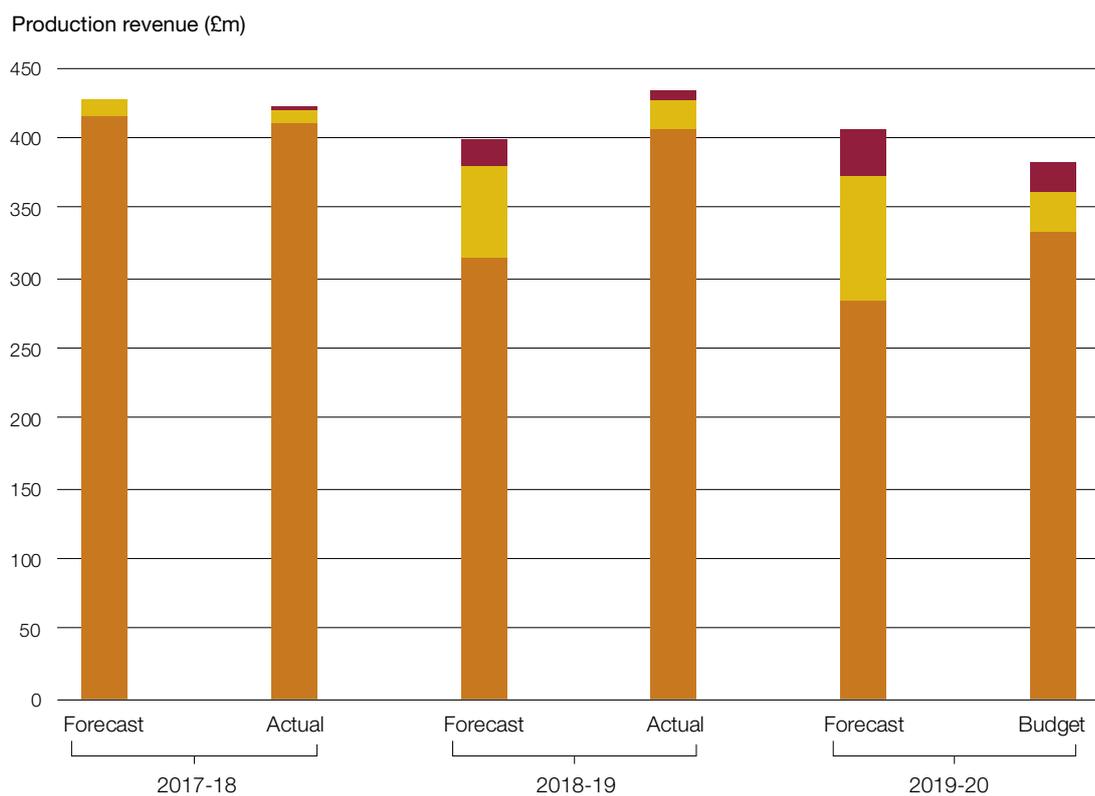
3.20 The returns target attempts to measure the value that BBC Studios returns to the BBC as a whole. It is unique to the BBC as it combines the value that BBC Studios delivers as the BBC's main producer and distributor of content – such as its upfront contributions to the financing of BBC programmes, including those that it produces itself, its payments to PSB for the right to use IP, including archive material, and the right to use the BBC brand – with the value that the BBC receives as BBC Studios' owner via dividend payments. However, the BBC does not report publicly on the composition of this target or of the annual returns figure 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 considered the target to be stretching as it represented a 21% increase on the outturn for the previous five years.

¹³ Comptroller and Auditor General, *The BBC's commercial activities: a landscape review*, Session 2017–2019, HC 721, National Audit Office, March 2018.

Figure 12

BBC Studios' production revenues 2017-18 to 2019-20, compared to 2016 forecasts

Actual production revenue in 2018-19 came mainly from its work on existing BBC programmes, with less revenue from new work than planned in 2016



Third party	0	1	18	8	31	22
BBC new	10	9	65	20	89	27
BBC existing	416	411	315	406	285	334
Total	426	421	398	434	405	383

Notes

1 The forecast figures are contained in the BBC's August 2016 business case for establishing BBC Studios as a commercial entity from April 2017.

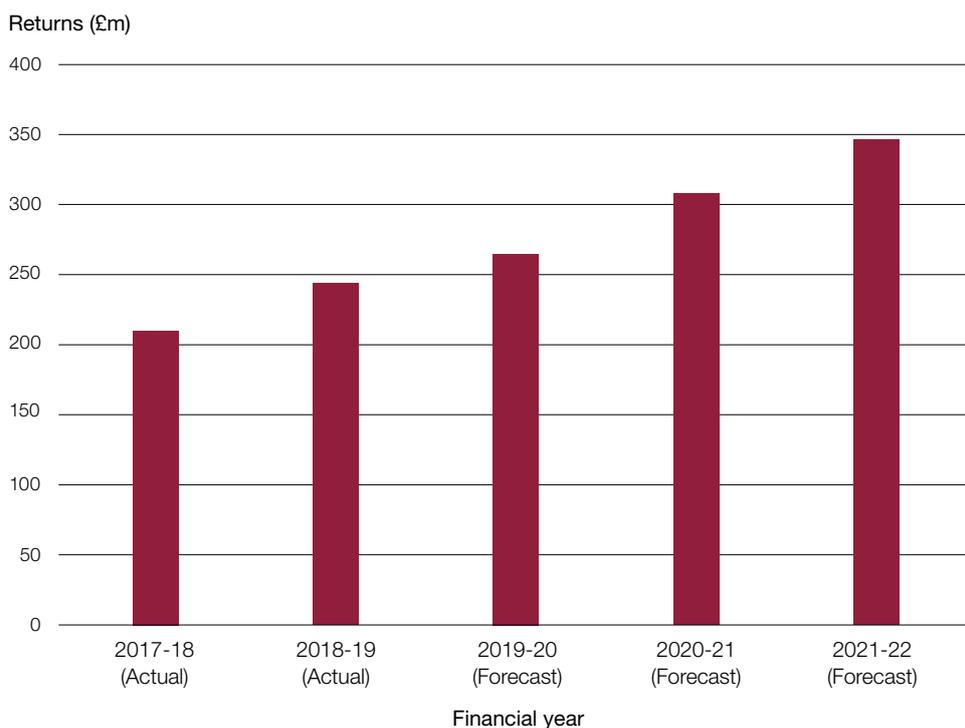
2 The actual and budget figures are as at November 2019.

Source: National Audit Office analysis of BBC data

Figure 13

BBC Studios' returns to the BBC 2017-18 to 2021-22

Returns to the BBC are forecast to increase over time



Source: National Audit Office analysis of BBC data

3.21 In July 2018, the Committee of Public Accounts concluded that the returns target was confusing and recommended that the BBC should assess whether it was fit for purpose and, as a minimum, set sub-targets to distinguish between dividends and upfront contributions to programme costs.¹⁴ An independent review of the transparency of the BBC's commercial operations (the Saul Review), commissioned by the BBC Board, found in January 2019 that the target was an opaque measure and recommended that the BBC should bring more clarity to the concept of returns delivered by BBC Studios to the BBC. The BBC considers the returns 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.

¹⁴ HC Committee of Public Accounts, *BBC Commercial Activities*, Fifty-first Report of Session 2017–2019, HC 670, July 2018.

Governance and performance reporting

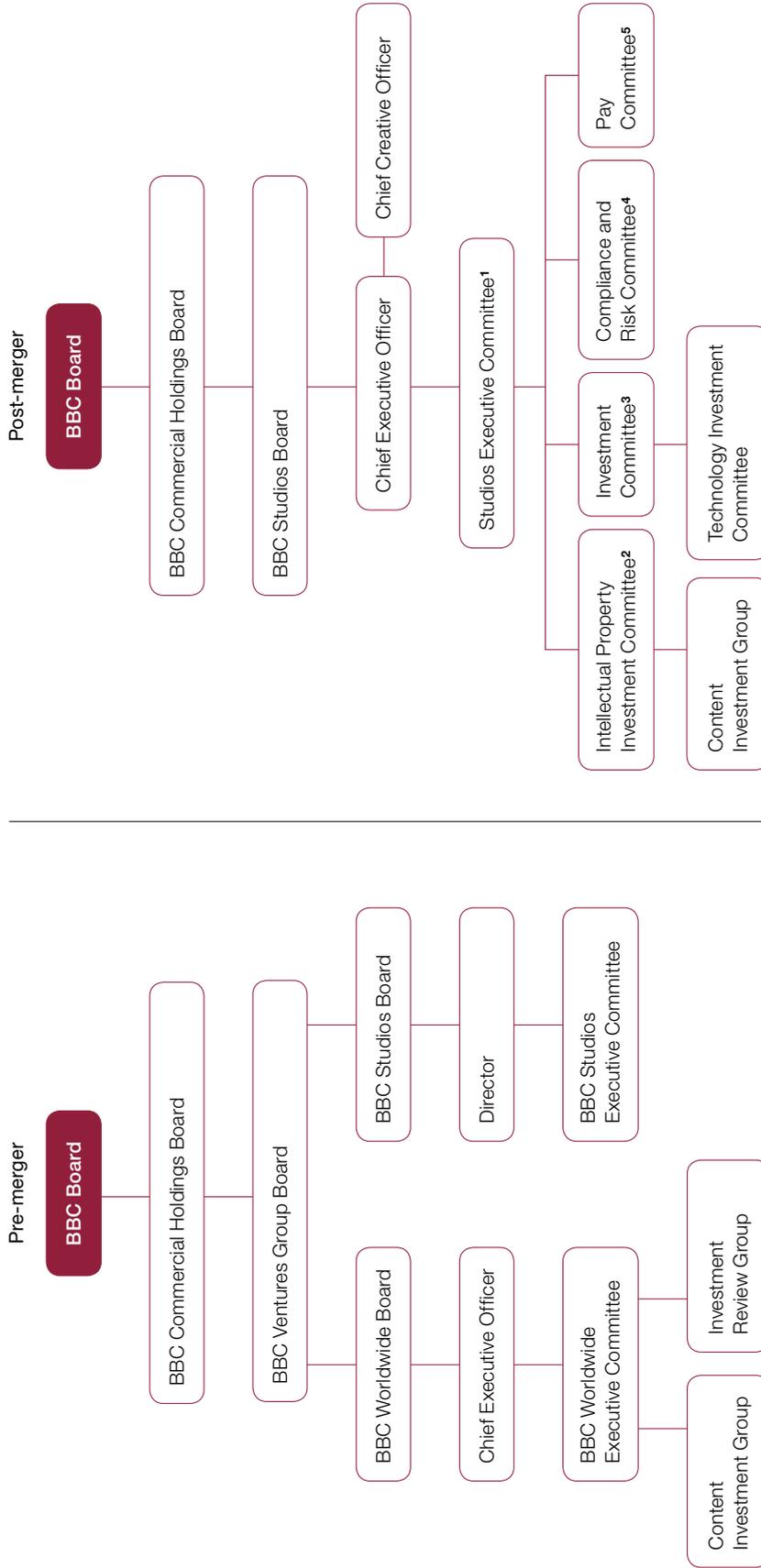
3.22 The BBC restructured governance of its commercial activities to take account of the merger of the former BBC Studios and BBC Worldwide (**Figure 14** overleaf). The merged BBC Studios has its own Executive Committee and is led by a Chief Executive Officer, who acts as the single point of accountability. He sits on the BBC's Executive Committee and works in partnership with BBC Studios' Chief Creative Officer.

3.23 In line with the BBC's other commercial subsidiaries, BBC Studios regularly reports to the BBC Commercial Holdings Board and main BBC Board on its financial performance, using a range of financial measures (paragraph 3.2). It focuses particularly on its performance in meeting the profit target which the BBC Board set for it at an organisation-level (paragraph 3.3). It must also report regularly to the BBC's regulator, Ofcom, on the profitability of BBC Studios and its lines of business.

3.24 In contrast, there are gaps in the reporting of commercial subsidiaries' non-financial performance, including BBC Studios. According to the BBC, the BBC Commercial Holdings Board and main BBC Board do not receive regular updates on non-financial performance. Instead, in response to their requests, they receive ad-hoc reports on specific non-financial aspects and on significant and complex individual deals, as well as verbal feedback in any board discussions on non-financial performance. In January 2019, the Saul Review (paragraph 3.21) recommended the development of key performance indicators to shed more light on the priorities, and bring more focus to the key objectives, of these subsidiaries. Such indicators could, for BBC Studios, cover customer diversification, margins, the contribution of the top 30 shows and success in winning returning series that the BBC is putting out to tender.

3.25 In November 2019 the BBC started to address the gaps in the reporting of commercial subsidiaries' non-financial performance. With regard to BBC Studios, it included in its report to the BBC Commercial Holdings Board proposed measures for reporting key aspects of BBC Studios' non-financial performance measures, such as the strength of its pipeline, its success in securing new commissions and the extent to which it has grown priority branded services. The BBC intends to agree the final performance indicators for the regular reporting of BBC Studios' non-financial performance early in 2020.

Figure 14 Governance arrangements before and after the merger of the former BBC Studios and BBC Worldwide
 The BBC restructured the governance of its commercial activities to take account of the merger between the former BBC Studios and BBC Worldwide



Notes

- 1 The Studios Executive Committee (SEC) is the key decision-making body for BBC Studios, with decision-making in some areas delegated to four main sub-committees. It comprises senior management from BBC Studios Productions and BBC Studios Distribution. There are also separate leadership groups reporting to the SEC for production and the four regional distribution businesses.
- 2 This Committee deals with all investments in intellectual property (IP), including investments in programmes, BBC-invested production companies and external IP.
- 3 This Committee considers all non-content investments up to £5 million on, for example, technology and acquisitions.
- 4 This Committee manages BBC Studios' risk and compliance framework and monitors compliance with external audit recommendations and Ofcom's regulatory requirements.
- 5 This Committee is responsible for remuneration issues.

Source: National Audit Office analysis of BBC documents

3.26 In our opinion, the focus on financial metrics and the gaps on non-financial performance has meant that the boards have had insufficient oversight over key drivers of BBC Studios' performance and the rising risk profile it faces from increased competition and changing audience demand (paragraphs 1.6 and 1.7). These shortcomings in board reporting have also impacted on the ability of the boards to gain a sufficient understanding of the overall impact on BBC Studios' business of some of the new, more complex deals it has entered into (paragraphs 2.16 and 2.18) in terms of generating sustainable margins and returns, and of how these deals fit together as a portfolio. The planned improvements in board reporting should result in the BBC Commercial Holdings 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, there are still areas for improvement in the non-financial performance measures proposed in November 2019 around, for example, the measurement of the content delivery pipeline, the extent of new production commissions from the BBC and third parties, and staff satisfaction.

3.27 The BBC has taken steps to strengthen its oversight of BBC Studios. Until September 2017, the BBC Commercial Holdings Board only had two members and performed a limited role, fulfilling the statutory functions in respect of filing the company's accounts, with major strategic decisions and oversight exercised by separate BBC Studios and BBC Worldwide boards. In September 2017, the BBC expanded the BBC Commercial Holdings Board membership to 10, appointing two non-executive members for the first time. The BBC Director-General was appointed as the BBC Commercial Holdings Board's chair and the Board's remit was expanded so that it became responsible for developing the BBC's overall commercial strategy and the strategies of each of the main commercial subsidiaries, including BBC Studios, and for overseeing the performance of these subsidiaries. As a result, the role of the new BBC Studios Board, like its predecessor, the BBC Ventures Group Board, is limited to fulfilling statutory functions.

3.28 The January 2019 Saul Review recommended that there should be fewer BBC Group executives on the BBC Commercial Holdings Board and an increase in non-executives, including non-executive members from the main BBC Board itself for the first time. In April 2019, the BBC amended the Commercial Holdings Board's composition to include six executive and four non-executive members and appointed as its chair a non-executive from the main BBC Board.

3.29 The new Commercial Holdings Board chair intends for this Board to take a more proactive role in setting the strategic objectives for the BBC's main commercial subsidiaries, including BBC Studios. As the main BBC Board and the new Commercial Group strategy sub-committee of the executive team (paragraph 1.18) also have roles in reviewing and approving the subsidiaries' strategic objectives, in September 2019 the BBC Board approved changes to the relevant boards' terms of reference to clarify their respective roles. However, it is too early to tell how effective these changes and the April 2019 improvements made in governance will be in practice.

Appendix One

Our audit approach

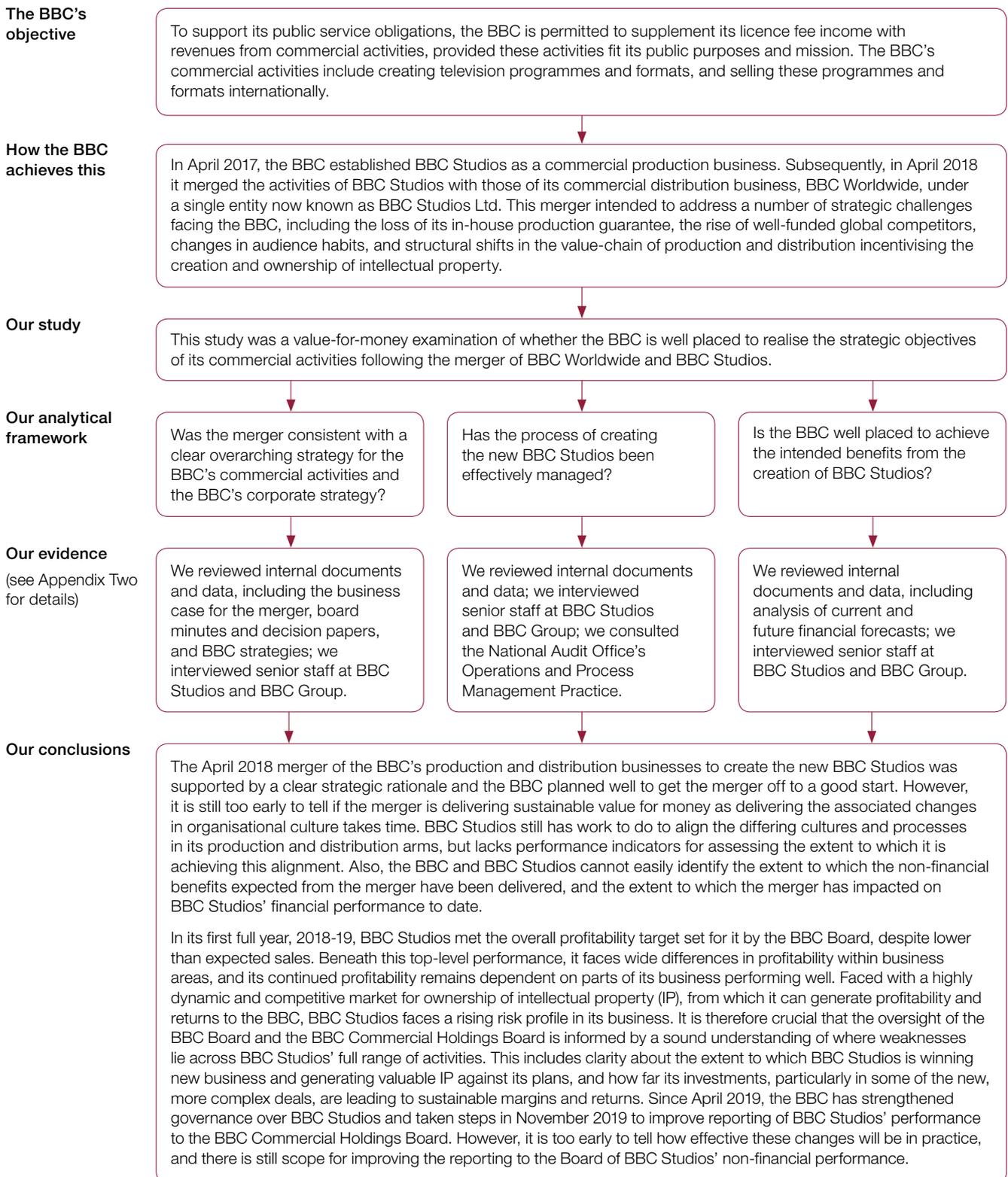
1 This study examined whether the BBC is well placed to realise the strategic objectives of its commercial activities, following the integration of its commercial production and distribution businesses at the level of a new holding company called BBC Studios.

2 We reviewed:

- whether the BBC's decision to create the new BBC Studios was consistent with a clear, overarching strategy for all its commercial activities;
- the extent to which the BBC had effectively managed the process of creating BBC Studios; and
- whether the BBC is well placed to achieve the intended benefits from the creation of BBC Studios.

3 Our audit approach is summarised in **Figure 15**. Our evidence base is described at Appendix Two.

Figure 15
Our audit approach



Appendix Two

Our evidence base

1 We reached our conclusions following analysis of evidence collected between July and September 2019. Our audit approach is outlined in Appendix One.

Document review

2 We reviewed more than 180 internal BBC documents, including:

- the business case for the merger, the business strategies of BBC Studios and its legacy companies, and strategies at the wider Group level;
- board papers and minutes to understand the BBC's strategic priorities about the merger and how it was overseeing its implementation;
- quarterly performance reports to the BBC Board and BBC Commercial Holdings Board, to review progress against strategic objectives and forecast performance, and assess the quality of reporting; and
- BBC Studios Executive Committee minutes and papers, to track progress with implementation of the merger and to understand strategic decision-making processes.

3 We reviewed the following publicly available documents, including:

- annual reports and accounts for the BBC and other media organisations to benchmark the BBC's performance against that of its competitors; and
- Christopher Saul's January 2019 report assessing transparency in the BBC's commercial subsidiaries.

Interviews

4 We conducted interviews with:

- senior management at BBC Studios to understand the rationale for the merger, how the merger had been implemented, and progress with realising the merger's benefits;
- senior management at the BBC to understand commercial objectives at Group level and the extent to which BBC Studios' objectives were aligned with wider Group strategies;

- operational staff at BBC Studios and the BBC Group to assess how effectively the merger had been implemented and any issues outstanding, and to understand performance monitoring and reporting processes;
- members of the BBC Board and the BBC Commercial Holdings Board to evaluate the effectiveness of governance and risk management; and
- representatives from the independent producers' organisation, PACT, to seek an external perspective of the BBC's commercial activities and an understanding of current and future market conditions.

Data analysis

5 We carried out the following analysis:

- reviewing BBC Studios' revenue, profit and sales targets and its performance against these over time, including by its individual lines of business;
- reviewing BBC Studios' returns to the BBC, including detailed consideration of EBITDA (the BBC's chosen profit measure – earnings before interest, tax, depreciation and amortisation) performance and forecasts; and
- reviewing management information collected by BBC Studios on its intellectual property (IP) pipeline, including by expected returns and by share of BBC and third-party IP.

Operations and Process Management Practice

6 We engaged our Operations and Process Management Practice (OPMP) to access subject matter experts with extensive experience of operations and process management. To inform our assessment of the implementation of the merger, the OPMP reviewed three BBC Studios processes, assessing the extent to which management systems at BBC Studios were aligned to operational delivery and performance. These three processes were:

- HR activities to support the merger;
- oversight of BBC-owned production companies; and
- monitoring and progress towards delivering the new landmark natural history target.

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