National Audit Office

The BBC's strategic financial management

BBC

REPORT

by the Comptroller and Auditor General

SESSION 2019–2021
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Report by the Comptroller and Auditor General

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Comptroller and Auditor General
National Audit Office

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Key facts

£3.52bn

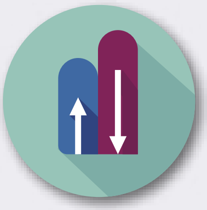
BBC income from licence fee 2019-20

£208m

financial returns from commercial activities 2019-20

£310m

decline in licence fee income between 2017-18 and 2019-20



£119m

amount by which BBC spending as a whole exceeded income in 2019-20

£618m

annual savings delivered by the end of 2019-20

£125m

additional savings required to meet the financial impact of COVID-19

22,749

average number of full-time equivalent staff employed by the BBC in 2019-20

1 in 2

16–34 year-olds tune into BBC TV channels in an average week in 2019-20

30%

decline in BBC TV average per person per day viewing minutes between 2010 and 2019

Summary

1 The BBC is the UK's main public service broadcaster, providing a wide range of television, radio and digital services. Public service broadcasting (PSB) is defined as the collective output of specified television services designed to meet purposes and objectives set by Parliament. The BBC's mission, as set out in its Royal Charter, is to inform, educate and entertain. Under its Charter, the BBC undertakes five public purposes covering, for example, the provision of impartial news and information, and reflecting the UK, its culture and its values to the world.

2 The BBC is primarily funded by households paying the television licence fee, receiving £3.52 billion in 2019-20. The BBC is also permitted by its Charter to generate income from commercial activities, such as creating and selling television programmes. The BBC is independent of government but is a public corporation sponsored by the Department for Digital, Culture, Media & Sport (DCMS) and regulated by Ofcom, the communications regulator.

3 The future of the BBC and its funding model is subject to considerable public and parliamentary debate, with a particular focus on how the BBC chooses to spend its money and whether the licence fee funding model remains appropriate. The BBC operates in a marketplace in which it increasingly competes not only with traditional television and radio services, but also with new online services, such as Netflix. In addition, the BBC began negotiations with government in November 2020 about the future funding it will receive from the licence fee. The BBC will also be subject to a mid-term review of its Charter by government between 2022 and 2024.

4 This report assesses how the BBC has positioned itself to respond to the financial and strategic challenges and opportunities within the media landscape in which it operates. It examines:

- the key financial challenges facing the BBC and the opportunities open to it (Part One);
- its responses to these challenges and opportunities (Part Two); and
- its preparedness for its long-term challenges and opportunities (Part Three).

Key findings

The BBC's financial challenges

The licence fee

5 **The BBC is heavily reliant on its main source of income, the licence fee.** In 2019-20, the BBC received £3.52 billion from the licence fee. The licence fee has provided the BBC with considerable financial stability throughout its existence, enabling it to plan ahead with more certainty than its rivals. This is in stark contrast to other UK public service broadcasters (PSBs), which rely on income sources such as advertising, and newer entrants to the marketplace funded by subscriptions and debt (paragraphs 1.3 and 1.4).

6 **The BBC's licence fee income has fallen in recent years due to the gradual withdrawal of government funding for free licences for the over-75s.** Since 2017-18, the BBC's income from the licence fee has fallen by £310 million (8%). This fall is the result of the 2015 licence fee settlement between the BBC and government which, while awarding the BBC some financial concessions, also included the gradual withdrawal of government funding for free TV licences for the over-75s until 2020-21 when this funding reduced to zero. The BBC estimated that the withdrawal of this funding would cost it £745 million annually by 2021-22 (paragraphs 1.6, 1.17 and 1.18, and Figure 8).

7 **There is some uncertainty over the BBC's financial future.** As part of the 2015 licence fee settlement, the BBC was given statutory responsibility for deciding the policy of offering free licences to those aged over 75 from 2020-21. After public consultation, in August 2020 the BBC continued to offer free licences to those aged over 75 who are in receipt of Pension Credit and began charging other over-75s for their licences. The BBC estimates that, in the medium term, this policy could provide it with more than £500 million annually, compared with the £745 million it would have received had the government continued to fund free licences for all over-75s. As the new policy has not yet been in place for a full year, it is unclear how much it will eventually raise. In addition, in November 2020, government and the BBC started negotiations about the level of the licence fee after 2022, when the current agreement for the licence fee to increase in line with inflation ends. Government is also consulting on decriminalising licence fee evasion, which the BBC estimates could reduce its cumulative income by more than £1 billion from 2022-23 to 2026-27 inclusive (paragraphs 1.6, 1.18 and 1.19).

8 **The BBC has experienced some uncertainty over its income as a result of COVID-19.** The BBC initially estimated that it would need to make annual savings of up to £125 million in 2020-21 to offset the net loss arising from COVID-19. Other PSBs have also experienced income reductions due to COVID-19 such as falls in advertising sales. Channel 4, for example, reported that it needed to make savings of £245 million. None, however, had a guaranteed income source such as the BBC’s licence fee income. In October 2020 the BBC forecast that licence fee income would be £132 million higher in 2020-21 than it had expected in April 2020 when initially estimating the impact of COVID-19. The BBC has used £68 million of this to fund content for the autumn and winter 2020 schedules and pay for additional COVID-19-related expenditure. It has not earmarked the rest of this forecast income increase for use as there remains a risk the pandemic could adversely affect its finances. The BBC, therefore, still plans to deliver the savings of £125 million arising from COVID-19 (paragraphs 1.3, 1.22, 2.6 and 2.9).

Long term trends in audience viewing habits

9 **The BBC’s falling audience share poses a risk to its licence fee income.** Although broadcast TV remains the most common form of on-screen viewing, in recent years there has been a marked move away from watching broadcast television to streaming and online viewing on demand. The BBC has sought to compete in this new marketplace, including through making more content available on iPlayer and launching its BBC Sounds service. While the BBC remains the most used media brand in the UK, its share of younger audiences has been under pressure. Although on average 80% of those aged 16 to 34 spent time using BBC services in 2019-20, almost half of them did not regularly use BBC TV channels on a weekly basis. The amount of time that an adult spent watching broadcast BBC TV dropped by 30% from 80 minutes a day on average in 2010 to 56 minutes in 2019. Falling audience share poses a financial risk as people are less likely to pay the licence fee if they do not view licensable content.[1] Between 2017-18 and 2019-20 there was a fall of 450,000 in the number of non-over-75 households buying TV licences, due to changes in audience viewing habits and increasing numbers of these households qualifying for a free over-75 licence (paragraphs 1.11 and 1.13 to 1.17, and Figure 6).

1 Live programmes shown on any TV channel or on online TV services, such as ITV Hub or Amazon Prime Video, and programmes shown on BBC iPlayer.

The BBC's financial commitments

10 **The BBC's financial flexibility is constrained by factors over which it has varying degrees of control.** For example, alongside the income it receives from the licence fee, the BBC is regulated more closely than other PSBs. In practical terms this means that there is a broad range of programming that the BBC must make which its competitors do not and to which it must therefore commit significant portions of its budget. The lead times involved in producing some programmes can be long, requiring expenditure to be committed in advance, and the spending power of new market entrants has caused costs for some genres to grow in excess of general inflation. There are also a number of funding commitments placed on the BBC by licence fee settlements, such as funding S4C, the Welsh language channel, and there are large items of other, committed expenditure such as long-term contracts to maintain the TV and radio broadcasting network, and the cyclical nature of some of its spending (for example, on major sports events every two years). The BBC also has limits placed on its ability to borrow, set by DCMS (paragraphs 1.8, 1.10, 1.12 and 2.13).

The BBC's response to its financial challenges and opportunities to date

11 **The BBC has used its cash reserves to meet budgeted deficits in recent years as planned.** For three of the past five years, the BBC's costs have outstripped its income, with the BBC as a whole making a loss of £119 million in 2019-20. As the BBC was aware that its income would be insufficient, it budgeted for these losses and made planned use of its cash reserves, which fell by 23% between 2017-18 and 2019-20, to £401 million. Pre-COVID-19, it had budgeted for these to fall further to £93 million by the end of 2020-21. The BBC has to date chosen to make only limited use of its borrowing facilities. Instead, it has raised extra funds to redevelop parts of its estate through sale and leaseback arrangements. The complex nature of these arrangements entails additional risks for the BBC to manage to ensure these deliver value for money (paragraphs 2.2 to 2.4, and Figure 10).

12 **Although the BBC has made substantial savings, it faces significant challenges in delivering its remaining planned savings.** In February 2017 the BBC introduced a programme to deliver £800 million savings annually by 2021-22. This was designed to address the estimated shortfall in its finances resulting from the 2015 licence fee settlement and trends in inflation and licence fee payments. By 2019-20, the BBC had delivered annual savings of £618 million, and was broadly on track to meet its £800 million target. In 2020 the BBC then increased its annual savings target to £1 billion by 2021-22, reflecting the need to make extra savings because of the impact of COVID-19 and its decision to continue to offer free licences to some over-75s. Despite progress on delivering savings, the BBC has delayed making what it considered to be the most challenging aspect of its savings programme as it involved a large number of redundancies. Beyond this, the BBC contends that the number of areas in which it could make further savings without significant audience impact is limited: for example, its indirect costs were among the lowest of comparable media companies. In measuring its savings performance, the BBC does not regularly monitor all savings achieved by expenditure category, which might better help it identify scope for further savings (paragraphs 1.7, 2.7 to 2.9, 2.14 and 2.16, and Figure 3).

13 **Despite high levels of inflation in the entertainment industry, the BBC has been able to maintain its content spending, but this will be a challenge for the future.** The reported level of inflation in the entertainment industry is high, particularly in genres such as high-end drama. Although it has been making savings, the BBC has, to date, made little change in the amount that it spends on producing content, which has remained consistent at around £2.7 billion a year. This is partly because of the financial contribution that BBC Studios, the BBC's largest commercial subsidiary, and other partners make to the funding of individual public service broadcasting productions in return for valuable distribution rights. According to the BBC, such contributions totalled more than £365 million in 2019. As a result, for every £1 that the BBC spent on commissioning network TV programmes from its own funding, £1.30 was available to producers to spend on this content. While the BBC's spending on content is greater than that of rival PSBs, it is, however, far below that of certain subscription video-on-demand (SVoD) competitors (paragraphs 1.12 and 2.10 to 2.12, and Figure 12).

14 **The BBC has not always accurately estimated its project costs, which will become more important in light of increasing financial challenges.** While the BBC has executed considerable savings programmes in recent years, it has on occasion under-estimated the costs and uncertainties involved at the start of critical projects. For example, in 2018, we reported that its construction project to renew the *EastEnders* set was due to be delivered 31 months late and more than £25 million over budget. Similarly, a BBC-commissioned review in 2019 found that the organisation tended to under-estimate the scale and complexity of its technology programmes. In June 2020, the BBC estimated that implementation of the new systems required to charge some over-75s for their TV licence would cost £65 million, compared with the budget estimate of £44 million, with £6 million of the cost increase due to the unexpected impact of COVID-19. In 2020, the BBC has sought to strengthen the governance of its critical projects to ensure that lessons learned on previous projects are applied going forward. However, it is too early to assess how effective its efforts have been (paragraph 2.19).

15 **The BBC's commercial activities do not yet contribute significantly to its overall income position.** Although the BBC's commercial activities generate significant income each year, £1.57 billion in 2019-20, given the nature of the industry the BBC also incurs substantial costs generating this income. As a result, the only financial returns from these activities to the BBC's PSB business are the dividends paid by its commercial subsidiaries from their profits, and certain payments made by the main commercial subsidiary, BBC Studios. In 2019-20 the returns paid by the commercial businesses for the BBC to use on its programme-making were £208 million, equivalent to under 6% of licence fee income. The BBC has looked to act on some of the opportunities offered by the increased number of providers in the current media market. It has, for example, entered into a partnership with ITV to provide a new SVoD service, BritBox. The BBC also sees the increased number of broadcasters as an opportunity to increase the number of buyers for its content and increase the number of companies with which it co-produces content (paragraphs 1.11, 1.12 and 2.20 to 2.23, and Figures 14 to 16).

16 The BBC has not yet set out how it intends to pay for its new strategic priorities set in September 2020. The new Director-General has been clear that the BBC's four main priorities are: a renewed commitment to impartiality; a focus on unique, high-impact content; extracting more from online; and increasing commercial income. As he himself has identified, the BBC will need to make fundamental changes and accelerate its pace in areas such as meeting the needs of underserved audiences. The Director-General has also identified that, for the BBC not to fall further behind its competitors, it needs to develop its online presence to be cutting-edge. Addressing this while also meeting other new challenges such as developing high-impact content is likely to require new investment – while also continuing to deliver extensive savings. As of October 2020, given the Director-General's recent appointment, the BBC had yet to set out how its new strategic priorities would be funded, but intended to do so by February 2021. It had also not conducted analysis of other potential fundamental changes to the licence fee from 2022-23, such as an end to annual indexation of the licence fee, or, in the longer term, the impacts of alternative funding models in the event of abolition of the licence fee. According to the BBC, it had been too early to undertake such modelling of options that had not even been proposed (paragraphs 3.2, 3.4, 3.7, 3.9 and 3.10, and Figure 17).

17 In preparing for licence fee negotiations the BBC is in the process of updating its analysis of the wider economic value it provides to the UK. The BBC considers that it delivers significant wider value to British and global society. This includes delivering a range of content that appeals across all demographics and contributing to the UK media industry at a national and local level, and to the national economy generally. Despite this, the BBC had conducted no analysis of its wider economic value to the UK as a whole in almost 10 years. According to this previous work, the BBC increases the productive potential of the creative sector at a national level by investing in skills and technology, while stimulating demand by commissioning content from the independent production sector. In November 2020 the BBC commissioned KPMG to undertake a new assessment of the BBC's wider economic value in preparation for its negotiations with the government over the new licence fee settlement (paragraph 3.11).

Conclusion

18 As it prepares for upcoming licence fee negotiations and subsequent mid-term Charter review, the BBC faces significant strategic financial challenges. In addition, its financial position as at the end of 2020 has been unexpectedly weakened by the impact of COVID-19, although not to the extent experienced by some other broadcasters. Despite its purpose of being a universal broadcaster and still being the most used media brand in the UK, the BBC has seen a notable drop in audience viewing times. In parallel, its principal source of income, the licence fee, has also declined, and the BBC now faces considerable uncertainty about the income it will receive from the licence fee at a time when its net commercial income is not yet at a level to make a significant contribution to its overall income position. The BBC believes its ability to overcome these financial challenges through its savings programme will be tested as it seeks to deliver the remaining savings which it considers most challenging.

19 In recent years, many of the BBC’s competitors have swiftly moved ahead in the global marketplace in terms of size and scale of services offered, gaining audiences and investing in technology. For its part, the BBC has introduced new initiatives to capitalise on the opportunities offered by this new marketplace including, most recently, BBC Sounds and improvements to the iPlayer service. To take further advantage, while continuing to meet its obligations as a universal public service broadcaster, the BBC will need to overcome certain challenges. These include continuing to make savings while investing in new technology and addressing an underlying lack of pace when implementing change. More immediately, as the BBC enters into licence fee negotiations, it needs to be able to articulate its current wider value to the UK economy.

Recommendations

20 The BBC should develop its strategic response for its longer-term financial future by:

a as soon as it is possible, **producing a long-term financial plan** which sets out the detail for the next stage of its savings, and how it will fund its new strategic priorities

b **setting out a plan** to fulfil its requirement to represent all audiences by reaching out to underserved audiences while also making significant changes to its operations in the UK's nations and regions;

c **setting out a clear strategy** for its aspirations for technology and personalisation of its services, with a focus on timing and how this will be funded;

d **setting out how it will monitor its wider economic value** within the UK's media and broadcasting landscape on a more regular basis in the future; and

e **monitoring all savings achieved** by expenditure category, in order to more effectively identify the scope for further savings.

21 The BBC should **assess**, a year from now, the **effectiveness of the mechanisms** it has established for learning from its experiences of managing projects and bearing down on the costs associated with these.

Part One

The BBC's financial challenges and opportunities

1.1 This part of the report sets out the background against which the BBC operates including: its constitutional set-up; funding and spending; constraints it faces; the wider media environment; its audiences; trends in licence fee income; and the impact of COVID-19.

Constitutional set-up of the BBC

1.2 The BBC's Royal Charter states that its mission is to inform, educate, and entertain, and sets out the BBC's public purposes (**Figure 1**). The BBC is one of the four UK-wide public service broadcasters (PSBs), alongside ITV, Channel 4 and Channel 5. The BBC and Channel 4 are both public corporations sponsored by the Department for Digital, Culture, Media & Sport (DCMS), while ITV and Channel 5 are privately owned. A framework agreement between the BBC and DCMS places obligations on the BBC in relation to topics addressed in the Charter. DCMS sets the amount that the BBC is permitted to collect from the licence fee and, in its sponsorship role, will conduct a mid-term review of the BBC's Charter between 2022 and 2024, focusing on the BBC's governance and regulatory arrangements. In September 2020 a new Director-General started in the role, and a new Chairman is likely to take office in early 2021.

BBC funding and spending

1.3 UK law states that a person must be covered by a TV licence to: watch or record programmes as they are being shown on TV on any channel; to watch or stream programmes live on an online TV service (such as ITV Hub or Amazon Prime Video); and to download or watch any BBC programmes on iPlayer.[2] In 2019-20 a licence cost £154.50 a year and almost 26 million households in the UK had one. In contrast, all other UK-wide PSBs rely on income sources such as advertising, and some of the newest entrants to the media marketplace are funded by subscriptions and debt.

2 TV licence fees or other public funding of public service broadcasters are common across Europe. Many European countries use mixed funding systems that rely on a combination of public funding and advertising revenues and/or other commercial sources such as programme sales. Four of the big five European markets (France, Germany, Italy and the UK) mainly rely on licence fee revenue.

Figure 1
BBC's public purposes

The BBC has five public purposes

1 

To provide impartial news and information to help people understand and engage with the world around them.

2 

To support learning for people of all ages.

3 

To show the most creative, highest-quality and distinctive output and services.

4 

To reflect, represent and serve the diverse communities of all of the UK's nations and regions and, in doing so, support the creative economy across the UK.

5 

To reflect the UK, its culture and values to the world.

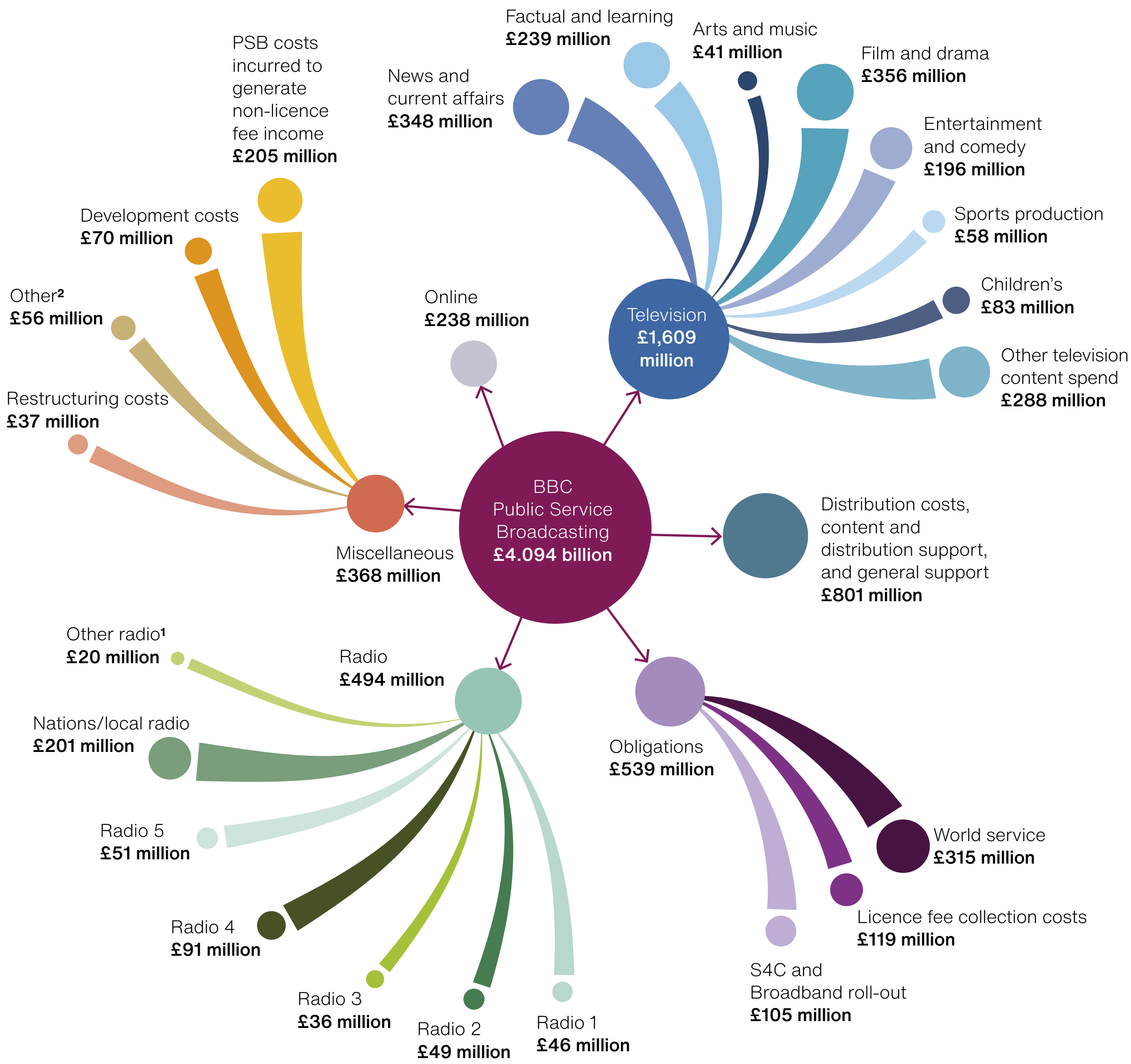
Source: BBC Charter

1.4 In 2019-20 the BBC generated total income of £4.943 billion, of which £3.52 billion was public funding from the TV licence fee. Most of the remainder was the income generated by the BBC's commercial subsidiaries, through activities such as advertising and sales of content. The BBC also received a government grant for the BBC World Service (£86 million in 2019-20). In 2019-20, BBC expenditure totalled £5.093 billion, including the costs incurred by the commercial subsidiaries in generating their income. It also included the BBC's expenditure on Public Service Broadcasting (PSB) which totalled £4.049 billion (**Figure 2** overleaf). This paid for 10 UK television services, 56 radio stations, an online presence and a news service overseas in English and more than 40 other languages.

Figure 2

BBC Public Service Broadcasting expenditure, 2019-20

The BBC's Public Service Broadcasting expenditure totalled £4.049 billion in 2019-20



Notes

1 'Other radio' consists of expenditure on Radio 6 and Asian Network.

2 'Other' consists of expenditure on orchestras and performing groups, Public Service Broadcasting pension deficit reduction and BBC Monitoring.

Source: BBC Group Annual Report and Accounts 2019-20

1.5 The level of the licence fee is set every few years in negotiations between the BBC and government. The most recent settlement was negotiated in July 2015 and the next negotiation started in November 2020 to set the licence fee level from April 2022 for at least five years. The settlements that emerge from licence fee negotiations typically result in the BBC both taking on more responsibilities and making financial gains. Under the 2015 settlement, the government agreed to: increase the cost of the licence fee each year in line with inflation from 2017-18; close the legal loophole that allowed people watching iPlayer not to pay the licence fee, with effect from September 2016; and remove a previous obligation on the BBC to pay a broadband levy from its licence fee income. This contrasts with the previous settlement in 2010 which, among its provisions, included the freezing of the cost of a licence fee from 2010-11 and which, according to the BBC, resulted in a real-terms reduction in its licence fee funding of about 24% to 2016-17.

1.6 As part of the 2015 settlement, the government also decided to stop funding the provision by the BBC of free TV licences for the over-75s. As a transition, government continued to fund this concession at a reducing level until 2020-21, when its funding would reduce to zero and the BBC would assume statutory responsibility for deciding the future of this concession.[3] In June 2019, after public consultation, the BBC decided to continue offering free TV licences to those aged over 75 who are in receipt of Pension Credit, but to charge other over-75s for their licence from June 2020.[4]

1.7 In February 2017 the BBC estimated that, as a result of the changes in the 2015 licence fee settlement and projected future trends in household licence fee payments and cost inflation, there would be an £800 million shortfall in its finances by 2021-22 if it did not take action. The BBC put in place a programme of savings measures to address this shortfall (**Figure 3** overleaf).

Constraints facing the BBC

1.8 In addition to complying with the obligations placed on it by its Mission, Public Purposes, Charter and framework agreement with the DCMS (paragraph 1.2), under the terms of its Charter, the BBC is also subject to regulation by Ofcom. All UK broadcasters are required to be licensed by Ofcom. In view of the income it derives from the licence fee, the BBC is subject to more TV regulations than the other broadcasters. This includes additional conditions in its operating licence from Ofcom and, according to our calculations, 20 different categories of TV programming quotas, 14 more than the other PSBs (**Figure 4** on page 19). Unlike other PSBs, the BBC is required to provide programmes in a number of areas, including religious affairs, comedy and arts. These Ofcom quotas have a material effect on the BBC's scheduling.

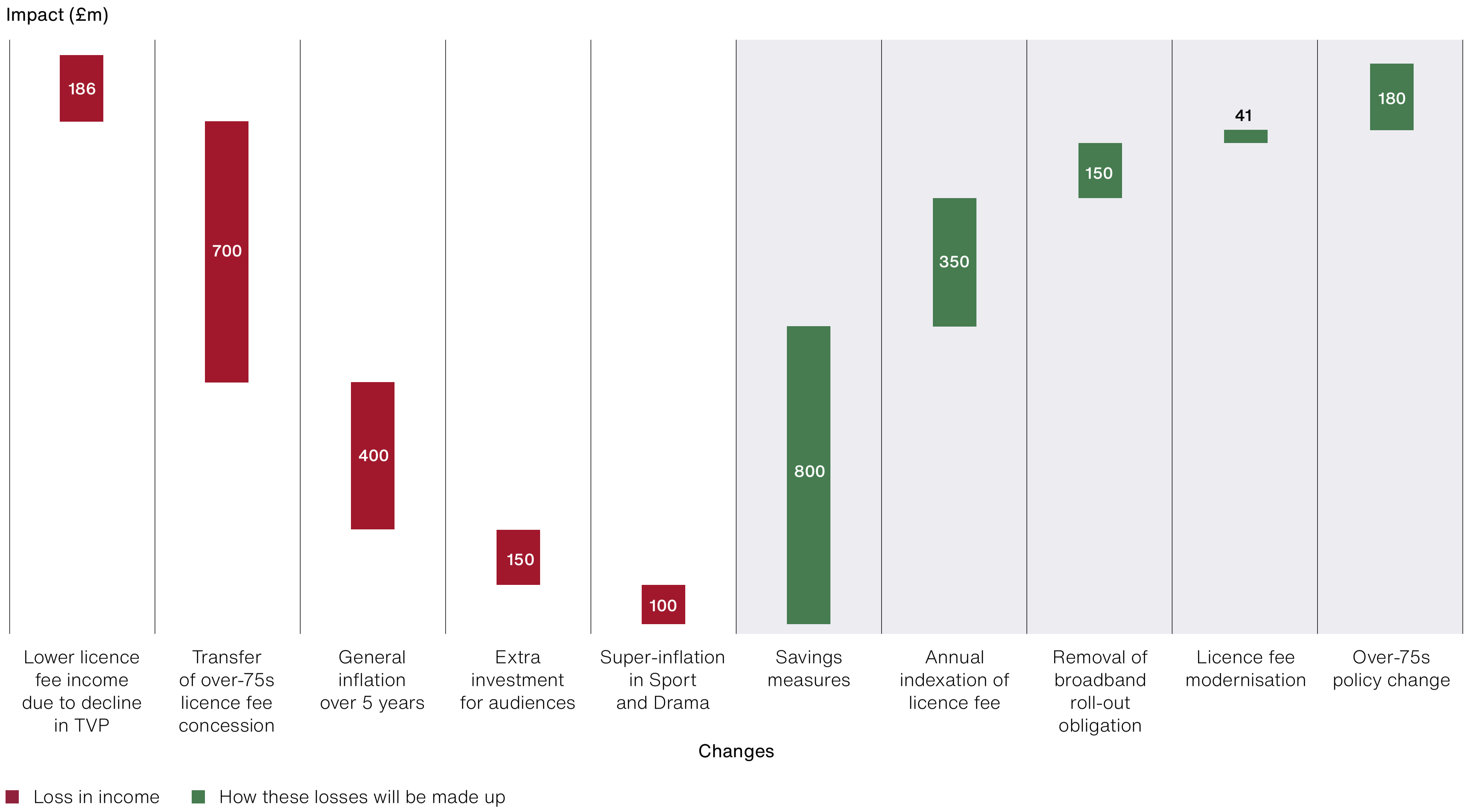
3 The Digital Economy Act 2017 gave the BBC responsibility for determining whether there should be a concession with regards to the payment of the TV licence fee by those aged 65 or over.

4 Over-75s in care homes are exempt from payment as the requirement to have a licence rests with the care home.

Figure 3

Original estimated impact of 2015 BBC licence fee settlement and other factors

In February 2017, the BBC identified a series of measures to address the impact on its funding of the 2015 licence fee settlement and other factors, such as inflation



Notes

1 TVP stands for TV penetration (percentage of households requiring a TV licence).

2 Transfer of over-75s licence fee concession – BBC estimate of the amount of grant it would have received in 2021-22 if government had continued to meet in full the cost of free TV licences to all over-75s.

3 Over-75s policy change: The BBC assumed that it would change its policy in 2020-21 so that all members of a household had to be over-75 in order to qualify for a free licence. This was not the option it chose in May 2019.

Source: National Audit Office analysis of BBC documents

Figure 4

Comparison of TV programming quota requirements for UK-wide public service broadcasters (PSBs)

The BBC is subject to more TV quotas than other UK-wide PSBs

	BBC	ITV	Channel 4	Channel 5
Independent productions	✓	✓	✓	✓
Original productions	✓	✓	✓	✓
News programming	✓	✓	✓	✓
Current affairs programmes	✓	✓	✓	✓
Network programmes made outside the M25 area	✓	✓	✓	✓
Programmes of national or regional interest	✓	✓	✗	✗
Arts and music programmes	✓	✗	✗	✗
New arts and music programmes	✓	✗	✗	✗
First-run UK originations	✓	✗	✗	✗
Religious programmes	✓	✗	✗	✗
Comedy programmes	✓	✗	✗	✗
Drama	✓	✗	✗	✗
Factual programmes	✓	✗	✗	✗
Non-news programmes	✓	✗	✗	✗
Programming made in England	✓	✗	✗	✗
Programming made in Scotland	✓	✗	✗	✗
Programming made in Wales	✓	✗	✗	✗
Programming made in Northern Ireland	✓	✗	✗	✗
Coverage of Scotland, Northern Ireland and Welsh Assemblies	✓	✗	✗	✗
Originated programming for learners of the Gaelic language	✓	✗	✗	✗
Schools programming	✗	✗	✓	✗

Source: National Audit Office analysis of Ofcom licence conditions

1.9 Ofcom also regulates key aspects of the BBC's place in the wider market. Ofcom regulations, for example, determine that BBC 1 and BBC 2 appear as the first two channels on TV guides on platforms such as Sky and Freeview. Ofcom must also sign off on any changes to the BBC's PSB or commercial activities which could potentially have material implications for competition. The time taken to obtain this can vary greatly, depending on whether Ofcom considers that a change has material implications for competition. Such changes are subject to a more detailed evaluation. As a result, it took more than a year to gain Ofcom's sign-off in 2019 for the BBC to increase the period for which programmes are available on iPlayer from 30 days to 12 months. Ofcom judged that this proposed change could have material implications for competition and therefore directed the BBC to undertake a public interest test prior to its own competition assessment. Its competition assessment then took four months. Where Ofcom judges that the potential changes have no material implications for competition, the time it takes to reach a decision is shorter. For example, its 2019 evaluation of the BBC's involvement in BritBox took only four months. Ofcom has sought to reduce the time taken for its evaluations by engaging with the BBC more regularly.

1.10 In addition to the regulations set by Ofcom, DCMS restricts the BBC's borrowing capability, as government accounting rules mean that BBC borrowing is recorded within DCMS's accounts. The BBC's total borrowing limit for public service broadcasting, excluding that for leases, is £200 million, and £350 million for commercial activities. These limits have been in place since 2003.

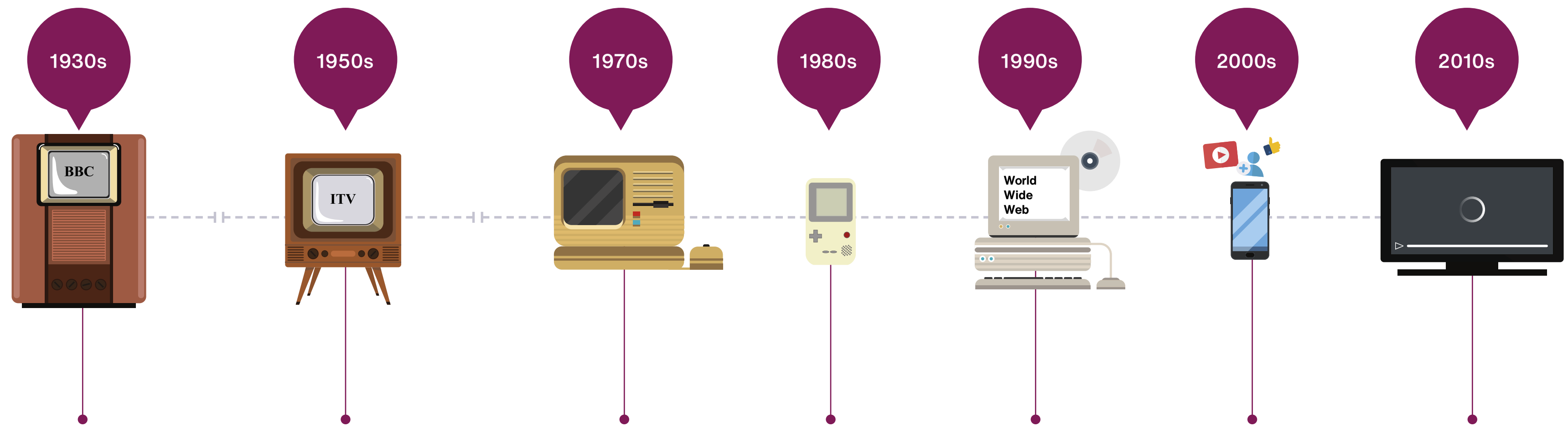
The wider media environment

1.11 The number of channels on free-to-air television has increased more than 10-fold over the past 20 years. In parallel, the range of on-screen entertainment options has also multiplied (**Figure 5**) with the advent of social media sites, including Facebook and YouTube, and increased online viewing of content with the arrival of subscription video-on-demand (SVoD) services such as Amazon Prime, Disney Plus, Netflix, Peacock and BritBox. These developments not only provide a challenge to the BBC in terms of increased competition for audiences but also an opportunity. The BBC has expanded its online TV services, making content available on iPlayer for 12 months instead of 30 days. The BBC has also entered into a partnership with ITV to provide an SVoD service in the UK – BritBox – building on its service in North America, which is expanding further internationally.

Figure 5

Selected on-screen entertainment innovations: from the 1930s to the 2010s

The pace of innovation has changed, with the amount of competition the BBC faces increasing in recent years



1932: First experimental **BBC TV** programme.

1955: First TV competition to the BBC as **ITV** begins broadcasting.

1975: The first **personal computers** are introduced.

1979: World's first cartridge-based handheld **console** released.

1989: Gameboy launched.

1990: Creation of **British Sky Broadcasting**.

1991: First-ever **website** published.

1996: World's first **DVD** player launched.

2000: First product to be officially billed and marketed as a **smartphone** launched.

2005–2006: Social media sites YouTube and Facebook launched.

March 2012: Netflix launches UK film and TV **streaming service**.

October 2012: Analogue TV signals end and conversion to **Digital TV** (with Freeview offering in excess of 100 free-to-air channels).

Source: National Audit Office analysis

1.12 As well as competing with the BBC for audiences, SVoD providers increasingly commission content in areas of traditional BBC specialism, including drama and natural history. The spending power of these companies has led to growth in the cost of content for some genres in excess of general inflation. For example, the BBC reports that the costs of its non-continuing drama production have increased by nearly two-thirds over five years. The rapid expansion of entertainment providers does, however, also afford the BBC new opportunities in the secondary UK and international market for its own finished content and programme formats, and in finding partners with which it can potentially co-produce content. Additionally, some analysts of the media industry have suggested that the model of substantial growth funded by debt followed by some SVoD providers is not sustainable over the long term.

The BBC's audiences

1.13 As viewing options have increased, habits have changed, with television audiences declining and online viewing on demand markedly increasing. Between 2017 and 2020, SVoD providers' share of UK viewing time trebled, from 6% to 18%; live TV now makes up less than half (46%) of viewing time (**Figure 6**). Although the BBC remains the most used media brand in the UK, the amount of time an adult spent watching broadcast BBC TV on average each day dropped from 80 minutes in 2010 to 56 minutes in 2019. This decline (30%) compares with a drop of 24% for ITV's channels and 34% for Channel 4's channels over the same period.

1.14 Although the BBC was one of the earliest adopters of digital viewing platforms, launching BBC iPlayer in 2007, take-up of iPlayer and other Video-on-Demand services provided by traditional broadcasters has not been as great as for SVoD providers. Nor has it fully compensated for the decline in traditional TV viewing: although average weekly iPlayer viewing increased by 1.1 billion minutes between 2016-17 and 2019-20, average weekly TV viewing declined by 3.8 billion minutes over the same period. Viewing via iPlayer still makes up only a fraction of the BBC's viewing, at around 10% of this. The BBC takes the view that it needs to improve the personalisation of its content to compete more successfully in the digital market. A 2018 internal review concluded that the BBC is middling or underperforming on all measures of radical technological innovation.

Figure 6

Share of video viewing per person per day, 2017–2020

Subscription video-on-demand (SVoD) providers' share of the UK population's viewing time trebled from 6% to 18% between 2017 and 2020

	2017 (%)	2018 (%)	2019 (%)	2020 (%)
Live TV	60	56	53	46
SVoD	6	9	12	18
YouTube	10	12	13	12
Recorded playback	10	10	10	10
Games console	4	4	4	5
BVoD	3	3	4	3
DVD	1	1	1	1
Other video	6	6	5	5

Notes

1 The figures are for individuals aged 4 years and over.

2 BVoD stands for Broadcaster Video on Demand: this refers to the online platforms run by the BBC, ITV, Channel 4 and Channel 5.

3 The 2020 column represents the position in April 2020.

4 In certain years, the percentage figures add up to more than 100% due to rounding.

Source: National Audit Office analysis of Ofcom Media Nations Reports

1.15 SVoD providers and YouTube are also increasingly the go-to option for younger audiences. In the last half of 2017, 16-24 year olds' audience time on Netflix surpassed total BBC TV/iPlayer time and during 2019, the BBC lost its place as the media provider that 6-15 year olds spend most time with. Although on average 80% of those aged 16 to 34 used BBC services each week in 2019-20, almost half of this age group did not regularly use BBC TV channels on a weekly basis (**Figure 7**), compared with only 22% of UK adults. In addition to concerns about the fall in audience share among young people, the BBC is seeking to improve its appeal to other viewing groups it defines as 'underserved', including Black, Asian and minority ethnic groups and those in manual occupations. Addressing declining audiences is critical to the BBC's financial health as its research has found that people are less likely to pay the licence fee if they do not view licensable content such as that provided by the BBC.

1.16 BBC radio audience time has also declined among adults, falling by 15% between 2013-14 and 2019-20. In contrast, national commercial radio stations have maintained or increased their audience time over the same period. In 2018, the BBC launched its BBC Sounds audio download service, although it is too early to assess the impact this may have on the BBC's share of the audio market.

Trends in licence fee income

1.17 The BBC's licence fee income fell by £310 million (8%) between 2017-18 and 2019-20, from £3.83 billion to £3.52 billion (**Figure 8** on page 26). This decrease occurred because of the staged reduction in government funding for free TV licences for the over-75s (paragraph 1.6) from £656 million in 2017-18 to £253 million in 2019-20 as a result of the 2015 licence fee settlement. In parallel, income from the sale of licences to non-over-75 households increased by 3%, from £3.174 billion to £3.267 billion, but this increase was insufficient to compensate for the removal of government funding. Income from licence sales only increased by 3% from 2017-18 to 2019-20, despite annual increases in the cost of a TV licence, as there was a fall of 450,000 in the number of non-over-75 households buying licences in those years due to changes in audience viewing habits (paragraph 1.15) and increasing numbers of these households qualifying for a free over-75 licence (paragraph 1.6).

1.18 The BBC is forecasting that competing trends could potentially impact upon its licence fee income in different ways:

- The proportion of households with licences will continue to decline. In March 2020, it forecast that reductions in its licence fee income due to falling licence sales would exceed additional income generated by the annual increase in the cost of TV licences for the first time in 2021-22.

- The BBC estimated in June 2019 that the government's withdrawal of funding for free TV licences for all over-75s would cost it £745 million a year by 2021-22. According to BBC estimates, its decision to continue offering free licences to those aged over 75 who are in receipt of Pension Credit and charge other over-75s (paragraph 1.6) will leave it with approximately £200 million less income than if the government had continued to fund the cost of free licences for all as the BBC has estimated that, in the medium term, its new policy could raise income of more than £500 million a year. This is a significant income stream, without which the BBC considers it would need to make significant reductions to its services and content. It is not yet clear how much this new policy will eventually raise. However, according to BBC forecasts in October 2020, the income generated in 2020-21 from the new policy will be £67 million higher than expected.

Figure 7

Percentage of population aged over 16 watching BBC each week, by age, ethnicity and socio-economic group, 2019-20

BBC TV viewing varies by age, ethnicity and socio-economic group

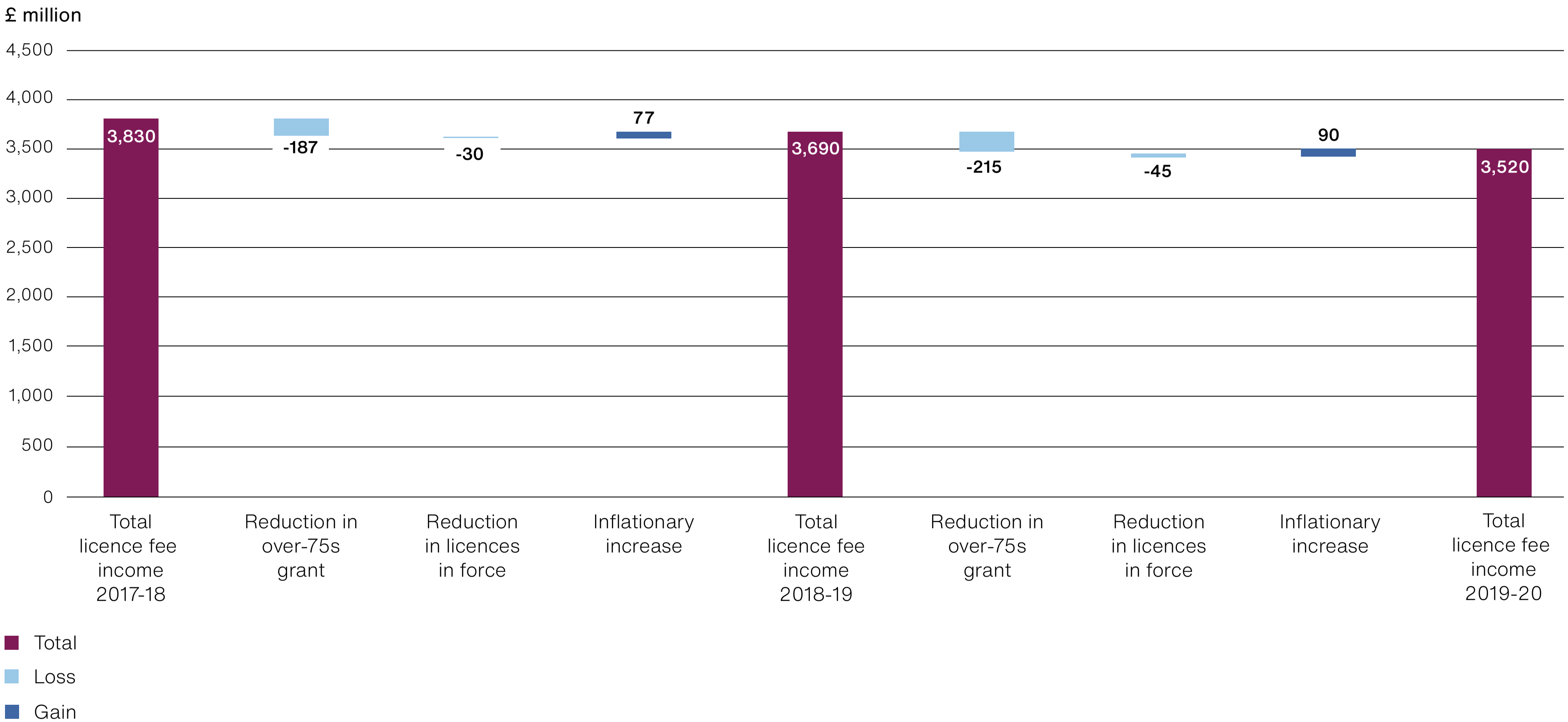
	Watching BBC TV weekly (%)
16–34	55
35–54	79
55+	92
White	77
Black and minority ethnic	60
Managerial, professional, supervisory and clerical workers	75
Skilled, semi-and unskilled manual workers and the unemployed	72

Source: BBC Group *Annual Report and Accounts 2019-20*

Figure 8

Movements in licence fee income, 2017-18 to 2019-20

The BBC's total licence fee income fell in 2018-19 and 2019-20



Note

1 All figures are at cash terms.

Source: National Audit Office review of BBC documents

1.19 Under the BBC's Charter and legislation, the existence of the licence fee is guaranteed until 2027. This guarantee enables the BBC to plan ahead with more certainty than its rivals, whose income is less secure. Despite this, there are still a number of factors which pose a risk to the future level of the BBC's income from the licence fee. For example, in February 2020, DCMS consulted on decriminalising the non-payment of the TV licence fee from April 2022.[5] In its consultation response, the BBC estimated that such a move could reduce its cumulative income by more than £1 billion from 2022-23 to 2026-27 inclusive due to increased administration costs and an increased number of households not paying the licence fee.

1.20 Other potential changes in government policy could also impact on the BBC's finances. In November 2020, DCMS and the BBC started negotiations about the level of the licence fee from 2022-23 (paragraph 1.5), when the current agreement for the licence fee to increase in line with inflation ends. These negotiations will set the level of the licence fee until at least 2026-27. Additionally, under the BBC's Charter, the Secretary of State for Digital, Culture, Media & Sport will undertake a mid-term review between 2022 and 2024 of the governance and regulatory arrangements for the BBC. According to the Charter, the review must not consider the BBC's mission or public purposes, or the licence fee funding model. Other than these constraints, the Secretary of State is free to determine the scope of this review after consultation, and potential changes to regulation arising from the review could impact the BBC's PSB and its commercial operations and finances.

1.21 As at December 2020, Ofcom was undertaking a review to provide advice to government on the role of PSB in the current fast-changing media landscape and how to ensure that public service broadcasting adapts to audience needs, including different ways in which such broadcasting could be delivered. This review could also therefore have a significant impact on the future role of the BBC. In December, Ofcom went out to public consultation on its findings to date, inviting responses by March 2021. It intends to make final recommendations to government later in 2021.

Impact of COVID-19

1.22 Although licence fee income has to some extent protected the BBC against the financial effects of COVID-19, it has still seen its income fall and its costs increase as a result of the pandemic (**Figure 9** overleaf). For its PSB operations, in April 2020, the BBC announced that it would need to make additional annual savings of up to £125 million in 2020-21 to offset the net loss arising from COVID-19. Other PSBs have also had to make savings due to COVID-19. Channel 4, for example, reported that it needed to make savings of £245 million, and ITV £150 million.

5 If an individual does not purchase a TV licence when legally required, they may eventually be subject to a criminal prosecution and fined up to £1,000. In 2018, there were 129,446 prosecutions for TV licence evasion, resulting in 121,203 convictions, with an average fine of £146. Wilful refusal to pay the court-imposed fine can result in imprisonment. In 2018, five people were imprisoned for this reason.

Figure 9
Impact of COVID-19 on the BBC's finances

COVID-19 has had an impact on the finances of both the BBC's public service broadcaster (PSB) operations and its commercial subsidiaries

Impact on the finances of the BBC's commercial activities

- There has been a significant decline in advertising revenue for BBC Global News and UKTV, the business acquired by BBC Studios in June 2019. UKTV reported a significant fall in such revenue in May 2020.
- The cancellation or delaying of productions due to COVID-19 impacted significantly on the income of BBC Studios and BBC Studioworks.
- BBC Studios has been able to generate additional income from its sales of content as broadcasters around the world have sought extra content to show during the crisis.
- The commercial subsidiaries undertook a number of actions to mitigate the financial impacts of COVID-19, including a reduction of £155 million in planned dividend payments to BBC Group from 2019-20 to 2021-22 inclusive, from £319 million to £164 million. Instead, the BBC planned to retain the £155 million within Commercial Group to help ensure the commercial subsidiaries did not breach the BBC's borrowing limits.

Impact on the finances of the BBC's PSB operations

- The £155 million reduction in planned dividend payments from the commercial subsidiaries means that BBC Group has less funding for PSB operations.
- The introduction of the UK-wide lockdown in March 2020, and compliance with social distancing requirements in offices and call centres when lockdown was eased, have hindered the BBC's ability to collect the licence fee. These difficulties contributed to income from the sale of licences in 2019-20 to those under the age of 75 being £58 million lower than budgeted for the year.
- In March 2020, the BBC postponed the introduction of the new policy for charging some over-75s for their TV licences from June to August 2020 due to COVID-19, at an estimated cost of £70 million in total.
- The postponement of significant sporting events, such as the Olympics, Paralympics and Men's European Football Finals, to 2021, and the delays in programme production due to COVID-19 reduced the BBC's planned spend on TV content in 2020-21 by £318 million, from £2.932 billion to £2.614 billion. Some of this spend has been pushed back to 2021-22 when the delayed events are planned to take place.
- In March 2020 the BBC paused its plans for significant operational changes to its News and Nations and Regions divisions, to ensure that it continued to provide national and local news coverage during lockdown. The BBC had intended that these changes help deliver its savings target of £800 million. The delays to these changes meant delays to savings and consequently higher costs in 2020-21 than budgeted.

Source: National Audit Office review of BBC documents

1.23 The BBC's commercial subsidiaries have also taken steps to reduce the financial impact of COVID-19, including a planned reduction of £155 million in dividend payments over three years. However, even after allowing for these reductions, in April 2020 the BBC forecast a reduction of £380 million (24%) in the income of its commercial subsidiaries and a £141 million (81%) fall in their profits, with both BBC Global News and BBC Studioworks falling into deficit.

Part Two

The BBC's response to its challenges and opportunities

2.1 This part of the report sets out the BBC's overall financial position, and how it has responded to the challenges and opportunities of its environment by making savings, controlling costs and seeking to grow its commercial income.

Overall financial position

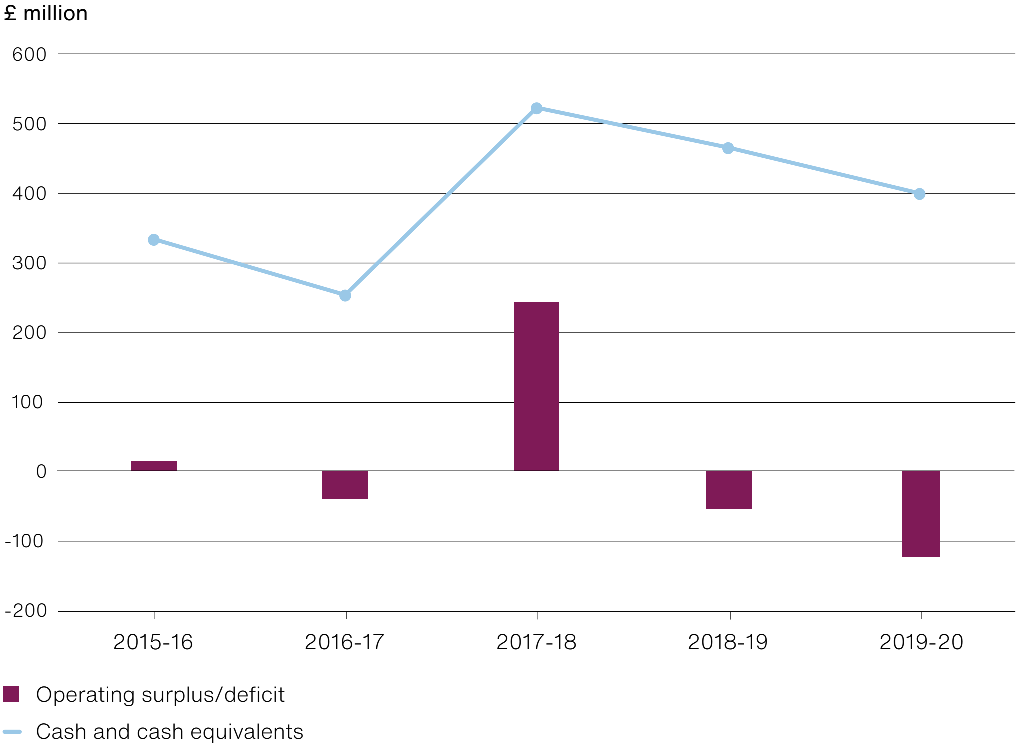
2.2 The BBC has responded to income and cost pressures by making planned use of its cash reserves as it delivered planned savings. For three of the past five years, its costs have exceeded income, with it making a loss of £119 million in 2019-20 (**Figure 10** overleaf). The BBC has used its cash reserves to meet its planned losses, with its reserves falling by 23% between 2017-18 and 2019-20, from £523 million to £401 million.

2.3 To date, the BBC has made only limited use of its borrowing facility. This contrasts with comparable media companies we identified, which all increased their total debt over the past five years. The BBC's ability to borrow is constrained by limits imposed by the Department for Digital, Culture, Media & Sport (paragraph 1.10). These limits have also affected how the BBC has financed some of its major building projects, entering into complex 'sale and leaseback' arrangements whereby special purpose vehicles raise finance on the bond markets to develop buildings.

2.4 Pre-COVID-19, the BBC was again budgeting for a significant deficit in 2020-21 (£197 million) and a consequent significant reduction in its cash reserves (down to £93 million). This was due to the costs of acquiring the rights to major biennial sporting events and the withdrawal of government funding for free TV licences for the over-75s. The BBC expects its financial position to improve from 2021-22 onwards as its policy of charging some over-75s for their TV licences becomes fully established.

Figure 10
The BBC's financial position

The BBC has made planned use of its cash reserves while operating a deficit



Source: *BBC Group Annual Report and Accounts*

2.5 In April 2020, the BBC updated its budget for 2020-21 to reflect the estimated worst-case impact of COVID-19. While the BBC forecast that, for its Public Service Broadcasting (PSB) operations, the cost savings it had identified of £125 million (paragraph 1.22) would be sufficient in 2020-21, the reductions in profits of the commercial subsidiaries due to COVID-19 meant that, despite its subsidiaries taking mitigating actions including the withholding of dividend payments to the BBC Group (paragraph 1.23), there was still some risk that these subsidiaries might breach their debt limit of £350 million.

2.6 Since its April 2020 budget revisions, the BBC has performed better than expected. In October 2020 the BBC forecast that licence fee income from sales to both over-75 (paragraph 1.18) and non-over-75 households would be £132 million higher in 2020-21 than it had expected in April 2020 in the immediate aftermath of the initial COVID-19 lockdown. The BBC is using £68 million of this to fund content for the autumn/winter 2020 schedule and pay for additional COVID-19-related expenditure. The BBC has also forecast that income generated by its commercial subsidiaries will be £73 million higher than it had forecast in April 2020, and their profits £35 million higher. The BBC has not earmarked the rest of this forecast income increase for use as there is still a risk that further developments in the pandemic could adversely affect its finances.

The BBC's savings programme

2.7 In 2016-17 the BBC began an efficiency programme to deliver the £800 million savings a year by 2021-22 that it had identified it required in its PSB operations as a result of the 2015 licence fee settlement (paragraph 1.7). By 2019-20 it had delivered annual savings of £618 million, broadly on track against its original schedule of delivering £625 million of the £800 million total by this date. While delivering savings, the BBC sought to limit reductions in content, which often attract public criticism,[6] in favour of improvements in efficiency and productivity, particularly in divisions such as Corporate Functions and Design & Engineering (**Figure 11** overleaf). As a result of reducing its back-office costs, the BBC's spending on its PSB overheads reduced from 5.7% of spending in 2017-18 to 4.8% in 2019-20, with its indirect costs in the top quartile of comparable media companies in terms of efficiency.

2.8 The BBC categorised £268 million (43%) of its £618 million savings as coming from increased productivity. According to the BBC, productivity savings delivered in 2019-20 arose mainly from savings on its major strategic contracts (£99 million), the purchase of goods and services (£66 million) and technology (£41 million). In measuring its savings performance, the BBC does not regularly monitor all savings achieved by expenditure category, but by BBC division responsible for delivering the savings.

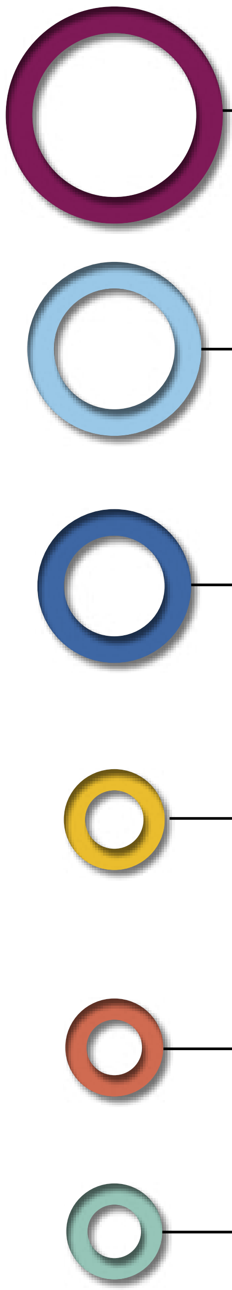
2.9 By September 2020 the BBC had increased its savings target from £800 million to £1,012 million by 2021-22, mainly to include the extra savings required due to COVID-19 and the BBC's decision to continue to offer free licences to some over-75s. Measures which the BBC are implementing to make these additional savings include the cancellation of the 2020 pay award and a pay freeze for senior leaders until August 2021 at the earliest. In addition, in June 2020 the BBC invited its PSB staff to express an interest in voluntary redundancy, with significant numbers subsequently expressing an interest. Despite these actions, in September 2020 the BBC estimated that £327 million (32%) of its new savings target of £1,012 million was at risk and would require service or content changes. As at October 2020, the BBC was working on plans for delivering the remaining savings.

6 Examples of public criticism include public concerns in response to previous proposals to shut Radio 6 and the BBC red button service.

Figure 11
BBC efficiency savings by 2019-20, by source

As at the end of 2019-20, the BBC had delivered savings of £618 million

By Public Service Broadcasting division



Content: £235m

Key savings initiatives:
- Reduction in Drama and Factual programming.
- Reduced sports coverage.
- Inflation absorbed into programme contract pricing.
- Organisational design efficiencies.

Corporate Functions: £144m

Key savings initiatives:
- London property strategy and rationalisation of estate.
- Renegotiation of outsourcing contracts, including finance business processing and licence fee collection.
- Increasing licence fee and commercial income.
- Headcount reductions, restructuring and payroll savings.

Design and Engineering: £109m

Key savings initiatives:
- Digital and innovation scope savings.
- Cost savings from outsourcing contracts.
- Portfolio reduction and efficiencies.
- Restructuring of divisions to create synergies.

Radio and Education: £46m

Key savings initiatives:
- Programme cuts, changes to slates and scheduling.
- Production efficiencies, streamlining production management and operations.
- New forms of commercial income.
- Headcount reductions.

Nations and Regions: £43m

Key savings initiatives:
- Reduction in programme spend and reduced sports coverage.
- Reduced overhead and technology spend.
- Headcount reductions.
- Reprioritisation to fund BBC Scotland.

News: £41m

Key savings initiatives:
- Efficiency reviews and overhead reductions.
- Restructuring.

Total savings: £618m

Source: BBC

BBC spending on content

2.10 Despite prioritising productivity savings, to deliver savings the BBC has also reduced its services to licence fee payers. According to the BBC, it delivered £239 million (39%) of the £618 million through such scope reductions. These included closing BBC Three as a linear channel, reducing sports coverage, including the loss of Formula 1 motor racing coverage, and a smaller BBC Online.

2.11 As a result of these scope reductions, the BBC's spending on content of £2,777 million in 2019-20 was 3.6% lower in real terms than in 2015-16 (**Figure 12**). This is despite the high level of inflation in the entertainment industry (paragraph 1.12). The BBC has sought to mitigate the impact of this inflation on its content spending in part through the financial contribution that BBC Studios and other partners make to funding individual PSB productions in return, for example, for valuable distribution rights. According to the BBC, such contributions have increased by almost 80% between 2015 and 2019 to more than £365 million. As a result, in 2019 for every £1 that the BBC spent on commissioning network TV programmes from its own funding, £1.30 was available to producers to spend on content.

Figure 12
BBC expenditure on content, 2015-16 to 2019-20

BBC expenditure on content in 2019-20 of £2,777 million in 2019-20 was 3.6% lower in real terms than in 2015-16

	2015-16 (£m)	2016-17 (£m)	2017-18 (£m)	2018-19 (£m)	2019-20 (£m)
Content costs					
Television	1,832	1,843	1,643	1,729	1,609
Radio	510	504	499	513	494
BBC online	164	199	189	218	238
BBC World Service	242	262	297	333	315
Miscellaneous	134	117	101	120	121
Total	**2,882**	**2,925**[1]	**2,729**	**2,913**[1]	**2,777**
Public service broadcasting (PSB) on-air talent costs	214	208	154	162	145

Notes

1 The higher figures for spending in 2016-17 and 2018-19 reflect expenditure on major sports events.

2 'Miscellaneous' consists of expenditure on orchestras and performing groups, content for S4C and content development.

3 On-air talent costs are the salaries for PSB employees who appear on television or radio, working across its Network News, Radio Continuous Programmes, Nations, English Regions, World Service and Sport programmes.

4 PSB on-air talent costs fell in 2017-18 when the BBC established BBC Studios as a commercial subsidiary.

5 All figures are at 2019-20 prices.

Source: *BBC Group Annual Report and Accounts*

2.12 Despite scope reductions, the BBC's content spending is still greater than its UK competitors. For example, ITV planned to spend £1.1 billion on content in 2020-21, prior to COVID-19, and Channel 4 £650 million, compared with BBC expenditure on TV content in 2019-20 of £1.6 billion. However, it is significantly less than the content budgets of its global competitors; for example, Netflix reportedly spent more than $15 billion on content in 2019.

Potential constraints on future savings

2.13 The BBC's ability to deliver savings in the short term is constrained by the fact that there are a number of funding commitments placed on it as a result of licence fee settlements (paragraph 1.5) which it has to meet from the licence fee income it receives. For example, in 2019-20 it had to provide S4C, the Welsh language channel, with about £74 million from the licence fee and more than 500 hours of content in Welsh free of charge, at an estimated cost to the BBC of £22 million. There are also large items of committed expenditure in its budget. These arise from: long-term contracts to maintain the TV and radio broadcasting network; the long lead times involved in producing some programmes, such as natural history; the cyclical nature of some of its spending (for example, on major sports events every two years); and legal obligations arising, for example, from its pension schemes, which at present cost the BBC 5.7% of its income each year. As at March 2020, the BBC had financial commitments of £1.008 billion which were due to be paid from its 2020-21 budget under long-term outsourcing contracts.

2.14 Reflecting the size of its committed costs, some senior BBC staff have expressed concerns about the ability of the BBC to deliver further savings without significant reductions to its content and services. Overhead costs are already relatively low (paragraph 2.7) and, at 39%, scope cuts have accounted for a higher share of the £618 million savings to date than under the previous BBC efficiency programme, Delivering Quality First, where such cuts delivered 28% of total savings of £712 million. Nevertheless, prior to the current efficiency programme, the BBC had suggested that the need for sizeable savings could require it to reduce the scope of its services significantly. This has not substantially occurred.

BBC spending on its headcount

2.15 The size of the BBC's workforce has increased by almost 1,500 (7%) over the past four years (**Figure 13**). This is mainly because the Foreign, Commonwealth & Development Office funded the expansion of the BBC World Service, involving the recruitment of more than 1,100 new staff. Without this, the BBC's workforce increased by under 2% as, for example, it expanded its digital workforce and opened a new BBC Scotland channel to meet business needs.

Figure 13
BBC workforce numbers and costs, 2015-16 to 2019-20

The BBC's workforce has increased by 7% (around 1,500 posts) over the past four years and total workforce costs by 9% in real terms

	2015-16	2016-17	2017-18	2018-19	2019-20
Workforce numbers[1]					
Public service broadcasting (PSB) staff	19,269	19,357	18,210[2]	19,231	19,572
Commercial staff	1,996	1,914	3,221	3,097	3,177
Total	**21,265**	**21,271**	**21,431**	**22,328**	**22,749**
	(£m)	**(£m)**	**(£m)**	**(£m)**	**(£m)**
Workforce costs[3]					
Total remuneration	**1,403**	**1,484**	**1,454[4]**	**1,506**	**1,532**
Remuneration includes:					
• Pension costs	199	228	268	275	282
• Severance payments	28	35	39	18	23

Notes
1 Workforce numbers are for average full-time equivalent for the years and exclude casual staff. Numbers, particularly in the commercial subsidiary, BBC Studios, fluctuate with content production activity.
2 In 2017-18, approximately 1,600 PSB staff transferred to the BBC's commercial operations when the BBC established BBC Studios as a commercial subsidiary.
3 All cost figures are at 2019-20 prices.
4 The 2017 pay award was delayed until summer 2018 while the BBC agreed changes to terms and conditions with staff.

Source: *BBC Group Annual Report and Accounts*

2.16 The size of the BBC's workforce has not reduced because it delayed more than once planned changes to its News and Nations & Regions divisions which involve significant post closures. The BBC had identified early on in its efficiency programme the need for change in these divisions but had delayed introducing this until 2020 as it had recognised that such change was likely to be difficult to implement and generate opposition from both its workforce and the public. It then delayed planned changes again as a result of COVID-19 (Figure 9). Subsequently, in June and July 2020, the BBC announced that, as part of delivering its £800 million savings target, it would be reducing the number of staff working in News by 520 and in Nations & Regions by about 600 as it introduced new ways of working.

2.17 Total employee remuneration costs increased in real terms by 9% to more than £1.5 billion between 2015-16 to 2019-20 (Figure 13), compared to employee growth of 7% in the same period. This difference between the two growth rates was, in part, due to the short-term costs of introducing new terms and conditions for its staff in 2018-19. As we reported in 2019, according to the BBC cost was not a driving factor for these reforms, which were designed to improve fairness, transparency and consistency.[7] In February 2019, it calculated that the changes would produce a net saving of £4.9 million in its paybill over the seven years from 2017 to 2023, less than 0.1% of the total staff paybill over that period.

2.18 We also reported in 2019 that the BBC had tightly monitored and controlled pay for those in on-air roles and its senior managers, including those earning more than £150,000.[8] This continued in 2019-20. There is little scope for further significant cost savings in these areas. According to our calculations, reducing the pay of all those earning more than £150,000 to this level would save only £15 million a year.

BBC performance in project delivery

2.19 At any one time, the BBC is implementing a number of projects which it defines as critical due to their high strategic importance and high level of complexity or risk. As we have previously reported, there have been examples of the BBC under-estimating the costs and uncertainties involved at the start of some of these projects. For example, in 2018 we reported that the renewal of the *EastEnders* set was due to be delivered 31 months late and more than £25 million over budget.[9] Reasons for the cost increase included, among other things, higher than expected inflation in the UK construction industry and extra funding to cover known and unknown risks. Similarly, a BBC-commissioned review in 2019 found that it tended to under-estimate the scale and complexity of its technology programmes. In June 2020, the BBC estimated that the implementation of the new systems required to charge some over-75s for their TV licence would cost £65 million, compared with the budget estimate of £44 million. Reasons for this cost increase included extra funding for contractors to ensure they delivered on time, and an extra £6 million due to the unexpected impact of COVID-19.[10] In 2019-20 it also cancelled its implementation of a new Campaign Management System for licence fee collection at a cost of £7 million. In 2020, the BBC sought to strengthen the governance of its critical projects to ensure that lessons learned on previous projects are applied going forward. However, it is too early to assess how effective its efforts have been.

7 Comptroller and Auditor General, *Managing the BBC's paybill,* Session 2017-2019, HC 2142, National Audit Office 16 May 2019.
8 See footnote 7.
9 Comptroller and Auditor General, *E20: renewing the EastEnders set*, Session 2017-2019, HC 1782., National Audit Office, 13 December 2018.
10 According to BBC forecasts in October 2020, the income generated in 2020-21 from these systems will be £67 million higher than expected (paragraph 1.18).

Commercial income

2.20 The BBC has been trying to grow the returns it receives from its commercial subsidiaries. In 2019-20, income from these subsidiaries grew by 16%, and profits by 44% in 2019-20 (**Figure 14**), mainly due to the purchase of UKTV by BBC Studios in June 2019.

2.21 The BBC measures the financial returns it receives from its commercial subsidiaries using a measure which is unique to the BBC. This seeks to recognise 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, as well as the value that the BBC receives as owner of the commercial subsidiaries via dividend payments.[11] Thus, in 2019-20 the BBC reported that its financial returns from its commercial subsidiaries totalled £279 million, comprising £205 million in contributions to BBC programming and other rights and £74 million in dividend payments (**Figure 15** overleaf).

Figure 14

BBC Group commercial income and profits, 2015-16 to 2019-20

Commercial income and profits have increased over the past four years

	2015-16	2016-17	2017-18	2018-19	2019-20
	(£m)	(£m)	(£m)	(£m)	(£m)
Commercial income[1]	981	1,013	1,380	1,358	1,570
Commercial profit[2]	81	39	106	140	201

Notes

1 Commercial income increased in 2017-18 with the establishment of BBC Studios as a commercial subsidiary.

2 Commercial profits, as measured by profit after tax.

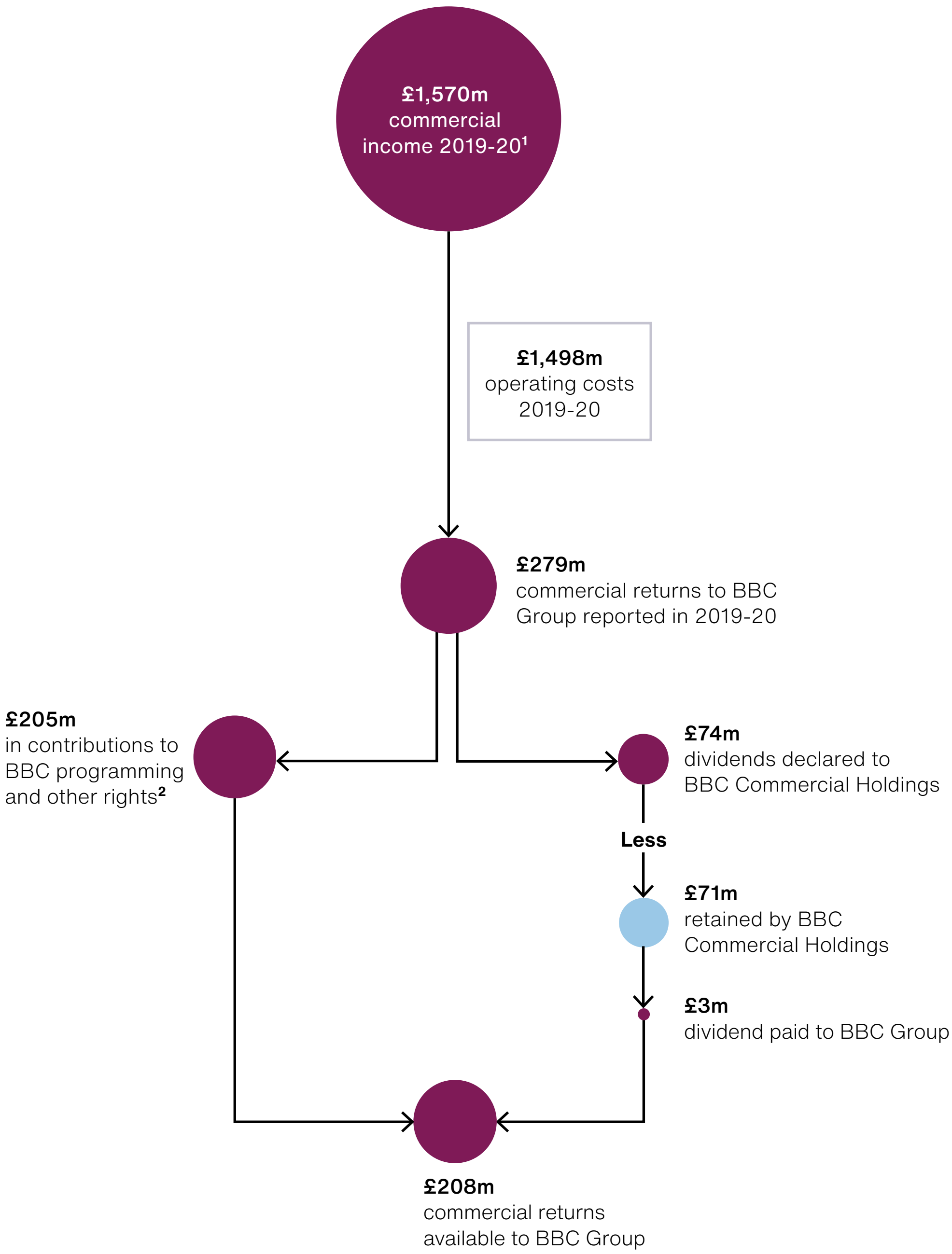
3 All figures are in cash terms.

Source: BBC Commercial Holdings accounts

11 Until recently, only BBC Studios made sufficient profits to pay any dividends. Of the BBC's other main commercial subsidiaries, BBC Global News has not paid any dividend, while Studioworks paid dividends of £800,000 and £400,000 in 2018-19 and 2019-20 respectively. Both these subsidiaries are small, with income in 2019-20 of £115 million and £40 million respectively.

Figure 15
Financial returns from the BBC's commercial subsidiaries, 2019-20

Financial returns available to BBC group from the BBC's commercial activities totalled £208 million in 2019-20



Notes

1 The commercial income figure does not include the BBC commercial subsidiaries' share of operating income from associate companies and joint ventures.

2 These contributions are included within operating costs.

Source: National Audit Office

2.22 In line with normal business practice, the BBC’s commercial subsidiaries pay their dividends to the commercial group holding company, BBC Commercial Holdings. BBC Commercial Holdings has the right to retain these dividends to help fund developments in the commercial group and it has exercised this right on occasion. For example, in 2019-20, it retained £71 million of the dividends of £74 million it received and paid over only £3 million to improve liquidity for the commercial subsidiaries in response to COVID-19.

2.23 Thus, the financial returns available to the BBC to help with PSB operational costs in 2019-20 totalled £208 million, equivalent to just under 6% of licence fee income of £3.52 billion.

2.24 In October 2015, the BBC set BBC Worldwide a target to deliver £1.2 billion of financial returns between 2017-18 and 2021-22. It then continued to apply this target to BBC Studios on its merger with Worldwide. Since 2017-18, the level of reported financial returns from BBC Studios has increased (**Figure 16** overleaf), totalling £729 million, 61% of the £1.2 billion target. Of this, £207 million related to dividends that BBC Studios had paid to BBC Commercial Holdings. Not all the dividends paid to BBC Commercial Holdings by BBC Studios and the other commercial subsidiaries have been paid over to the BBC Group as the BBC maintains a level of liquidity within BBC Commercial Holdings. From 2017-18 to 2019-20, BBC Commercial Holdings retained dividends of £99 million for this purpose.

Figure 16

Financial returns from commercial activities, 2017-18 to 2019-20

Financial returns from the BBC's commercial activities have increased between 2017-18 and 2019-20

	2017-18 (£m)	2018-19 (£m)	2019-20 (£m)
Contributions to BBC programmes	117	158	188
Dividends	71	65	71
Other[1]	22	20	17
Returns made by BBC Studios	**210**	**243**	**276**
Dividends paid by other commercial subsidiaries	0	3	3
Returns made by commercial subsidiaries	**210**	**246**	**279**
Extra dividends paid/(dividends retained) by BBC Commercial Holdings	(33)	5	(71)
Returns to BBC Group	**177**	**251**	**208**
Dividends paid by commercial subsidiaries to BBC Commercial Holdings	71	68	74
Dividends paid by BBC Commercial Holdings	38	73	3
Extra dividends paid/(dividends retained) by BBC Commercial Holdings	(33)	5	(71)

Note

1 The 'Other' category includes rights archive payments, brand fees, fees for the retransmission of the Wimbledon Tennis Championships, and fees for distribution rights for radio content.

Source: National Audit Office analysis

Part Three

The BBC's preparedness for its long-term challenges and opportunities

3.1 This part of the report sets out the BBC's current strategic priorities, the enduring challenges that these will need to be balanced against, and the obstacles that the organisation will need to overcome to deliver its priorities.

Strategic priorities

3.2 The new Director-General of the BBC has set out the organisation's four strategic priorities (**Figure 17** overleaf) for tackling the enduring challenges facing the BBC (**Figure 18** on page 43), including changes to audience viewing habits, increased competition for audiences and content (paragraphs 1.13 to 1.15) and risks to the BBC's main source of income, the licence fee (paragraphs 1.18 to 1.21). Indeed, according to the BBC, the pace of change in these areas has accelerated recently with, for example, large increases in audience take-up of subscription video-on-demand services.

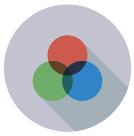
3.3 According to the new Director-General, fundamental to achieving the BBC's priorities will be delivering unique content that provides value for all licence fee payers. Therefore, while the BBC needs to continue to address the decline in younger audiences and reach underserved audiences, the new Director-General is also aware of the need to retain existing audiences. The BBC is therefore examining what it would do if it could only make 80% of its current content hours in order to identify and prioritise content that is most likely to appeal to its various audiences.

3.4 The new Director-General has identified that developing the BBC's online presence further is essential if it is not to fall behind. It will need to be cutting-edge in its use of technology in order to improve search and recommendation functions and access for audiences, and to make better use of the data it holds in order to create a closer relationship with its audiences.

Figure 17
BBC's new strategic priorities as at September 2020

The new Director-General has set four strategic priorities for the BBC

1  A renewed commitment to impartiality.

2  A focus on unique, high-impact content which delivers value for all audiences.

3  The extraction of more online.

4  The building of commercial income to secure additional investment for programme-making and maximise financial value for licence fee payers.

Source: BBC

3.5 To increase its commercial income, the BBC intends to examine opportunities to develop more direct-to-consumer services in news, video and audio overseas, building on its existing overseas BritBox service, as well as continuing to develop major partnerships with other companies producing content. It also plans to continue to invest in its overseas news services to further build the reputation of the UK and BBC. Its ambition, with the support of government, is to replace its existing target of reaching a global audience of 500 million by 2022 with a new target of a billion people globally over the next decade.

3.6 The new Director-General is also seeking to ensure that the BBC is more representative of the UK as a whole if it is to get closer to all its audiences. He has announced new diversity targets for the composition of the BBC's workforce and senior management, and is seeking to increase the BBC's regional presence outside London. There will also be a continued focus on cost reduction, including a reduction in the size of the Public Service Broadcasting workforce due to the post closures announced in News and Nations & Regions (paragraph 2.16).

Figure 18

BBC senior manager and Board views of key strategic priorities and challenges

There are a number of key priorities and challenges facing the BBC going forward

Source: National Audit Office interviews with senior BBC managers and Board members

3.7 According to the new Director-General, the BBC has been slow to change when it felt it was not essential. This matches our experience in certain areas, such as addressing the decline in viewing by younger audiences, where there is still no central strategy for tackling this problem, and its measured approach to workforce and paybill reforms (paragraph 2.16). The need for the BBC to pick up the pace of change is pressing as the pace of market change has itself accelerated. The new Director-General aims for a simpler, leaner BBC, with fewer committees, meetings and management layers, which is better able to respond to market changes more quickly. As at October 2020, the BBC was examining what lessons it could learn from the new ways of working introduced to cope with COVID-19 and the resulting increases in the speed of its decision-making.

Financial planning

3.8 Addressing new priorities and ongoing challenges by, for example, delivering high-quality content and developing online presence further is likely to require increased investment. The BBC has historically funded such investment from its own resources, by reallocating money between divisions or making savings, rather than by borrowing. The BBC is adapting a similar approach going forward. For example, its consideration of what it would do if it could only make 80% of its current content hours is designed to help it re-allocate funds to where they generate most value for all. The new Director-General has also flagged up the need for further savings. However, the BBC still has to achieve its current savings targets and has raised concerns about its ability to deliver new savings.

3.9 As at October 2020, as it started its annual budget planning, the BBC had yet to set out how delivering the new strategic priorities would be funded. As part of this budgeting, the BBC prepares projections for the next three years and less-detailed, long-range plans that look five years into the future. It also stress-tests its projected cash-flows for the next three years for the impact on these should a handful of significant risks occur. It has not, however, modelled the financial impacts of fundamental potential changes to the licence fee from 2022-23, such as an end to annual indexation of the licence fee, or, in the longer term, the impacts of alternative funding models in the event of the licence fee's abolition.

3.10 According to the BBC, it has not undertaken such modelling to date as the changes outlined above are still only proposals and, even if approved, would not come into effect until 2022-23 at the earliest. Under the existing Charter, the licence fee is guaranteed until the Charter's end in December 2027. The BBC considers that it has demonstrated its ability to revise its budgets quickly in light of significant changes when it set a new budget for 2020-21 in April 2020 to take account of the emerging COVID-19 crisis. It has also already modelled the effects of significant losses of licence fee income and the actions it would need to take in response, when in early 2019 it modelled the various policy options for TV licences for the over-75s.

Added value

3.11 The BBC considers that it delivers considerable value both in the content it delivers to a range of audiences and in its contribution to the wider media industry at a national and local level, and to the national economy. Although the BBC is positive about the wider contribution it makes, it has not assessed this impact in several years. According to a BBC report in January 2013, the BBC increases the productive potential of the creative sector at a national level by investing in skills and technology, while stimulating demand by commissioning content from the independent production sector. In the report, the BBC estimated that its UK operating expenditure of £4.3 billion in 2011-12 had generated a gross value added of £8.3 billion for the UK economy, equivalent to £2 of economic value for every £1 of BBC spend.[12] In November 2020, the BBC commissioned KPMG to undertake a new assessment of the BBC's wider economic value to inform its negotiations with the government over the new licence fee settlement (paragraph 1.5).

3.12 The BBC's local impact is partly determined by regulatory requirements. For example, Ofcom has set the BBC annual quotas of making at least 50% of programming hours on first-run originations for network TV, and spending at least 50% of network programming expenditure, outside London.[13] In 2019-20, 62% of the BBC's relevant network TV hours were made, and 51% of relevant expenditure incurred, outside London. Similarly, the BBC has its own target of locating at least 50% of its employees outside London, achieving 52% in 2019-20. The new Director-General has confirmed an ambition to increase the proportion of the BBC workforce working outside London.

12 Gross Value Added is the value generated for the UK economy as a result of the BBC's expenditure.
13 London is defined as the area within the M25.

Appendix One

Our audit approach

1 This report examined how the BBC has positioned itself to respond to the financial and strategic challenges and opportunities within the media landscape in which it operates. It examines:

- the key financial challenges facing the BBC and the opportunities open to it (Part One);
- its responses to these challenges and opportunities (Part Two); and
- its preparedness for its long-term challenges and opportunities (Part Three).

Figure 19
Our audit approach

The BBC's objective

The BBC is the UK's main public service broadcaster, providing a wide range of television, radio and digital services. Its mission, as set out in its Royal Charter, is to inform, educate, and entertain. Under the Charter, the BBC undertakes public purposes ranging from providing impartial news and information, to supporting learning for all ages, to reflecting the UK, its culture and values to the world.

How the BBC achieves this

The BBC is primarily funded by payment of the television licence fee (£3.5 billion in 2019-20) and is also permitted by its Charter to generate income from commercial activities, such as creating and selling television programmes. The future of the BBC has been subject to considerable public and parliamentary debate, with a particular focus on how the BBC spends its money and whether the licence fee funding model remains appropriate. In addition, in November 2020 the BBC began negotiations with government about the future funding it will receive from the licence fee.

Our study

This report assesses how the BBC has positioned itself to respond to the financial and strategic challenges and opportunities within the media landscape in which it operates.

Our analytical framework

What are the key financial challenges facing the BBC and the opportunities open to it?

Have the BBC's responses to these challenges and opportunities been effective?

Is the BBC well prepared to address its challenges and opportunities in the long term?

Our evidence

(see Appendix Two for details)

We reviewed internal documents, including board papers and BBC strategies; we interviewed BBC senior staff and board members, and key third parties; we undertook a limited international comparison to establish how the BBC compared to public sector broadcasting in other countries.

We reviewed internal documents, including budget papers, and financial data; we interviewed senior staff and board members at the BBC.

We reviewed internal documents and data, including analysis of current and future financial forecasts; we interviewed senior staff and board members at the BBC, and key third parties.

Our conclusions

As it prepares for upcoming licence fee negotiations and subsequent mid-term Charter review, the BBC faces significant strategic financial challenges. In addition, its financial position as at the end of 2020 has been unexpectedly weakened by the impact of COVID-19, although not to the extent experienced by some other broadcasters. Despite its purpose of being a universal broadcaster and still being the most used media brand in the UK, the BBC has seen a notable drop in audience viewing times. In parallel, its principal source of income, the licence fee, has also declined, and the BBC now faces considerable uncertainty about the income it will receive from the licence fee at a time when its net commercial income is not yet at a level to make a significant contribution to its overall income position. The BBC believes its ability to overcome these financial challenges through its savings programme will be tested as it seeks to deliver its remaining savings, the element of this programme it considers the most challenging.

In recent years, many of the BBC's competitors have swiftly moved ahead in the global marketplace in terms of size and scale of services offered, gaining audiences and investing in technology. For its part, the BBC has introduced new initiatives to capitalise on the opportunities offered by this new marketplace including, most recently, BBC Sounds and improvements to the iPlayer service. To take further advantage in this marketplace, while continuing to meet its obligations as a universal public service broadcaster, the BBC will need to overcome certain challenges. These include continuing to make savings while investing in new technology and addressing an underlying lack of pace when implementing change. More immediately, as the BBC enters into licence fee negotiations, it needs to be able to articulate its current wider value to the UK economy.

Appendix Two

Our evidence base

1 We reached our conclusions following analysis of evidence collected between June and October 2020. Our audit approach is outlined in Appendix One.

Document review

2 We reviewed key internal BBC documents, including:

- BBC board and committee papers;
- strategic and budget planning papers; and
- internal management reports.

Interviews

3 We conducted interviews with:

- senior management staff at the BBC, including their senior strategic and financial staff, and members of the BBC Board, to understand their perception of the key challenges facing the organisation, and their view of the organisation's response to these; and
- key third parties, including Ofcom, the Department for Digital, Culture, Media & Sport (DCMS), market analysts (Enders), trade unions and trade associations.

Data analysis

4 We conducted analysis of the BBC's financial data in comparison to other UK public service broadcasters and global media companies. For this, we used BBC documentation, market analysis reports, the BBC's most recent sets of financial accounts and Bloomberg's financial database.

International comparison

5 We conducted a limited desk-based international comparison exercise to establish how the BBC compares to public service broadcasting in other countries in key areas such as reach and funding.

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