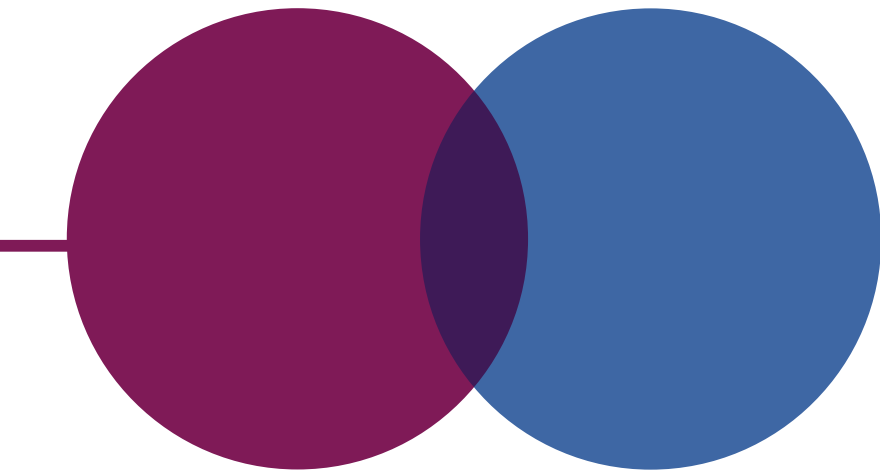




National Audit Office



The BBC's strategic financial management

BBC

REPORT

**by the Comptroller
and Auditor General**

**SESSION 2019–2021
20 JANUARY 2021
HC 1128**

Key facts



£3.52bn

BBC income from licence fee 2019-20



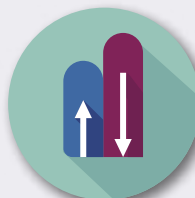
£208m

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.