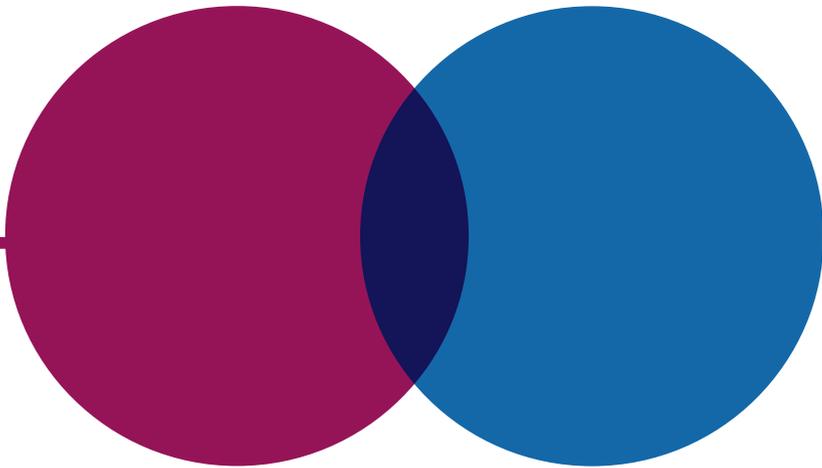




National Audit Office



REPORT

BBC Studios

BBC

SESSION 2024-25
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HC 306

Key facts

£1,837mn

income generated by BBC Studios in 2023-24, compared with £1,189 million in 2018-19

£202mn¹

profit generated by BBC Studios in 2023-24, compared with £159 million in 2018-19

£1,906mn

the value of returns to the BBC by BBC Studios in the seven years to 2023-24

9% to 11%

published target annual profit margins set by the BBC for BBC Studios in 2018, which BBC Studios has met or exceeded each year between 2018-19 and 2023-24

£1.5 billion

published target set by the BBC in 2021 for financial returns from BBC Studios to the BBC between 2022-23 and 2027-28, against which BBC Studios had delivered £687 million by the end of 2023-24

100%

BBC Studios' ambition for the growth in income, profits and free cash flow between 2021-22 and 2027-28

30%

the average proportion of production income from 'work for hire' contracts, where the intellectual property and distribution rights from commissioned programmes are retained by the programme commissioner, in 2022-23 and 2023-24, compared with an average of 3% between 2018-19 and 2021-22

£272 million

the value paid in March 2024 by BBC Studios for the full acquisition of BritBox International, a streaming service providing British content in North America, Australia and the Nordics

¹ The BBC's chosen profit measure is Earnings Before Interest Taxation Depreciation and Amortisation (EBITDA), which is consistent with market practice. BBC Studios calculates EBITDA by taking its statutory operating profit for the year and adding back the following operating expenses: depreciation; non-content-related amortisation; impairments; earnout costs and non-cash settled long-term incentive plan costs; transformational restructuring costs; and other non-recurring exceptional items. BBC Studios also offsets costs with production tax credits it has received, in line with market practice.

Summary

1 The BBC is the UK's main public service broadcaster, providing a wide range of television, radio and digital services in the UK and internationally. In 2023-24, it received public funding of £3,660 million from television licence fees to meet its public service commitments.

2 The basis of the BBC's activities is a Royal Charter establishing its independence, primary mission and public purposes. Under its Charter, the BBC can also undertake commercial activities, but they must be carried out by commercial subsidiaries of the BBC, and not directly by the BBC itself. The BBC's commercial activities must:

- fit with the BBC's mission and public purposes;
- exhibit commercial efficiency, being undertaken with a view to generating a profit and not funded by the licence fee;
- not jeopardise the BBC's reputation or the value of its brand; and
- not distort the market or create an unfair competitive advantage because of their relationship with the public service functions of the BBC.

3 The BBC oversees both its public service functions and commercial activities within a group structure, which for this report we refer to as 'the BBC'. Within this structure, the BBC's commercial activities are overseen by its wholly-owned subsidiary, BBC Commercial, and delivered by two principal commercial subsidiaries, BBC Studios and BBC Studioworks. Of these, BBC Studios is by far the largest, generating income in 2023-24 of £1,837 million, compared with £37 million from BBC Studioworks. BBC Studios was formed out of a merger in April 2018 between two of the BBC's commercial subsidiaries – its former content production and distribution businesses. BBC Studios aims to deliver value to licence fee payers through its mandate to deliver long-term, sustainable returns to the BBC.

4 BBC Studios comprises two main lines of business: Content Studio and Global Media & Streaming. Its Content Studio makes and sells programmes to UK and international broadcasters and streaming services. In 2023-24, productions included *Doctor Who*, *EastEnders* and *Dancing with the Stars USA*. The Global Media & Streaming business includes a portfolio of broadcast channels including UKTV; digital services such as its international website, BBC.com; and streaming services including BritBox International.

5 As a public corporation, the BBC is operationally and editorially independent of government but sponsored by the Department for Culture, Media & Sport (DCMS) and regulated by Ofcom, the communications regulator. Ofcom is responsible for setting the BBC requirements for ensuring that the BBC's commercial activities do not benefit from an unfair advantage over competitors by virtue of their relationship with the BBC.

Focus of our report

6 Under the 2016 Framework Agreement between DCMS and the BBC, the National Audit Office may carry out examinations into the economy, efficiency and effectiveness with which the BBC and its commercial activities have used their resources in discharging their functions. We last published an examination, on the performance of BBC Studios, in 2020 following the 2018 merger.² The report concluded that there was a clear strategic rationale for the merger and that BBC Studios had met its overall profitability target in its first full year of operation. However, we identified that a highly dynamic and competitive market for ownership of intellectual property (IP) meant that BBC Studios was facing a rising risk profile in its business. In addition, we found that, despite improvements in the governance of BBC Studios, there was still scope for improving the reporting to the BBC's boards of its performance to support effective governance.

7 This report focuses on the performance of BBC Studios and does not cover the performance of BBC Studioworks, due to its small size. It follows on from our 2020 report and covers:

- the performance of BBC Studios from the 2018 merger to date (Part One);
- BBC Studios' future plans (Part Two); and
- the governance and oversight of BBC Studios (Part Three).

Key findings

Performance of BBC Studios to date

8 BBC Studios' income and profits grew between 2018-19 and 2022-23, meeting or exceeding expectations set out in November 2018. Between 2018-19 and 2022-23 income increased by £901 million (76%) from £1,189 million to £2,090 million and profit increased by £81 million (51%) from £159 million to £240 million, above expectations set by BBC Studios in November 2018 following the merger.³ BBC Studios has also met or exceeded the BBC's published profit margin target for it of between 9% and 11% between 2018-19 and 2023-24. In addition, in the seven years to 2023-24, BBC Studios provided £1,906 million of financial returns to the BBC through dividend payments and contributions made as part of its work as the BBC's main production and distribution partner, exceeding its targets for this period (paragraphs 1.9 and 1.11 to 1.13).

9 BBC Studios' income and profits fell in 2023-24, partly due to challenging market conditions and its own investment needs. In 2023-24, BBC Studios' income fell by £253 million (12%) to £1,837 million and profits fell by £50 million (20%) to £202 million.⁴ This was partly due to challenging market conditions, including a reduction in spend by commissioners, including the BBC and global streamers, on the production of programmes and the ending of some high-value contracts which generated significant income in 2022-23. In addition, its profits were reduced by higher costs as BBC Studios invested in its digital services such as BBC.com and BritBox International to support its future growth (paragraphs 1.8, 1.14, 1.19 and 1.33).

3 The BBC's chosen profit measure is Earnings Before Interest Taxation Depreciation and Amortisation (EBITDA), which is consistent with market practice. BBC Studios calculates EBITDA by taking its statutory operating profit for the year and adding back the following operating expenses: depreciation; non-content-related amortisation; impairments; earnout costs and non-cash settled long-term incentive plan costs; transformational restructuring costs; and other non-recurring exceptional items. BBC Studios also offsets costs with production tax credits it has received, in line with market practice. The profit margin is calculated as EBITDA as a proportion of income. The BBC uses EBITDA as this measure avoids one-off items that could distort performance and make year-on-year comparisons difficult.

4 To ensure consistent comparisons, we have used a restated 2022-23 profit figure of £252 million in paragraph 9 and the original figure of £240 million in paragraph 8. In 2023-24, the BBC updated how its commercial activities measure profit (EBITDA) in order to more accurately reflect market practice. Under the new approach certain costs are excluded which had previously been included in profit calculations. When using this new approach to report its 2023-24 financial performance, BBC Studios also restated the profits it reported for the previous financial year, 2022-23, increasing these from £240 million to £252 million.

10 BBC Studios has adapted its business strategy in response to changing market conditions and audience behaviours. BBC Studios has adapted its strategy to reflect the movement of global audiences away from traditional broadcast TV to on-demand streaming and digital services. Although its strategy has previously included providing streaming and digital services, BBC Studios has increased its focus on these areas in response to market changes and to provide it with greater resilience in the event of a downturn in some of its markets. BBC Studios has invested in the growth of its digital and streaming services including BBC.com, U (formerly UKTV Play) and BritBox International. In addition, global streamers have become an increasingly prominent commissioner of BBC Studios' productions. Streamers often require production to be on a 'work for hire' basis where the IP and distribution rights from commissioned programmes are retained by the streamer. The proportion of production income from 'work for hire' contracts has increased significantly from an average of 3% between 2018-19 and 2021-22 to an average of 30% between 2022-23 and 2023-24.⁵ There are advantages and disadvantages to BBC Studios from such work. For example, it can be highly profitable in the short to medium term but does not generate longer-term returns through the sale of distribution rights (paragraphs 1.7, 1.16, 1.24, 1.25, 1.29, 1.31, 1.33 and 2.9).

11 BBC Studios has diversified how it generates income from its production and distribution of content, but has not met its targets for generating new IP. A large proportion of BBC Studios' business comes from its production of programmes for customers in the UK and overseas. It has significantly increased the amount of such income that comes from non-BBC third parties. In 2018-19, most came from the production of programmes for the BBC, but by 2023-24, half was generated from contracts with non-BBC third parties. BBC Studios has adapted and diversified its content production strategy to reflect market conditions. Although it still stresses the importance of generating new content and the related IP, from 2022-23 it has increased its focus on other ways of generating income, including increased 'work for hire' contracts (paragraph 10) and exploiting already successful brands such as *Doctor Who* and *Bluey*. Through generating new IP, BBC Studios can create long-term sustainable returns as it can sell distribution rights to programmes in the UK and internationally. In our 2020 report, we identified that BBC Studios had been less successful than planned in winning new commissions and generating IP. Since then, although generation of new IP has grown, BBC Studios has not met its targets in this area and remains reliant on the IP from BBC programmes created before it was first established in 2016. In 2023-24, of the 10 titles from its production business which provided the most profit to the BBC, only one was from new IP generated by BBC Studios (paragraphs 1.22 to 1.26 and 2.8).

⁵ These data do not include wholly owned labels and international production and formats as data for these were only included in BBC Studios' reporting from 2022-23 onwards.

BBC Studios' future plans

12 BBC Studios plans to double its size between 2021-22 and 2027-28 by further transformation of its business model. In October 2021, the government announced that it would increase the borrowing limits placed on the BBC's commercial activities from £350 million to £750 million between 2022-23 and 2026-27. In October 2022, BBC Studios announced its ambition to double the size of its business between 2021-22 and 2027-28 by using this increased borrowing capacity to make investments across its business and thus double its income, profits and free cash flow.⁶ BBC Studios' plans for growth involve a significant transformation of its business model by 2027-28. This includes: a larger share of income and profits to come from digital and streaming services; the production of more content for non-BBC third-parties; and exploiting existing successful key brands such as *Doctor Who* and *Bluey*. In particular, BBC Studios intends to increase its profitability in its Global Media & Streaming business through its investments in BritBox International, which it fully acquired in March 2024 for £272 million, U (formerly UKTV Play) and BBC.com (paragraphs 1.33, 2.2, 2.5 to 2.7 and 2.9 to 2.12).

13 BBC Studios is seeking to manage both internal and external risks to growth. BBC Studios is targeting growth in areas and markets where it considers there is scope for its expansion. In March 2024, it forecast that, to meet its ambition, it needed to achieve above-average market growth rates in most of its key markets. Delivering such levels of growth is made more difficult by adverse market conditions in recent years, which have led to falls in advertising income for broadcasters and intense competition in the streaming market. The focus of the streaming market has also shifted towards achieving profitability rather than subscriber growth. These factors have contributed to a reduction in content spending, with an impact for companies such as BBC Studios. BBC Studios is aware of these risks and is seeking to manage them, including by mitigating the impact for risks outside of its control. It seeks to identify new risks each quarter and regularly revisits its plans and business model in light of developments in fast-moving markets. BBC Studios has shown its willingness to make significant adjustments to its plans when market assessments suggest this is necessary, for example, its decision not to expand BritBox International to 25 countries as originally planned (paragraphs 1.7, 2.13 to 2.15 and 2.17).

⁶ Free Cash Flow (FCF) is a measure of a company's financial performance. It is calculated as the cash generated through the ordinary course of business less cash payments for leases and capital expenditure. It excludes tax, interest, acquisition investments and dividends paid.

14 The BBC has not updated its published financial targets for BBC Studios despite significant changes to its business model and the market in which it operates. The BBC has two published financial returns targets for BBC Studios; a target to achieve profit margins between 9-11% set in December 2018 (paragraph 8) and a five-year financial returns target of £1.5 billion between 2022-23 and 2027-28 published in March 2021. In the period following the publication of these targets, BBC Studios has made significant changes to its business model to adapt to changing market conditions and audience behaviours (paragraph 10) and is planning further transformation in the future (paragraph 12). However, the BBC has not updated its published financial targets to reflect these changes. The BBC intends to undertake a review of its commercial activities, as required under its 2016 Framework Agreement with DCMS, before December 2027 and will be guided by the results of this as to whether it needs to update the published profit margins target (paragraphs 1.9 to 1.11 and 2.3 to 2.4).

BBC oversight and governance

15 The BBC has improved governance and risk management arrangements for its commercial activities, including BBC Studios. In April 2022 the BBC restructured the governance arrangements for its commercial activities. This included appointing a new Chair and a majority of non-executive directors to its BBC Commercial Board, which oversees the BBC's commercial activities, including BBC Studios. These changes were designed to ensure that Board members provide more challenge and support to management, with senior figures from the industry appointed as non-executive directors for their commercial, financial, digital and global expertise, and with a view to achieving BBC Studios' growth ambitions. Reviews of the refreshed governance arrangements by Ofcom (June 2022), and DCMS (January 2024), have been positive about these changes. The BBC has also refreshed its approach to risk management for its commercial subsidiaries. This included establishing a subgroup to the BBC Commercial Board in 2023 to provide independent challenge on the appropriateness of the controls and processes in place for commercial subsidiaries (paragraphs 3.3, 3.4 and 3.11).

16 The BBC has clarified its approach to balancing its own needs with those of its commercial subsidiaries when deciding the dividends to be paid. In our March 2018 report *The BBC's commercial activities: a landscape review*, we highlighted the challenge the BBC faced in striking the right balance between the payment of dividends to itself by its commercial subsidiaries, and the subsidiaries' need for investment. The BBC has subsequently agreed a mandate under which its commercial subsidiaries would seek to maximise the financial returns to the BBC, while prioritising long-term sustainable returns over short-term ones. The BBC has also taken a more structured approach to deciding the levels of dividend payments, including issuing guidance and introducing annual checks on the proposed dividend levels. The BBC discusses the level of dividends with its commercial subsidiaries, based on its assessment of what is needed for the delivery of the BBC's public service functions, as part of its annual budget-setting. BBC Studios' financial plans assume increases in annual dividend payments based on its discussions with the BBC, but, in March 2024, the BBC flagged up it needs extra savings of £100 million in each of 2026-27 and 2027-28, at least some of which could come from BBC Studios (paragraphs 3.5 to 3.7).

17 The BBC has complied with the regulatory requirements surrounding its commercial subsidiaries. Between 2018-19 and 2023-24, the BBC received independent assurance each year that, in line with Ofcom requirements, it had established and applied a system of internal controls to ensure that its commercial activities do not benefit from an unfair advantage over competitors by virtue of their relationship with the BBC. In June 2022, Ofcom found two areas where it was not satisfied that the BBC had appropriate controls and procedures: secondary content sales by BBC Studios; and some of the administrative processes relating to the BBC's supply of goods and services to BBC Studios. In both areas, Ofcom was content with the action that the BBC subsequently took (paragraphs 3.9 and 3.10).

18 BBC Studios has improved its internal performance reporting since we last reported in 2020, but there is room for further development. In July 2023, BBC Studios improved its internal performance reporting, including setting clear, forward-looking financial and non-financial key performance indicators (KPIs) which are more aligned with its strategy. However, there are still some weaknesses in its reporting regime which we consider make it difficult for the BBC Commercial Board and BBC Studios' own Executive Committee to identify whether BBC Studios is meeting its performance targets, and to make good strategic decisions. These include rolling forward of internal targets over a three-year period resulting in no reporting against the original target set for the period, and KPIs not being agreed for the beginning of the 2023-24 financial year. In addition, BBC Studios regularly reforecasts its financial metrics during the year and subsequently reports performance against these re-forecasted levels rather than the original budget, making it more difficult to use these reports to track performance over time (paragraphs 3.14 to 3.16).

Conclusion on value for money

19 To date, BBC Studios has succeeded in delivering increasing returns to the BBC. In the seven years up to and including 2023-24, it had returned £1,906 million to the BBC in dividends and payments through its production and distribution work with the BBC, exceeding its targets for this period. BBC Studios has met its returns targets by substantially growing both its income and profits. Between 2018-19 and 2023-24, income increased to £1,837 million and profits to £202 million, such that BBC Studios has consistently met the BBC's published profit margin target for it of between 9% and 11%. BBC Studios has adapted to changes in the market to enable its growth to date, investing in its digital services, including its website and streaming, and increasing its production of programmes for third parties, including global streamers. It will need to ensure its strategic plans continue to evolve to deliver success in a dynamic and challenging market. It will also need high-quality internal performance reporting to identify areas for development in its business and monitor its progress in meeting its objectives.

20 The BBC and BBC Studios face challenges in ensuring that returns to the BBC are sustainable in the longer term. BBC Studios has ambitious plans to double its income and profits between 2021-22 and 2027-28, which, if achieved, will support it in providing increased returns to the BBC in the future. However, to do so, BBC Studios must significantly grow the size and profitability of its digital services in a competitive market facing macro-economic challenges, and focus on generating new IP while continuing to exploit existing IP and brands. In parallel, the BBC must balance its immediate need for commercial dividends as licence fee income falls with ensuring that BBC Studios has sufficient cash available for investment.

Recommendations

21 We recommend that the BBC and BBC Studios take the following action:

- a BBC Studios should review the risks associated with not meeting its targets for generating new BBC Studios' owned IP.** It should consider whether it fully understands the risks to the delivery of its long-term strategy associated with its current mix of income from 'work for hire' and from the production of new content whose IP it owns, and whether any action is necessary to ensure long-term, sustainable returns to the BBC.
- b The BBC should review its published financial targets for BBC Studios.** As part of the intended review of its commercial activities, the BBC should consider whether its December 2018 profit margin targets for BBC Studios of between 9% and 11% and its March 2021 target for returns to the BBC of £1.5 billion need updating in light of the significant changes to its business model and the market in which it operates, and its future plans.

- c** **The BBC should ensure that BBC Studios' strategic plans for delivering the growth ambition continue to evolve to reflect market developments.** The BBC should include within the intended review of its commercial activities an examination of whether BBC Studios' growth strategy is still likely to deliver success in a dynamic and challenging market.
- d** **BBC Studios should improve the consistency and effectiveness of its internal performance reporting.** It should ensure that it strikes the proper balance between allowing flexibility in its performance framework to respond to market developments and corresponding changes to its plans, while maintaining sufficient consistency so that it is possible to track and compare progress and trends over time.