

Summary of the BBC's licence fee settlement bid

Overview

This document provides a high level summary of the BBC's licence fee bid, outlining its service vision and funding needs through the period of digital switchover to 2013/14. This bid was prepared by BBC management, but was reviewed by the BBC's Governors and their appointed advisers, PA Consulting, to obtain their endorsement before being formally submitted to DCMS in September 2005.

The BBC's proposals require an increase in investment to deliver the services vision, digital infrastructure and the industry's switchover costs which will ensure that public service broadcasting successfully enters the fully digital age. The BBC proposes to fund 70% of its planned increase in investment (excluding industry switchover costs) from its own self-help measures (efficiencies, improved licence fee collection and growth, and commercial dividends), but proposes that the TV licence fee should increase by the following amounts to fund the remainder:

- RPI+1.0% p.a. for the seven years to 2013/14 to fund the services that are priorities for our audiences; plus
- An extra 0.8% p.a. to fund the digital infrastructure required by the BBC; plus
- An extra 0.5% p.a. to fund specific industry switchover costs (all of Digital UK's marketing costs and the BBC's share of its operating costs and, from 2012, to pay estimated spectrum charging taxes on its DTT multiplexes should that be introduced); and
- An extra sum, yet to be agreed with the Government, to fund targeted support to help vulnerable households achieve digital switchover.

As can be seen, the majority of the proposed above inflation licence fee bid will be invested in digital infrastructure and industry switchover costs.

This gives a total requirement of RPI+2.3%, plus whatever may be required to fund targeted help. On this basis, the licence fee will be £150.50 in today's prices by 2013/14 vs. £131.50 at present.

As the independent report by Oxera Consulting Ltd.¹, which we have also submitted, confirms, the bid is also lower than the forecast long term growth in GDP and household

¹ Oxera Consulting Ltd. Affordability of the BBC's licence fee (April 2006)

disposable income, even for the poorest 10% of households. Therefore, the licence fee should be more affordable in 2013/14 than it is today.

This level of increase is lower than the expected growth in media market revenues – the BBC forecasts that its share of revenues will have fallen from 46% in 1992/93 to c. 20% in 2013/14.

The BBC's licence fee bid is summarised within the following five sections:

- **Section 1: BBC's performance since the licence fee settlement in 2000:** This section reviews how the BBC has delivered against the priority investment areas and the funding settlement received, including stretching self-help targets, agreed at the time of the last settlement;
- **Section 2: Changing world:** This section sets out the BBC, DCMS and Ofcom views of how the media environment is changing and the challenges this is likely to present for public service broadcasting in the future;
- **Section 3: The investment proposals:** This section summarises the BBC's proposed investment proposals and explains how they were developed;
- **Section 4: Funding the vision:** This section summarises the overall impact on the licence fee of the BBC's proposed expenditure plans on its current services and proposed investment proposals, after taking into account the funding that it proposes to generate through self-help. As regards the various forms of self help, it sets out the detail behind the BBC's estimates of cash releasing and non-cash releasing efficiency savings, household growth, combined benefits from reduced licence fee collection and licence fee evasion, and commercial dividends. It also examines the financial impact and affordability issues associated with the proposed licence fee level; and
- **Section 5: Performance management:** This section covers the BBC's current procedures and its proposals for performance management in the future, including how the Public Value Test will be applied before launching new, or making significant changes to current, services. This will ensure transparent and consistent decision-making and that the BBC will meet the key objective of delivering licence fee payers' expectations of quality at the lowest possible cost.

Section 1: BBC's performance since the licence fee settlement in 2000

In 2000, the BBC received a licence fee settlement of RPI+1.5%, along with demanding targets for self-help, to fund improved services for licence payers, based upon a shared view of the future. In particular, it was recognised that without the BBC's provision of free-to-air digital services, digital TV take-up could end up capped at 50-60% of the population.

Therefore, the agreed priorities at the time were to:

- develop new, high quality free-to-air digital TV and radio services;
- improve the BBC's existing services;
- expand the BBC's educational services;
- develop interactivity, which was in its infancy at the time; and
- respond to devolution and increase the BBC's national and regional broadcasting output.

The BBC has delivered well against these objectives:

- It has launched a range of new digital TV (BBC Three, BBC Four, CBBC and CBeebies) and digital radio (1Xtra, 5Live Sports Extra, 6Music, BBC 7) services which, although still developing, are already delivering substantial audiences
- bbc.co.uk has been taken to the next stage of development and now reaches 15m people every week (source: BBC)
- the BBC helped rescue the DTT platform via its support for Freeview, which along with the BBC's investment in digital services, has helped to drive digital take-up to over 65% of households (source: Ofcom)
- the BBC has made additional investment in high quality content on BBC One helping it become the licence fee payer's favourite channel and also the most popular, both critically and in terms of share and impact
- due to its investment in high quality content, BBC services are rated the best for most public service genres, despite the growth in specialist channels (source: PBTS)
- in education, there have been major achievements in both specialised services such as usage of GCSE Bitesize and also at a broader level with programmes such as *Who Do You Think You Are?* which is a typical example of a knowledge-building programme that enables people to research a subject further
- interactive TV is now a mainstream proposition, with 6m people now using interactive services on a weekly basis, rising to 9m for big events like the Olympics (source: BBC)

- the BBC responded to devolution by investing increased funds in coverage of the new political institutions, reflecting other aspects of local culture via expansion of locally produced non-news output (e.g. drama, entertainment and factual) and developing new regional TV services, (e.g. in Hull, Cambridge, Oxford and London / Tunbridge Wells), plus the launch of open centres and BBC community buses to take services to licence fee payers
- the 6.30 regional news bulletin is now the most popular bulletin in all regions.

This has helped the BBC to adapt to new technologies and new consumer developments and maintain the appeal and relevance of public service broadcasting. The BBC continues to play an important role in delivering high standards of quality and making the sort of programmes that the commercial sector does not provide. Audiences value the whole breadth of BBC services, as evidenced by a range of research into licence fee payer approval of its services, the most recent carried out by Opinion Leader Research for the Governors, supervised by Professor Patrick Barwise².

Self-help

Since 2000, over 75% of the additional funding required to invest in the priorities described above has been delivered by the BBC's self-help targets for income growth and cost efficiency. Over the five years to the end of 2004/5, the BBC had cumulatively generated an additional £2.2bn from self-help. In total the BBC is forecasting to deliver self-help of £3.9bn against the target of £3.3bn agreed with Chris Smith (advised by PKF³ and the Davies Panel⁴). Self-help includes all efficiency initiatives but also includes the benefits that arise from improved licence fee collection, commercial performance and asset sales. The breakdown of this is shown overleaf.

² Patrick Barwise, *The Licence Fee Bid: What does the Public Think?*, BBC Governance Unit, April 2006

³ Department for Culture, Media and Sport (2000), *'Review of the BBC's Financial Projections: Management Summary of the Review by Pannell Kerr Forster for the Department for Culture, Media and Sport'*, January

⁴ Department for Culture, Media and Sport (1999), *'The Future Funding of the BBC: Report of the Independent Review Panel, Chairman Gavyn Davies'*, July

Sources of extra cash (£m 1999/00 real)	Cumulative 5 yrs to March 2005	Cumulative latest forecast to March 2007	Cumulative target to March 2007	Inc/ (dec) vs target
Licence Fee settlement	509	964	960	4
Self help				
Capture of Household Growth income	376	644	650	(6)
Reduction in evasion/collection	261	367	100	267
Total licence fee self help	637	1,011	750	261
Commercial cashflow	210	312	300	12
Asset sales	135	281	250	31
Total commercial cash flows incl asset sales	345	593	550	43
Cash releasing efficiencies	549	1,182	790	392
Non cash releasing efficiencies (to absorb superinflation)	683	1,140	1,200	(60)
Total efficiencies	1,231	2,322	1,990	332
Total self help	2,214	3,926	3,290	636
Total from self help and settlement	2,723	4,890	4,250	640

Note – all current self-help figures are quoted in the terms in which the original targets were set (£1999/00m).

When the targets were set, they were not split-out in this level of detail, therefore the above sub-targets have been calculated by the BBC from the assumptions in its submission overlaid with PKF's recommendations, both dating from 2000.

Efficiency

The BBC delivered very high levels of catch-up efficiencies in the 1990s. As part of the review of the last licence fee bid review by PKF, in 1999, they stated that:

- the BBC had delivered significant levels of savings in recent years;
- the BBC's 'Producer Choice' strategy and recent savings provided a sound foundation for ongoing competitively priced programme making; and
- the proposed annual efficiency levels to 2006/7 were, not surprisingly, lower than the achievements of recent years.

Therefore, DCMS, based on PKF's recommendation, set a total efficiency target of 2.5% p.a. (a cumulative total of £2.0bn), of which 1.2% p.a. was cash releasing efficiencies and 1.3% p.a. non-cash releasing efficiencies to absorb rising costs. The BBC has delivered the cash releasing target slightly faster than planned (1.3% p.a. to end 2004/5) and would deliver the cumulative cash releasing target for the settlement period without making any further cash releasing savings. The non-cash releasing savings are broadly in line with the forecast as the BBC has managed to make efficiencies to offset broadcast and wider economy super-inflation as planned.

However, rather than wait until the next Charter period, the new Director General, supported by the Governors, undertook an extensive VFM review with the aim of ensuring that the BBC would be as efficient as possible at the start of the next Charter period. As with the overall licence fee bid, the BBC management's plans were reviewed independently, by PA Consulting, on behalf of the BBC's Governors.

Based on this review, the BBC set a new 3 year target of £355m p.a. for additional cash releasing efficiencies (note - this straddles two licence fee periods, 2005/6 to 2007/8, and therefore the first two years contribute to self-help in the current settlement period and the incremental third year benefit is included in the self-help forecast for the new Charter period). This represents 11.7% cash releasing, or 15% total efficiencies (including non-cash releasing efficiencies to offset super-inflation) over the three year period (before one-off implementation costs).

These transformational VFM plans are focussed on those areas of the BBC's cost base where the BBC has a realistic chance of generating efficiencies over the next three years. Therefore, there are a number of exclusions from the plans to reflect those areas which are deemed to be unaddressable during the three year period to which the £355m p.a. target applies. Examples of these exclusions are: long term contracts that have been competitively tendered but are not due for renewal during the period; sports rights costs which are fixed in advance and subject to market forces outside the BBC's control; and performing groups / orchestras where the potential for efficiencies is extremely limited.

Key themes within the three year VFM plan are:

- in total, c3,750 jobs will close or be outsourced (c. 1,700 from support areas and c. 2,050 from content areas)
- new digital technology will be rolled out in production areas
- multi-skilled and multi-media working will be rolled out more widely
- better use of IT, smarter buying and improved space utilisation
- business processes will be centralised, standardised and, where appropriate, outsourced
- any duplication will be eradicated within, and across, divisional boundaries
- simpler, flatter structures will be implemented
- fit-for-purpose performance management and measurement processes will be embedded

The plans for support areas are based on a combination of benchmarking against external best practice and competitive tendering, covering all addressable expenditure. The targets are very substantial and stretching and will take the BBC to high levels of performance relative to external benchmarks - for example, by the end of the VFM programme the BBC will have reached upper quartile levels of best practice in its finance, human resource and property functions. The targets by area are:

Division	Cost savings as % of addressable cost base	Headcount savings as % of addressable base
Finance	44%	67%
HR	25%	56%
Property	18%	51%
Marketing	19%	26%
Strategy (incl. distribution)	28%	32%
Policy (incl. legal)	23%	14%
Rights & Business Affairs	28%	24%
Procurement	13%	n/a

The saving levels in individual content divisions are lower in percentage terms, but represent approximately two-thirds of the total VFM savings. Unlike with overhead areas, a significant amount of expenditure is in the production of discrete programmes within which it is more difficult to stretch resourcing and therefore the targets are challenging given the need to generate cost reductions over a relatively short period. The BBC believes that there will be room for further continuous improvement in reducing content costs over the remainder of the Charter period, but that being more aggressive in the short term could not be achieved without a real impact on content quality. Therefore, the content divisions were tasked with removing 10-15% from their baseline spend levels, with variations by genre. As the VFM programme will drive significant reductions in originated programme prices we expect to be at least in line, if not better than in some areas, the market by the end of the programme. Furthermore, the BBC has a continual market check on its television output through buying from independents, and in regional broadcasting it has a large universe of internal comparators to identify and drive towards good practice. The targets by area are shown overleaf:

Division	Cost savings as % of addressable cost base	Headcount savings as % of addressable base	Key initiatives
TV	15%	19%	Drive savings from independent production market at similar levels to those demanded of BBC production areas. Re-design commissioning and scheduling functions.
New Media	15%	20%	In preparing for 'on-demand', greater engagement and context, New Media is replacing its skill-base with a leaner model to meet new demands
Sport	16%	14%	Re-organise production into multi-media teams. Better central management of production and transmission planning across all platforms.
DEC	11%	7%	Move to freelance employment model. Digital production initiatives to improve production time, utilisation rates and resource prices. Restrict creepage of rate inflation for on and off-screen talent. More investment in pre-production.
F&L	13%	19%	Deliver simplified structure. Review business processes aiming to <i>stop, simplify, centralise or outsource</i> . Implement digital production initiatives to improve production time, utilisation rates and resource prices. Refine planning and development of programmes.
News	12%	12%	Better utilisation of production teams across output. Using technology to eliminate duplication by allowing material to be gathered once and used on multiple platforms.
Radio & Music	14%	8%	Merge craft, production and interactive staff into smaller, multi-skilled teams. Roll-out of self-operation and production lessons learnt from BBC7.
Nations & Regions	12%	13%	Better procurement and independent producer deals. Adopt best practice templates across its operations. Eradicate duplication through better use of technology and reducing low value activity. Simplify management structures.

Many of the plans are dependent upon the implementation of new technology to help drive productivity improvements.

The BBC believes that having achieved this additional catch-up efficiency by 2007/8, the BBC will again be at the efficiency frontier and benchmark well against the market across all its expenditure categories.

Licence fee collection

The Davies report recommended self help targets in licence fee collection of £750m from 1999/2000 to the end of the Charter period based on collection of income generated by household growth (HHG) and reductions in evasion. This target is now forecast to be exceeded by £261m with self-help reaching £1,011m by the end of FY 2006/07. This is as a result of improvements in the profile of licence fee sales growth, primarily via improvements in reducing evasion, compared to that predicted by the Davies Panel.

Since the BBC took over collection of the licence fee from the Home Office in 1991, evasion rates have been cut by 60% from 12.6% in 1991 to 5.0% in 2005. In 2002, the NAO⁵ praised the efforts the BBC has made in reducing evasion – in its press release announcing the publication of the report, Sir John Bourn said ‘The BBC has already done much good work to

⁵ NAO Report “The BBC: Collecting the Licence Fee”, 15th May 2002

reduce the evasion rate and continues to take steps to strengthen the collection and enforcement arrangements'. At the same time, the cost of collection as a percentage of revenue collected has been cut from 6.2% in 1991/92 to 5.2% in 2004/05 – the volume of licences in force has increased by 26% over the same period (19.6m to 24.7m). The combined cost of collection and evasion is now at an all time low of 10.2% – down from almost 19% in 1991/92 – and is forecast to be under 10% by the end of the current financial year.

The BBC's success in reducing evasion has been achieved through the following key strands:

- Ensuring that all customers have a way to pay
- Ensuring that customers are aware of the penalties for not paying the TV licence
- Development of a new, successful licence fee collection contract with Capita and AMV
- Ensuring that TV Licensing's agents are incentivised to reduce evasion
- Using modern marketing techniques to talk directly to customers to persuade them of the need and obligation to purchase a licence
- Development of the TV licensing database in particular development of the address structure to allow for capture of all licensable places.

The BBC has been successful in capturing household growth by identifying new households, capturing information regarding them from both the field and external sources and, where necessary, informing and chasing them to ensure that it generates additional licence fee sales and does not allow evasion to rise.

Whilst collection costs fell as a percentage of total income and did not increase with the volume of sales they rose slightly in real terms as the focus was on continuing to reduce evasion through detection measures. This was in line with the BBC's target.

Commercial cashflows

The BBC is forecast to exceed both elements of the commercial self-help targets set as part of the last licence fee settlement, which were set both in terms of asset sales (where the BBC is forecasting to achieve £281m against a target of £250m) and increased cashflows (where £312m is forecast against a £300m target). This is despite our businesses achieving lower revenue growth after the dotcom and technology boom and busts of 1999/2000. For example, the BBC Worldwide (BBCWW) plan was therefore changed during the period to follow more of a joint venture (JV) strategy, involving 'outsourcing' significant parts of turnover, which has been successful.

The asset sales were achieved through incorporating both BBC Technology and BBC Broadcast and selling them for significant sums, as well as generating future savings from signing long term contracts.

The main commercial subsidiary, BBCWW has met its increased cashflow targets whilst, particularly since 2003/4, focussing its business on core activities and the delivery of profitability rather than revenue or cashflow growth. In areas where BBCWW had been underperforming and there was deemed to be no prospect of this improving whilst the relevant operations were under sole BBCWW ownership, it has either closed, sold or turned those operations into JVs to improve performance. Through adopting this strategy BBCWW will more than double profits between 2003/4 and 2005/6 and forecasts that it will more than quadruple them between 1999/00 and 2006/7 bringing its performance into line with market benchmarks.

Due to all of the above initiatives, the BBC will be much more efficient and its finances much tighter and less flexible once it reaches the end of the current Charter period:

- Underlying costs will be tighter. The new services agreed as part of the last settlement are all up and running and distribution costs are rising. An increasingly competitive market environment continues to drive rises in some key costs above RPI, e.g. key talent, acquisitions and rights. Furthermore, at the end of the current transformational three year VFM plan, it will be much more difficult for the BBC to make high levels of efficiencies without eroding content quality
- The BBC will have no major assets readily available to sell. After a thorough review, most of our commercial assets have been sold, leaving only BBC Worldwide to deliver long term sustainable returns. The property portfolio, which had been underinvested in during the 1990s, is undergoing modernisation, together with the technology infrastructure required for full digital production, primarily funded by 30 year bonds. Outsourcing has taken place, or is in progress, for all major support services.
- Having halved licence fee evasion, there will be limited potential for further cost-effective reductions. Evasion is close to the effective commercial floor after which it costs more to collect each additional licence fee than the revenue obtained from doing so.

Section 2: Changing world

The BBC now faces new challenges from audiences and licence payers, from Government and from changes in the broadcasting market. We agree with both Ofcom and Government as to the challenges facing public service broadcasting.

Broadcasting has always both reflected and led changes in society. The complex interaction between broadcasting and society will continue into the next generation. A summary of some of the relevant key trends in society is:

- increasingly plural and diverse;
- becoming a mature multicultural nation;
- changing democratic engagement;
- growing interest in individual self-fulfilment and achievement;
- more open to global influences; and
- people increasingly value localness.

An understanding of these trends informs the programmes that the BBC broadcasts on existing linear networks, the development of the BBC's purposes, e.g. the addition of "Representing the UK" and "Bringing the UK to the world and the world to the UK", as well as many of the BBC's new investment proposals set out in section 3, e.g. local relevance proposals, active engagement, quality content etc.

1. *Digital universality*

Audience adoption of digital technologies has now reached a tipping-point, with digital television and radio in 66% of households and the internet in 58%⁶. However, take-up rates of digital television and the internet have been strikingly different according to age and socio-economic group. Many people have been left untouched by business models focused on a minority of subscribers paying substantial subscriptions (e.g. pay-TV).

Digital universality for basic digital technologies – the internet, and digital television and radio – is now a real possibility over the course of the next decade but both Ofcom⁷ and the BBC⁸ concur that much hard work remains to be done to persuade consumers of the benefits of

⁶ Ofcom Research, "The Communications Market; Q3 2005 Quarterly Update." Ofcom, February, 2006.

⁷ Ofcom, *Driving Digital Switchover*, 2004

⁸ BBC report to the Government, *Progress Towards Achieving Digital Switchover*, 2004

digital television. It is also a serious logistical challenge.

The Government notes that the market alone will not guarantee digital universality and the public purposes laid out by the Government place considerable responsibility on the BBC to help deliver it by 'Building digital Britain'. The BBC's response to this is set out within its digital infrastructure proposals in the next section.

2. *Technologies that will transform how people consume media*

The second phase of the digital age will bring with it new types of service that have the power to transform the media landscape as we know it:

- Programmes and content on demand: Digital radio and TV audiences will soon have the same flexibility as internet users to control when and where they watch and listen to programmes. Downloading and file-sharing of video and audio from the internet is already commonplace for many people.
- Navigation and search tools: As the media environment becomes more cluttered and people are faced with continuing growth in choice, they will increasingly look for simple ways to find the content and services that they need and that are most relevant to them. Trusted brands will be more important than ever and popular broadcast channels will remain important over the next decade.
- Increasing importance of a wider range of media devices for an increasing number of people. People will access content from a range of sources, on a range of devices, and store it cheaply and easily. Television and the internet will become as portable as radio over the next 10 years.
- Connecting audiences and broadcasters: Digital media is transforming audiences' ability to develop relationships with each other and with broadcasters. Globally, the internet is opening up new channels of communications and cultural exchange between communities and nations. Audiences are increasingly looking for greater interactivity with the media that they consume and are increasingly able to produce their own content and share it easily with others.

The BBC's response to this challenge is set out in its digital service proposals in section 3.

3. *Market pressures putting programme range and quality at risk*

Recent Ofcom research⁹ shows that people value quality and range above all other characteristics of programming.

⁹ Ofcom, *Review of Public Service Television Broadcasting: Phase 1 – Is Television Special?*, 2004

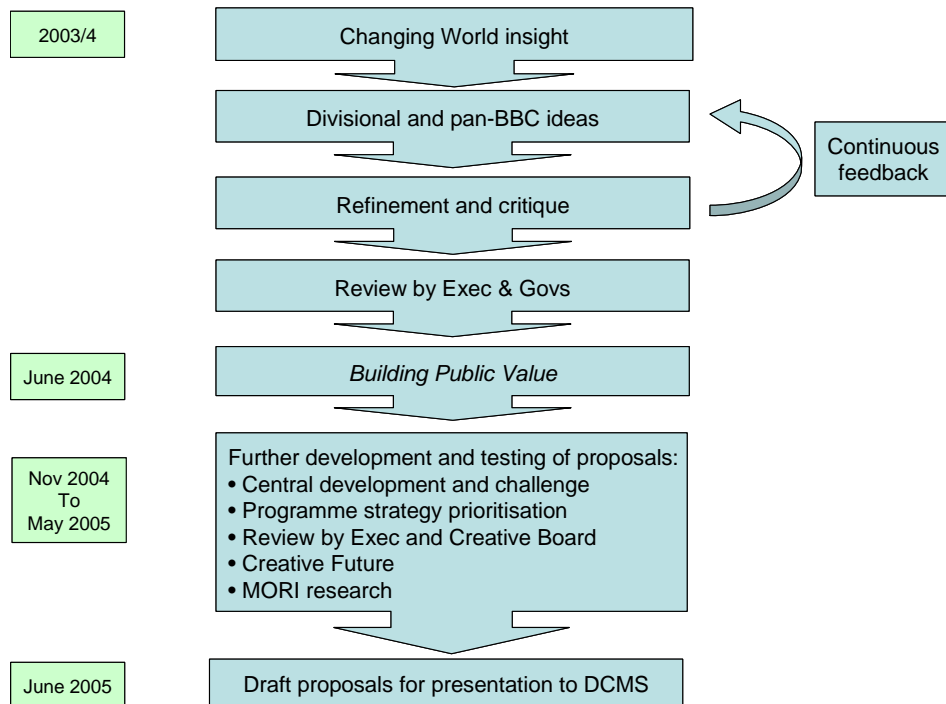
- Audience fragmentation is putting a strain on quality and range. This is particularly relevant for the commercial public service broadcasters, but considerable scope exists for self-help. There are strong reasons to believe that it is commercially sustainable for both Channel 4 and ITV1 to continue making a significant contribution to PSB during the transition to digital. However, ITV is beginning to focus less investment into regional programming and services and there is a particular responsibility here.
- Audience perceptions of the quality of television have decreased since the launch of digital TV in the late 1990's. Research shows that this is due to poor quality of many of the new channels which invest only modestly in original UK content.
- Ofcom notes that people in digital homes are watching fewer 'high ground' programmes than their counterparts in analogue homes – in news, current affairs, serious factual programming and the arts.
- Recent BBC research shows that people want less repeats and cheap derivative programming and more investment in high impact, well made output across a broad range of genres.
- The UK media industry has become more concentrated in all parts of the value chain, with more power in the hands of players with few or no public service obligations. Powerful international companies such as Microsoft are also entering the UK market and will have a powerful hold on important user interfaces.

The net effect of all these changes is to create new responsibilities and new challenges for the UK's public service broadcasters. The Government identifies a major challenge for the BBC in ensuring that the traditional values which have underpinned public service broadcasting – universality, quality, originality, diversity and choice – are maintained and strengthened in the longer term. The BBC's response to this is set out in its quality content proposals in section 3.

Section 3: The investment proposals

Process overview

The BBC has developed proposals for building public value in response to the rapidly changing media environment and based on an understanding of how audience needs, technologies and the market may develop as set out in section 2. This has been a highly iterative process over the past two years based around a need to prioritise limited resources:



Building Public Value

The BBC outlined initial ideas for where it needs to invest over the course of the next Charter period in *Building Public Value* in June 2004. It also outlined where it would not be investing. For example, a fundamental decision was made at this stage that the BBC would not propose launching new linear networks in the next Charter period:

“the transformation of the BBC’s range of linear radio and television channels for the digital world is now complete, and we have no plans for further channel launches.”

Development of investment proposals

These ideas have since been refined further since June 2004 by content and output divisions and influenced by audience, Government and industry feedback. The proposals for investment have been developed based on applying a framework covering the need, approach, benefits and market context of each proposal and costed thoroughly and in detail.

They were subsequently discussed by the BBC's Executive Board, Creative Board and Journalism Board at meetings through Autumn and Winter 2004.

At the same time extensive public research was conducted by MORI to assess the audiences' appetite for key proposals. Some of the ideas have been scaled back or removed completely as a result of this further analysis and discussion. For example, the distribution of the Digital Curriculum on digital TV platforms has been excluded as it was believed to represent poor value for money.

The ideas were further assessed as part of a prioritisation exercise that was approved by the Governors in March 2005. The focus for this exercise was for potential investment between 2005/6 and 2008/9, particularly for investing in quality content, and it was based on the emerging public value assessment framework (expected pressures on reach, quality, and consumer/citizen impact over the next decade). This led to a sharpening of the proposals ahead of them forming part of the licence fee bid submission in Autumn 2005.

The BBC's investment proposals

As described in section 2, the BBC now faces new challenges from audiences and licence payers, from Government and from changes in the broadcasting market. All of the BBC's plans for the next Charter period are rooted in what these groups, and particularly licence fee payers, are telling us about what they need and our view of the rapidly changing UK society.

The BBC's proposals are grouped under four main headings. A summary of these proposals follows:

Areas of investment	Annual 2013/14 £2006/7m	Cumulative 2007/08 - 2013/14 £2006/7bn
1. Digital Infrastructure	189	0.7
2. Digital Services	226	1.2
3. Quality Content	256	1.6
4. Local relevance	107	0.6
Total BBC investment	778	4.1

Note – all figures related to the BBC's future licence fee bid are quoted in £2006/7m.

1. Digital Infrastructure

As set out in section 2, the Government has noted that the market alone will not guarantee digital universality and the public purposes laid out by the Government place considerable responsibility on the BBC to help deliver it by 'Building digital Britain'. Therefore, the BBC plans to lead the transition to a fully digital Britain by 2012 with a special role in helping to make the benefits of the new technologies available to everyone. Because of its stable funding, the appeal of its content and the trust people have in its brand, the BBC can play a powerful role in supporting everyone as they make this digital journey and help to ensure that no one gets left behind. This will mean building out our digital TV and radio transmission, supporting switchover, developing pioneering and attractive new propositions, such as high definition television (HDTV), and promoting the benefits of these technologies to audiences.

In total the BBC is bidding to spend an extra £189 million p.a. on new digital infrastructure by 2013/14, a cumulative total of £0.7 billion over the seven year licence fee bid period to:

- build-out DTT to the same coverage as analogue TV to both deliver digital TV switchover and maximise access and availability to all the BBC's services. The timetable for switchover is to start during the last six months of 2008 and finish in early 2013 – this will require contracts to be signed and network build-out to commence during 2006/7;
- roll-out DAB to 95% coverage of the population to increase access to the BBC's digital radio services and move towards universal availability of the service;
- launch a free satellite proposition, in partnership with other broadcasters and manufacturers, to help push the take-up of digital TV before and during switchover, particularly in areas which currently cannot receive Freeview;
- launch a HDTV service, delivering a major improvement in picture resolution that is forecast to be the broadcasting standard of the future. This will help future-proof the BBC's content, especially as international broadcasters, particularly in the US and Japan, already require content to be delivered in HD. The BBC will make more of its output in this format initially for distribution by satellite and cable, and for export, but has the longer term aspiration to provide HDTV via DTT post-switchover – the BBC is currently undertaking technical trials;
- boost internet distribution to ensure the BBC's infrastructure keeps up with increasing demand to help drive internet and broadband take-up; and
- increase investment in improving media literacy across the UK to help ensure that the entire population benefits from the BBC's investment and that a digital divide does not form.

2. Digital services

Due to the technologies that will transform how people consume media described in section 2, the public value potential of this new media world is enormous. An understanding of these trends informs the BBC's proposals for digital services. Its own research, the success of the Radio Player and the rise of unauthorised file sharing sites on the web demonstrate very clearly that licence payers expect the BBC to respond to the world of what's been called "Martini media" by offering our content "any time, any place and anywhere". To maintain the relevance and appeal of public service broadcasting, such on-demand services must be offered universally and as a public service. Licence fee payers also want more opportunities to interact with the BBC and to create their own content.

Consequently the BBC will use the best of the new digital technologies to make its content more personal, more convenient, more relevant and more participative for all audiences. The BBC will combine old and new media to offer services that can make a difference to everyone's lives, working closely with other media companies across the value chain from search companies (e.g. Google, Yahoo) to broadcasters (e.g. ITV, Sky) to content providers (e.g. independent producers).

In total the BBC is bidding to spend an extra £226 million p.a. on new digital services by 2013/14, a total of £1.2 billion over the seven year licence fee bid period on:

- a range of integrated on demand services to provide public value to licence payers. Key components will be:
 - a 7 day on-demand service to make the majority of the BBC's content available for up to seven days after broadcast, giving licence fee payers the best opportunities to benefit from the content they have paid for;
 - an 'open archive' on-demand service to make available selective parts of the BBC's archive. Over the long run, the BBC archive could be a national asset of enormous value documenting the creative history of the UK, stimulating future creativity and enabling audiences to access programming which reflects their unique interests; and
 - specialist news and radio on demand services;
- navigation and search services to ensure licence fee payers can find the content. As the BBC offer online expands to include audio, video as well as text, graphics, and user-generated material, audiences will need new tools and advice to find, use and share the content relevant to them. The BBC will therefore provide the tools which will make our BBC content 'findable' in an increasingly fragmented media world; and
- active engagement services (e.g. the Creative Archive, Sport Action and Music for All) which will deliver tools, applications and events which develop the range and impact

of the audiences' engagement with the BBC and with each other. As part of the Creative Archive the BBC plans to open up its archive for audiences to use content extracts when they want and how they want. It also aims to find cost effective ways to stimulate grass roots participation in sport, music and citizenship.

3. Quality content:

At the heart of the BBC's services there has to be high quality content that people want to use. As described in section 2, market pressures are putting programme range and quality at risk. Therefore, one of the BBC's biggest responsibilities will be to improve the quality, range and ambition of its programmes and thereby remain guarantors of originality, innovation and creativity. As investment in new British programming comes under pressure elsewhere, we will maintain the BBC's commitment to British programme-making across the full range of its programmes. We will need to innovate in the style, content and range of BBC programmes to maintain relevance and appeal while staying true to public service values and delivering against the BBC's purposes. The BBC's ability to produce cut-through programming and deliver impact draws communities together. Furthermore, the tri-media nature of the BBC's services will be key to leading audiences to new services and platforms and maximising value from content.

The British public has the highest expectations of the BBC and recent research indicates the need for our programming to improve if it is to continue to reach audiences (especially younger audiences), meet their quality expectations and deliver greater impact. This means fewer repeats and less derivative programming and more ambitious original UK content, particularly in peak-time. However, this also means that the cost of output increases as the new content, by its nature, has a higher cost per hour than displaced output.

In total the BBC is bidding to spend an extra £256 million p.a. to increase investment on high quality content in core genres by 2013/14, £1.6 billion in total over the period. This will be focussed on UK originated content in the following key genres - learning and knowledge building, children's programming, drama and film, comedy and entertainment, original music, high quality journalism, and new local content. The forecast costs are based on current spend profiles for specific slots in the schedule, predominantly in peak-time, reduced by forecast VFM savings in line with the wider BBC plans as discussed in section 1.

4. Local relevance:

As described in section 2, the UK is an increasingly diverse and fragmented society – economically, socially, demographically and culturally. As the country changes, the BBC will

respond. The BBC will deepen its commitment to the nations, regions and local communities of the UK at a time when the scale and diversity of regional commercial broadcasting is under threat. There is clear support for more local television and radio services with more representative content and the BBC will direct investment in programme-making to reflect this need. This will include moving resources and production throughout the country to the benefit of audiences as well as the creative economy. The BBC will find cost effective ways to develop services with greater local relevance such as local TV, extending English local radio, open centres and investment in quality local programming.

In total the BBC is bidding to spend an extra £107 million p.a. by 2013/14 on new local and regional investments, a total of £0.6 billion over the period to:

- implement our Out of London strategy to make the BBC and its output more representative of the nation, particularly via a major relocation of operations to Manchester. The new media centre in Manchester will be the BBC's largest operation outside London and will act as a cornerstone of a specialist media and creative industries zone or "cluster". Previous experience shows that such clusters can have a sustainable economic impact not just in their immediate locality but across a wider regional spread. Partnerships with other broadcasters, media companies and the wider creative sector, as well as public sector agencies, are central to our plans. These plans will mean that close to a third of the licence fee is spent outside London and just over half of total BBC staff are based outside London;
- develop our local TV news service in up to 66 cities and counties across the UK with up to ten minutes per hour of relevant local news and information. There will be ten in Wales, six in Scotland and two in Northern Ireland, with the balance covering England. The structure will build on existing English Local Radio stations, turning them into multimedia production units at relatively low cost;
- create a new TV region for Central England centred around Milton Keynes to fill a gap in the BBC's coverage and serve 4m households;
- launch a limited number of new local radio services (Cheshire, Bradford, Dorset and Somerset) to fill specific gaps in the BBC's coverage;
- distribute local radio on digital satellite; and
- increase the number of buses and open centres.

As mentioned previously, to confirm that the proposals matched audience requirements the BBC commissioned MORI to undertake extensive audience research about them, using a sample of over 1,600 people. This suggested that the audiences tested recognise the need for the BBC to invest in these areas and believe that the proposals will be of high quality. For

example, 82% of people stated that they believe it is important for the BBC to build out digital infrastructure, 80% would be interested in using a BBC on-demand proposition and 79% would be interested in more local news coverage. These findings have been endorsed by the more recent research overseen by Professor Patrick Barwise which concludes that the public clearly endorses the idea that the BBC should build-out digital infrastructure and provide services that uses that infrastructure and that the public is attracted to the proposals for on-demand TV and radio, the open archive and creative archive.

The BBC believes that these proposals should complement its current services and leave it well placed to deliver the demanding public purposes that have been set in the recent White Paper:

- Sustaining citizenship and civil society
- Providing education and learning
- Stimulating creativity and cultural excellence
- Representing the UK, its Nations, regions and communities
- Bringing the UK to the world and the world to the UK
- Building digital Britain

Section 4: Funding the vision

This section summarises the impact on the licence fee level required of the BBC's proposed expenditure on its investment proposals and current services, after taking into account the funding that it proposes to generate through self-help. It then examines the financial impact and affordability issues associated with the proposed licence fee level.

Cost of new investment proposals

As detailed in section 3, the cost of rolling-out the new investment proposals (excluding the industry switchover costs associated with spectrum pricing and Digital UK and excluding targeted help) increases over the period, reaching £778m p.a. by 2013/14.

To summarise, this consists of investment in (all figures in £2006/7m):

- digital infrastructure to ensure the transmission networks and platforms are built out and accessible (£189m p.a. by 2013/14, a cumulative total of £0.7bn over the period);
- creating compelling digital services that enable audiences to access content more easily, thereby making the most of the new infrastructure (£226m p.a. by 2013/14, a cumulative total of £1.2bn over the period);
- creating enriching, quality content that draws audiences to the new services and platforms (£256m p.a. by 2013/14, a cumulative total of £1.6bn over the period);
- providing local relevance to ensure that communities across the country can be fully involved in the digital revolution and by moving production throughout the country (£107m p.a. by 2013/14, a cumulative total of £0.6bn over the period).

The cumulative cost of these proposals is £4.1bn to 2013/14. If the industry switchover costs are included (estimated to cost £181m p.a. in 2013/14); the figures increase to £959m p.a. by 2013/14 - a cumulative cost of £4.6bn as shown below.

Areas of investment	Annual 2013/14 £2006/7m	Cumulative 2007/08 - 2013/14 £2006/7bn
1. Digital Infrastructure	189	0.7
2. Digital Services	226	1.2
3. Quality Content	256	1.6
4. Local relevance	107	0.6
Total BBC investment	778	4.1
Industry costs	181	0.5
Total investment	959	4.6

BBC base cost

The ongoing expenditure required to deliver the BBC's current service portfolio is forecast to be broadly flat. However, there are two areas where spend will increase in real terms:

- the level of pension contributions as the BBC will have to revert to paying the long term contribution rate of its pension provision once the current surplus runs out at the end of this Charter period. However, proposed changes to members' contribution rate and benefits will reduce this and keep the scheme affordable; and
- areas of spend subject to inflation above RPI due to competition in the broadcast market or wider economy, e.g. independent production, talent and acquisitions.

The cumulative increase in the BBC's base costs will be £1.4bn over the period.

BBC self-help

Although the BBC will be entering the new Charter period with much tighter finances as discussed above, it is proposing to deliver a very significant amount of self-help which will fund 70% of the BBC's proposed increased investment (excluding industry costs). There are three sources of this self-help – efficiencies, improved licence fee collection and growth, and commercial dividends.

Efficiencies

Over the last fifteen years the BBC has driven through major savings in every area of operations, culminating in the £355m p.a. of cash releasing savings from the three year value for money programme (in addition to the £105m p.a. of non-cash releasing efficiencies to absorb super-inflation over the same period - 2005/6 to 2007/8).

The BBC believes that having achieved this additional catch-up efficiency by 2007/8, the BBC will again be at the efficiency frontier and benchmark well against the market across all its expenditure categories.

In order to remain at the frontier of best practice in this area, the BBC is forecasting to deliver a programme of continuous improvement from 2008/09, with annual total efficiency savings of 2.5% targeted. The 2.5% p.a. figure (worth c. £80m p.a.) refers to a 1.5% p.a. reduction in the BBC's costs (cash releasing efficiencies) plus a 1% p.a. absorption of above-inflation increases in input prices (non-cash releasing efficiencies).

To continue straight away with a further 2.5% p.a. is very stretching – it represents further efficiencies of 15% over the remaining period of the proposed seven year settlement. In

particular, many elements of the BBC's cost base, particularly overheads and infrastructure, will be tied up in competitively tendered, long term contracts meaning that future efficiencies are likely to impact disproportionately on content areas. Many organisations have a pause in efficiency targets after a major programme like the VFM programme, the BBC will not.

The BBC believes that this target compares well to practice in the wider economy:

- The Government has set targets of 2.5% a year for the Civil Service following the Gershon review. Of these savings, the report¹⁰ estimated that over 60% would be cash releasing (i.e. c. 1.5% p.a.).
- Based on a recent study for the BBC by Oxera Consulting Ltd. - a leading economics consultancy – a long term cash releasing efficiency of 1.5% is at least in line with, and often more challenging than, what would be implied by growth in productivity in the regulated industries, or in the economy more generally, for a company that is at the efficiency frontier and does not need to achieve catch-up efficiency.

Including the final year of the current VFM programme, 2007/08, which falls in the new Charter period, total efficiencies will deliver £2.6bn of self-help through to 2013/14.

Licence fee collection

The BBC has benefited in recent years from the significant reductions in licence fee evasion that it has driven. However, there are indications that the BBC is now approaching the 'commercial evasion floor', where the marginal cost of reducing evasion exceeds the revenue generated. In addition, digital switchover and the adoption of new technologies are expected to increase the risks associated with licence fee collection.

However, the BBC has plans for modernising licence fee collection through increasing automation and redesign of 'over the counter' services, reducing the cost of collection by £24m p.a. The cumulative level of self-help to be delivered by these improvements to licence fee collection through to 2013/14 is forecast to be £0.2bn.

The BBC has assumed that household growth will average 0.7% p.a. over the next seven years, in line with the latest ODPM forecasts. It has also assumed that it will continue to be successful in capturing household growth and not allowing it to cause evasion to grow. If successful, the BBC will generate an additional £0.7bn of cumulative self-help from this source.

Commercial dividends

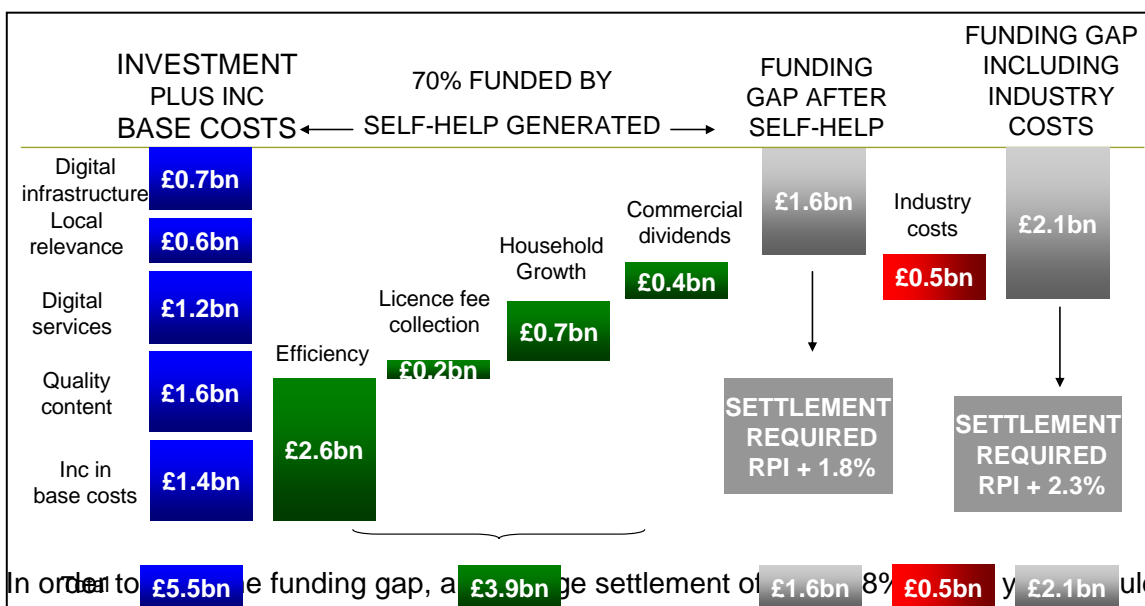
The BBC's refocused commercial subsidiaries are forecast to deliver £0.4bn in self-help through to 2013/14. The vast majority of this will be delivered by dividends from BBC Worldwide which are forecast to adopt a sustainable growth profile after a period of reinvestment. Although there are risks to the BBC's commercial plans, the BBC believes that they are stretching, but achievable.

Going forward all commercial businesses will be regularly assessed against the four criteria included in the White Paper to assess whether continued ownership or an alternative course of action represents better value for money. The four criteria are designed to ensure that:

- the proposed activity fits with the BBC's public purposes;
- it is commercially efficient;
- it protects the BBC's brand and values; and
- it does not distort competition in the market.

Licence fee settlement required

Taking into account cumulative increases in the BBC's base cost, forecast expenditure on new investment proposals and the proposed level of self-help, the total funding gap, based on a RPI settlement, would be £1.6bn, excluding industry costs, or £2.1bn including industry costs, other than targeted help, as shown below.



¹⁰ Gershon, P. (2004), 'Releasing Resources to the Front Line', Independent Review of Public Sector Efficiency,

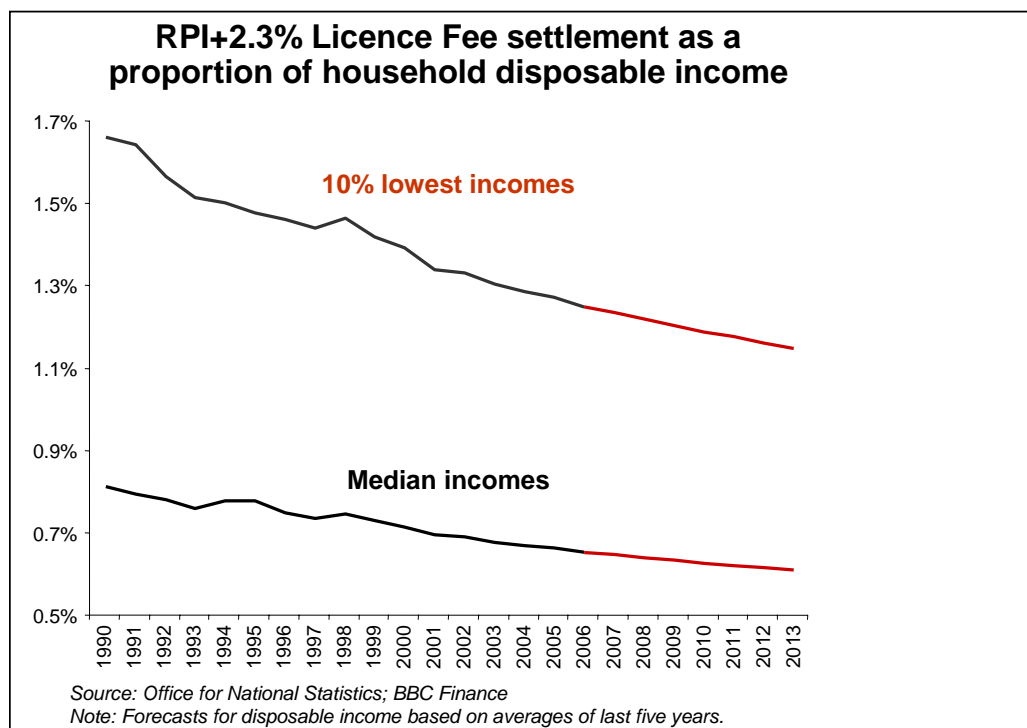
increase steeply during digital switchover in the early part of the next Charter period, such a settlement profile would lead to significant borrowings, rising to around £400m against the BBC's current borrowing limit of £200m.

Affordability

On the basis of the proposed settlement, we believe that the licence fee will fall relative to income.

As a share of spend on leisure services the licence fee has fallen from nearly 12% to around 4% since 1980. The licence fee has been falling in real terms compared to disposable income, even for the poorest. Today the licence fee (£2.43 per week) represents 1.3% of disposable income for the poorest 10% of households, down from 1.5% ten years ago and 1.8% twenty years ago.

As the independent report by Oxera, which we have also submitted, confirms, the bid is also lower than the forecast long term growth in GDP and household disposable income, even for the poorest 10% of households. Therefore, the licence fee should be more affordable in 2013/14 than it is today as shown below.



Section 5: Performance management

This section covers the BBC's current procedures and its proposals for performance management in the future, including how it will apply the public value test before launching new, or making significant changes to current, services. This will ensure transparent and consistent decision-making, providing clarity to external stakeholders and BBC management. Furthermore, it will strengthen the BBC's independence and ensure that it will meet the key objective of delivering licence fee payers' expectations of quality at the lowest possible cost.

Current performance management

The BBC's performance management systems have recently been reviewed by the National Audit Office (NAO). The framework is based on four drivers – Reach, Quality, Impact and Value for money (RQIV). The NAO review acknowledges the successful implementation of this framework as well as plans to improve performance management reporting even further.

Future plans for performance management

The BBC's proposals for performance management were first developed in its June 2004 publication *Building Public Value*. Since then they have been refined in the light of the extensive debate around the Charter review process. The Board of Governors conducted its own consultation on the approach to Service Licences and the Public Value Test in Autumn 2005. Full details of the procedures that will apply under the new Charter are contained in Chapter 5 of the Government's White Paper on the BBC.

The planned changes include proposals that:

1. The BBC Trust will subject every new service – or significant change to an existing service to a public value test before approving its launch, including an independent evaluation of its likely market impact by Ofcom.
2. Every BBC service will be granted a Service Licence by the BBC Trust. The licences will include clear indicators to allow the Trust to monitor and ensure the performance of the Executive in delivering individual services, provide clarity for licence fee payers and certainty for the rest of the market.
3. Every 3-5 years, the BBC Trust will commission a public value survey of licence payers.
4. A new performance measurement framework will be adopted, based around four overall criteria: reach; quality; impact; and value for money. Audience share and volume will continue to be considered as indicators of programme or service impact, but only as two among several.

Appendix 1: Status of the BBC's licence fee bid

The BBC's licence fee bid was prepared during the Spring and Summer of 2005, formally submitted to the DCMS in September 2005, following a review by the Governors with advice from PA Consulting, and publicly launched in October 2005.

When the licence fee bid was submitted to the DCMS, and its advisers, the BBC made it clear that a small number of important figures were estimates that were subject to refinement as more information became available. These figures were:

- the cost of our proposals with regard to the proposed move to Manchester, which were the subject of an ongoing feasibility study;
- the level of our required pension contribution, which was subject to an actuarial valuation of the fund that had not yet been received;
- the cost of the digital transmission roll-out, which was subject to a competitive tender; and
- the dividend stream arising from our commercial plans, which remained subject to approval.

As expected, things have moved on since then in some of these areas, although figures are still not finalised. The costs to the BBC of the move to Manchester have developed further following the latest stage of the feasibility study and the actuarial valuation of the pension scheme has now been agreed. However, there are also a number of areas, especially in relation to digital switchover, where figures can only be finalised following policy decisions by Government. In particular, the BBC's current licence fee bid excludes any provision for targeted help – support in achieving digital switchover for the most vulnerable households. This element will be the subject of further discussion with DCMS as the requirements become clearer.

The BBC therefore expects to update its funding bid and re-present it to DCMS as the costs of these initiatives become clearer.