



FUNDING THE BBC

AN ISBA/IPA SUBMISSION TO DCMS

MARCH 2006

1 MANAGEMENT SUMMARY

- 1.1 IPA and ISBA recognise the BBC's strong contribution to British society and to its world-leading broadcasting industry. To continue to deliver this, we believe it needs to be properly resourced and funded.
- 1.2 Having said this, we are mindful that an "over-funded" BBC, which is capable of outspending all its competitors on broadcast and on new media platforms – and, in consequence, of "unfairly" stealing their audiences – could seriously damage the commercial media sector on which we depend to deliver the advertising messages so important to the continued health (and growth) of British business.
- 1.3 There is clear evidence that the existing 2000 settlement has already had the effect of over-funding the Corporation - and all indications are that the proposed future formula could worsen this situation still further.
- 1.4 IPA and ISBA consider that the figures put forward to justify its bid by the BBC are excessive - and that insufficient attention has been paid to using cost savings to meet the objectives laid down in the Green Paper on Charter Renewal.
- 1.5 Against this background, we believe the BBC's proposed settlement formula of RPI + 2.3% is excessive. We believe that an overall settlement of RPI minus is a more appropriate target, and would certainly urge for the setting of a ceiling of no more than RPI.

We acknowledge that Government is seeking the BBC's support for Digital Switchover, which will have attendant costs. But neither do these span the whole Charter period, nor do we believe they should be 'rolled in' to any general settlement. Rather, they should be identified, separated and ring-fenced from any general settlement. We also call for any 'hidden accelerator' impacts of linkage to the number of UK TV homes to be neutralised, as this linkage is largely unjustified, yet has served to compound the BBC's relative overfunding in recent years and would continue to do so in future.

- 1.6 Elsewhere the Corporation should be encouraged as vigorously as possible to fund future activities via continued cost savings.

2 FUNDING THE BBC

2.1 IPA and ISBA welcome the opportunity to submit views to the DCMS on the proposed formula for BBC funding across the next seven years.

2.2 ABOUT THE IPA

The Institute of Practitioners in Advertising is the trade body and professional institute for UK advertising, media and marketing communications agencies. Our 247 corporate members, who are based throughout the country, handle over 80% of the UK's advertising agency business with an estimated value of £10 billion in 2005, on behalf of many tens of thousands of their client companies and organisations worldwide.

2.3 ABOUT ISBA

ISBA represents the interests of major UK advertisers in both the public and private sectors across all areas of advertising and marketing communications.

Its membership comprises some 400 companies and organisations (further details can be found at www.isba.org.uk), including most of the nation's largest advertisers. ISBA's members combined expenditure on marketing communications is in excess of £10 billion, about half of the total market for UK commercial communications of all kinds.

ISBA represents a very wide spectrum of advertisers: some are government departments, publicly owned bodies or charities; some are internationally-known branded goods manufacturers; some are engaged in service industries, such as banks and building societies; some are smaller, local players. Despite this breadth of constituency this response reflects a clear consensus.

2.4 The IPA and ISBA share the consistent objective of securing for British businesses cost-effective media for promoting their products at all levels, with the end-benefit of extending consumer choice and generating economic growth.

2.5 Since the activities of the BBC have an inevitable and critical influence on the UK broadcast and the wider media ecology, how the Corporation is funded, to what level and what it does with its money are of vital interest to our organisations' respective members and it is against this background that our observations are made.

3 How ISBA AND IPA VIEW THE BBC

- 3.1 Perhaps surprisingly for representative bodies of commercially-orientated companies, ISBA and IPA believe there is much to admire in the BBC.
- 3.2 As an informer and educator, we believe it has fundamentally helped shape the attitude of the nation, and via the World Service, has played a vital social and political role through the provision of accurate and balanced news programming across the globe.
- 3.3 Equally, we believe its values and the quality of its output have acted as benchmarks not only for its competitors in the UK, but also to broadcasters on an international basis.
- 3.4 For much of the time the BBC was establishing this position, however, it held a monopoly in UK broadcasting and even with the arrival of commercial operators in the late 50's (TV) and 70's (radio), it has been able to exercise enormous and undisputed power in the market place.
- 3.5 As is recognised by the Corporation itself, however, the onset of the digital age poses the BBC with a set of entirely new challenges. In a UK multi-media environment, we believe it behoves the Corporation to cease seeking to dominate in all the multifarious areas in which it operates and instead *complement* the marketing activities of the commercial players in those areas – enriching the *totality* of the offering before the public versus competing for the maximum audience.
- 3.6 It is against this backdrop that we have examined the BBC's proposed funding formula – which, in our belief, goes far beyond the resources needed for the BBC's specific role outlined above and, if unchecked, could actually threaten the entire shape of the UK broadcast market–place.
- 3.7 For British business seeking to promote its sales through the efficient communication of its advertising messages, this would pose a major problem with potential knock-on effects in many areas of the wider economy.

4 WHAT BASIS DO WE HAVE FOR OUR CONCERNS?

- 4.1 In a broadcasting market place which is fragmenting but where total viewing and listening figures are broadly static, it is self-evident that any gain by one broadcaster will lead to loss by another. When a broadcaster is the size of the BBC and is publicly funded, any further strengthening of its position will inevitably have profound implications for all its commercial competitors.
- 4.2 In the new media marketplace, the BBC has used considerable resource from the licence fee to develop a highly-used and much-admired web presence with bbc.co.uk, which the BBC claimed some time ago is already accessed by 50% of the UK population¹. It is now developing and launching a range of new online initiatives such as MyBBCPlayer, which will undoubtedly further extend and refresh the BBC's franchise. We are well aware of the concerns of commercial new media operators that the vast resource the BBC has been able to invest has made entry and participation in such markets by commercial competitors very difficult.
- 4.3 In a speech to the ISBA/WFA Annual Conference in March 2005, current BBC Chairman Michael Grade quoted Tim Gardam, a former senior executive at the BBC, who likened the historical activities of the Corporation to that of "well-meaning elephants, which would tramp good naturedly though the jungle inadvertently crushing underfoot smaller objects in whichever direction they turned".
- 4.4 The analogy was a good one, in that:
- it highlighted the massive all-encompassing power of the Corporation, which holds a dominant position in each market in which it operates and has the resources (and more concerning, the absolute control over these public funds) to outspend any single rival
 - it underlined the historical freedom with which the BBC had been able to enter markets, usually with the best of intentions - but usually to the severe detriment of those smaller commercial companies already operating in those sectors. (Commercial broadcasters, websites, magazine publishers and profit-making educational publishers have all felt the impact of the BBC entering and upsetting the market-places in which they operate – to the extent that a few years ago the educational publishers both took the Corporation to the OFT and made a "state aid" complaint to the EU in a bid to curtail its entrepreneurial activities.)

¹ Source : Broadcast magazine, May 6, 2005

4.5 The Corporation's ability to behave in this manner was, we believe, the result of three key factors :

- a lack of clarity as to the BBC's core purpose, which meant that it had sufficient latitude to justify whatever actions it took
- the weakness of its Board of Governors, who while comprising representatives from the regions, social groups and the "great and the good" generally lacked the necessary professional competencies to be able to understand fully the potentially enormous economic implications of sanctioning activities by the UK's largest single broadcaster and multimedia company, and finally
- the financial headroom arising from the recommendations of the Davies Panel in 1999, which saw the BBC benefit from an era of unprecedented public funding growth as a result of a 1.5% above-inflation settlement at a time when greater than anticipated expansion in the number of smaller and single-person households in the UK would have boosted revenues anyway.¹

4.6 Assuming that the proposals in the March 2005 Green Paper on Charter Renewal are followed, we are hopeful that at least some of the "looseness" surrounding the first two of the above factors will be removed. (Although we should underline our belief that an independent assessment of the economic impact of new BBC ventures is vital if the Corporation is to behave responsibly in the market.)

4.7 This will do little, however, to allay profound concerns that the BBC's proposed funding formula would see the Corporation move from Mark Thompson's³ now infamous "Jacuzzi of cash" – to an even deeper resource pool which could completely swamp the activities of its commercial rivals.

4.8 At his appearance before the House of Lords Select Committee on 7th December 2005, Charles Allen, the Chief Executive of ITV, suggested that the BBC's licence fee income is now growing so fast that it is already greater than that generated from advertising by ITV, GMTV, Channel 4, S4C and Five, including their respective digital channels - and that unless there is a significant upswing in overall advertising expenditure, which IPA member forecasts suggest is unlikely, the BBC could overtake the entire advertising-funded market as early as 2007.

4.10 Moreover, while the BBC may have been able to claim some justification for its income across the period 2000 – 2004 in order to fund its expansion into digital and new media

² The Davies Panel Report estimated a level of increase in household growth of around 0.85%, whereas the number of homes paying the full licence fee has risen by an average of 2% pa, largely from the rise in single occupancy

³ Then Chief Executive of Channel Four, now BBC Director General!

services, it has not announced significant plans to expand its services further in the next licence period except for additional activities re BBC online as part of its remit to drive the creation of Digital Britain (eg the Creative Archive, My BBC Player, mobile and broadband services).

- 4.11 However, if the commercial television stations face a daunting task competing against the BBC on the proposed funding formula, the threat before commercial radio is arguably even more acute. At a time when the commercial stations are suffering from a revenue downturn, BBC Radio's market share is currently 55% and growing, fuelled by an abundance of funding to support investment in content.

The extent of this funding imbalance with respect to the commercial sector is already enormous. According to the Commercial Radio Companies Association (CRCA), in 2005 the groups and individual broadcasters which make up the UK commercial radio industry had revenues of some £600 million from which to finance not only the broadcasting activities of their 290 analogue and 70 digital-only services but also development and returns to shareholders.

A recent report commissioned by CRCA from Indepen, "A Licence To Kill", adds considerable further weight to these views.

By contrast, the BBC - as a single player - spent an estimated £556 million on its radio activities (see Appendix), and this sum does not take account of the massive additional value in kind BBC radio enjoys from the frequent and heavy cross-promotion of these services across all its other media channels.

(The commercial channels are prevented from enjoying the benefits of such cross-promotion not only by their lack of common ownership, but also by regulation).

Should the BBC's proposed settlement go ahead, this situation would almost certainly worsen, thereby not just threatening the ability of the commercial sector to play its part in the development of digital radio, but potentially the very existence of some of stations and/or groups.

5 HOW VALID ARE THE BBC'S NUMBERS?

- 5.1 Given that neither the IPA nor ISBA are broadcasters, we are not best placed to comment in detail on the calculations put forward by the BBC to underwrite its bid. However, we would make a number of observations:
- 5.2 The DCMS will note that the BBC has costed the Green Paper on the assumption that it is already policy. While understandable, this should be borne in mind in the event that the Corporation's final remit differs from that laid out in the original paper.
- 5.3 Rival broadcasters have suggested the Corporation's bid to be "heavy" on costs and "light" in terms of cost savings. In this context, the DCMS will recall that at the last formula discussion in 2000, the Corporation initially requested £700 million in extra funding and then subsequently reduced this to £200 million plus £1 billion of "self help" measures. We think it significant that the BBC has already cut its initial estimate for moving to Manchester from £640 million to £400 million with a request from Tessa Jowell to cut this figure still further by working with ITV and independent producers. [Broadcast Magazine, 3 February 2006] Against such a track-record, we believe each of the BBC's other budgets need to be rigorously interrogated to ascertain if they too suffer from the same levels of over-generosity
- 5.4 We note that the BBC has not made clear which of its costs are one-off capital expenditure and which are ongoing. We call for clear and transparent identification and separation of these costs so as to avoid the compounding of "gross" budgets over the next seven years.
- 5.5 Given the extent to which the commercial sector is already being outspent by the BBC, we should question the need for the £1.6 billion additional costs by 2013/14, which the BBC estimates for "quality content". This is apparently on top of the Corporation's current programme budget and, as Charles Allen has pointed out, would alone be about twice the level of ITV1's annual programme budget. In all likelihood, the BBC's 'pitch' ignores likely changes in the market for broadcast content which may lead to reduced costs for all but the most lavish productions.
- 5.6 Similarly, while we are not in a position to judge whether the £1.2 billion the BBC plans to invest in digital services or the £600 million proposed for services "of local relevance" are excessive, these figures do appear high. We therefore believe there should be proper assessment of the economic impacts of each investment before it is underwritten.

- 5.7 Finally, in order to avoid the risk of suspicion that any of the proposed £0.8 billion funding for digital switch-over might find its way into other Corporation budgets, we would endorse the request made by numerous other parties that these monies should be clearly ring-fenced and accounted and reported separately, transparently and *publicly*.
- 5.8 We would also take this opportunity to reiterate the views we submitted at first consultation and Green Paper stages that the BBC's funding should be reviewed mid-term (ie by year 5 of the ten-year charter period), in order to ensure that it continues to be appropriate and proportionate.

6 WHERE DOES THIS LEAVE THE BBC'S FUNDING FORMULA?

- 6.1 In line with earlier submissions from both our organisations, we continue to believe that the BBC needs to be well-funded and resourced – and that until either market conditions render the device non-viable or another, more appropriate funding mechanism can be devised, this should principally be via the licence fee.
- 6.2 Having said this, we concur with all the main commercial broadcasters that the BBC's proposed funding formula is excessive and could significantly over-fund the Corporation to the detriment of its competitors, with potentially damaging knock-on effects for advertisers, and therefore the economy.
- 6.3 Given these circumstances, we believe that the BBC's future funding settlement should be capped within an absolute overall ceiling of RPI.
- 6.4 Indeed, we would argue that the settlement should be well within RPI, or "RPI minus". Not only are UK commercial media owners not forecasting growth at RPI, let alone RPI plus, but it is well-established corporate discipline, custom and practice to set stretch targets which rigorously encourage optimal efficiency.

We believe this argument holds even more power, given that the BBC is using public money obtained by a compulsory subscription.

- 6.5 We also argue for neutralisation of the 'demographic accelerator' which further (and, at least partly, covertly) compounds increases in the Corporation's revenues by dint of the fact that licence fee revenues are charges on TV homes and therefore benefit from the trend towards more households with fewer occupants.

The cost of BBC resources and creation or acquisition of content do not track the number of homes which can receive television. In truth, the only element of its activities which might be argued to need to be in any way geared to the total number of UK TV homes is licence fee enforcement, itself only a small proportion of total BBC expenditure (£120m vs current £3bn, let alone future £6bn revenues).

We might ask if Government would seriously be prepared to consider granting all the UK's commercial broadcasters similar financial incentives which track demographic movements, perhaps most practically by way of reductions in their licence payments and regulatory burdens?

Of course not! – but this illustrates that there is simply no continuing tenable basis for a settlement which guarantees that BBC revenues track largely irrelevant demographic shifts to its advantage.

We recognise that such any such adjustment would necessarily be retrospective, and therefore argue that licence fee revenues should be reviewed and adjusted annually to prevent the Corporation's future enjoyment of such unjustified and unwarranted incremental revenue increases.

- 6.6 Finally, we would argue that any funds granted the BBC for the purpose of helping Government achieve its policy objective of Digital TV Switchover by 2012 should be identified, separated and ring-fenced from a general settlement. These funds should then be subject to full, transparent and frequent public scrutiny before they are set, and both during and after their deployment.
- 6.7 As we have already suggested, we would also expect any settlement to be explicit in its expectations of the BBC to contribute towards its ongoing future needs by way of continuous cost savings and scale economy dividends.

7 CONCLUSIONS

7.1 We believe the BBC's proposed formula for its funding across the next seven years potentially threatens gravely to undermine commercial broadcasters by providing the Corporation with resources that will significantly exceed those likely to be available to its rivals from advertising revenues.

7.2 The upshot of this, we believe, would be twofold:

- to enable the BBC to outspend its commercial rivals across all aspects of broadcasting and beyond - leading to audience migration, advertising revenue loss and a potentially disastrous downward spiral in the free-to-air commercial sector
- subject to any additional controls in its new Charter, to encourage the Corporation to renew its recent entrepreneurial vigour and seek to extend its self-styled remit into new sectors, to the detriment of the commercial incumbents.

7.3 The end result, we would suggest, would benefit no-one:

- *not the BBC's commercial rivals*, who would find themselves outbid and outspent on talent and programming, thereby losing audience and thus their commercial revenues
- *not the advertisers*, who as a result of such audience migration would lose the key means by which they deliver advertising to their customers
- *not the BBC*, which would soon lack the serious competition necessary to maintain its standards and efficiency
- *and certainly not the public*, which in the longer-term would not only lose out on programming and channel choice - but could see the entire commercial free-to-air sector collapse and be replaced by a subscription system.

7.4 To avoid this situation arising, we would therefore call for :

- a much more modest funding settlement for the corporation, preferably keeping well within an absolute ceiling of RPI to encourage optimal BBC performance and value-for-money delivery to the public
- neutralisation of any revenue-enhancing impacts arising from the linkage of BBC licence fee funding to population shifts
- clear identification of and proper differentiation and accounting of capital and ongoing (revenue) expenditures
- and the clearest separation of any funds pursuant to Digital Switchover.

8 CONTACTS FOR FURTHER COMMENT & INFORMATION

IPA and ISBA would be happy to provide further comment, information and substantiation as required. Please contact :

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BBC Radio Expenditure: 2005

	£m
DIRECT	
Analogue	
National, Regional and Local Radio	142.2
Radio 1	17.8
Radio 2	23.8
Radio 3	32.0
Radio 4	71.3
Radio 5	<u>53.8</u>
	340.9
Digital	
Radio 1Xtra	5.7
Radio 5 Live Sports Extra	1.6
Radio 6 Music	4.5
Radio 7	4.8
Digital Radio	16.6
Asian Network	<u>5.4</u>
	38.6
Total	379.5
INDIRECT EXPENDITURE *	
Programme Related Spend (e.g. newsgathering, marketing, on-air trails)	61.0
Overheads	59.8
Distribution & Collection (licence fee and transmission)	55.7
TOTAL Radio Spend (Direct and Indirect)	556.0

* These figures are calculated at 18% of total BBC indirect expenditure, based on radio accounting for 18% of total direct expenditure.

(Source: *Delivering Public Value – Supporting Information (October 2005), Table 1.3*)