

Independent panel on BBC Charter review

Emerging themes

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Foreword

From 11 December 2003 to 31 March 2004, the Department for Culture, Media and Sport held a public consultation on BBC Charter review, which included meetings with the public and industry. The Secretary of State, Tessa Jowell, and the Minister for Broadcasting, Lord McIntosh, also took part in a series of visits across the UK to gauge the range of views on the BBC's future. Around 5,500 responses were received in total - a tremendous number for a Government consultation.

In June 2004, the Secretary of State appointed us as an independent panel to marshal the evidence from the public consultation and research. We do not represent any particular interests but rather draw upon our range of expertise and experience to bring the public interest to bear on the central questions that surround the future of the BBC.

In order to inform the Government's thinking in the run up to the Green Paper on the BBC's Royal Charter, we held a series of public seminars to ensure that:

- All the key issues were aired
- Assertions could be challenged and further evidence can be submitted
- The debate was constructive and the key issues were moved forward

We have also been mindful of other sources of evidence and discussion that have occurred concurrently – Ofcom's as yet unfinished PSTV review and the informative reviews of some of the BBC's services carried out by Philip Graf, Paddy Barwise and our colleague Tim Gardam.

This paper does not reflect all the findings from the seminar series but rather sets out some tentative propositions arising from our seminars and wider discussions so far. The paper does not cover the discussions in the recent "cross-cutting" seminars on the BBC's role in relation to education, regions, sport, culture, informed citizenship and the world.

We are grateful to everyone who has taken part in the seminars. The agendas, background papers, transcripts and live webcast footage can be accessed via the Charter Review website (www.charterreview.org.uk or through the BBC, www.bbc.co.uk/thefuture

We would like to thank all the guest panellists for their time and valuable contributions to the debate. The panel are also grateful to audience members, who included respondents to the public DCMS consultation and stakeholders from the media industry and elsewhere, for their questions and comments both during the seminars and in follow up (Full acknowledgements can be found at Annex A).

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1 The Panel's Findings and Emerging Themes

- 1.1 The purpose of this paper is to review some of the important themes that have emerged from our seminars so far and to provide an introduction to our final seminar on the regulation and governance of the BBC.
- 1.2 In highlighting the main themes, we have concentrated on those aspects of the debate that we judge to be central to a new BBC Charter. We have also taken account of the Secretary of State's remit that the next Charter should maintain a 'strong and independent' BBC.
- 1.3 The BBC's place in the changing media landscape was a persistent theme in our discussions. Section 2 of our paper sets out some of the developments that we judge to be relevant to the BBC's next charter.
- 1.4 The requirement for the BBC to have a clear purpose and remit in this rapidly changing environment has been a second theme in our seminars. The seminars, in examining the many different roles and purposes of the BBC, have exposed a number of arguments about the basis on which these purposes, and their delivery, could be effectively measured. Section 3 discusses this issue along with some of the challenges inherent in developing a workable and measurable approach to the delivery of the remit.
- 1.5 Not surprisingly, a third closely interrelated theme has been the method of funding the BBC. There is a general (although not complete) consensus that the licence fee has played a crucial role in helping the BBC to maintain its independence from political and short-term commercial pressures. This independence has contributed to the particular style and pattern of public service broadcasting, on both the BBC and commercial channels that we have become familiar with in the UK. However, the move to digital television and the other technological advances discussed in section 2 are likely to raise a series of challenges to the continuation of the licence fee in its present form. In section 4 we examine some of these challenges and some of the alternative funding mechanisms going forward.
- 1.6 The appropriate system of governance and regulation for the next charter period has been the other theme present in all of our discussions.
- 1.7 In many walks of life there has been a deliberate move away from an approach where institutions were run on the basis of unchallenged trust and informal understandings. This has been replaced by a much greater emphasis on more modern concepts of openness and transparency leading to a realisation that systems of governance in both public and private sector organisations need to be updated. Self-regulation without an external perspective has been judged increasingly inadequate.
- 1.8 Governance and regulation are central to the confidence we can have in the future delivery of the BBC's purpose and remit, the value for money that will be obtained from the licence fee and how successfully the BBC will adapt to the changes in the broadcasting environment. It is also likely that the degree of confidence in the system of governance and regulation could influence the public's trust in the justification for the BBC's future activities. The more publicly accountable the BBC appears to be, the greater will be the public's preparedness to allow it discretion in its purpose and remit as well as to accept the licence fee as an appropriate form of funding.
- 1.9 Section 5 sets out three possible models of governance and regulation as a basis for discussion in the final seminar. In an earlier seminar we had a useful discussion of some general

principles, which we have referred to in this section. We propose that the final seminar should take the three models and look in detail at the strengths and weaknesses of each. The purpose is to ensure that the BBC has the best possible combination of governance and regulation to enable it to carry out its role without political interference or continued disputes about its governance. We want to ensure that the BBC maintains a distinctive and valued position in the media landscape of the future, which will be significantly different from the past.

2 The changing media landscape, and the BBC's place in it

- 2.1 In each of our seminars we were reminded that this Charter review is taking place within a rapidly changing media landscape. Multi-channel, digital homes are already in the majority and we have the likely prospect of full digital switchover during the next Charter period. In addition, digital technology is likely to bring growing access to broadcast materials through broadband internet connections to the home and workplace, hand-held playing devices and even mobile telephones as well as widespread use of personal video recorders. And no doubt over time there will be other innovative applications for digital media material.
- 2.2 There is often a lively debate between those who expect to see a greater impact from these technologies on viewing and audience behaviour and those who predict a more gradual adjustment. There is, however, widespread agreement that the following trends are likely to be evident in sufficient degree that they should have an important influence on the design of the next BBC Charter.
- 2.3 The massive expansion of choice of channels is likely to lead to a declining audience share for the main channels that are now free to air – principally BBC1, BBC2, ITV1, Channel 4 and Channel 5. In existing multi-channel homes this pattern is already clearly evident. Even allowing for the possibility that early adopters are most likely to be attracted by alternative channels, the cumulative impact on the traditional, terrestrial channels could be significant.
- 2.4 The market pressures of a digital media world will lead to greater competition for advertising from other channels. This is likely to impose greater pressures on ITV and Channel 4 to include in their schedules less “landmark” programming, where the level of investment is not justified by the level of income generated, and more commercially dependable and demographically targeted “commodity” programming. OFCOM's Public Service Television Broadcasting Television review emphasised that we are already seeing trends in the direction of less public service broadcasting (PSB) programming on ITV and Channel 4, and that market pressures will continue to push in this direction.
- 2.5 A continuation of these trends will mean that some types of programming, for example general entertainment, films and sport, will be available and watched in greater amounts, whether funded by advertising or subscription. By contrast, traditional PSB programming will be less well funded, and so less available and watched in smaller amounts. These trends would also imply that the BBC will provide a greater share of traditional PSB programming in the future.
- 2.6 The decline in the scarcity of spectrum will significantly reduce the commercial value of a public service licence to broadcast. The consequent increase in commercial competitive pressure will in turn limit the ability of licensed commercial public service broadcasters to cross-subsidise different programme genres. The consequence is likely to be a relative scarcity of high quality and innovative content. As platforms converge, the ownership of intellectual property is likely to become more important than broadcast licences. This will involve some shift in the balance of power and earning from broadcasters to content providers, although prominence on the electronic programming guide and the continuing brand value of the traditional channels will have a lasting, if declining, impact on viewing patterns.
- 2.7 The differential value of some content will be further increased by the growing use of personal video recorders, for example Sky +. This gives viewers the ability to organise

viewing to suit their own preferences and reduces the impact of scheduling. This is the pattern seen in those homes that have adopted the technology so far. The ability to skip adverts when viewing recorded programmes could also have some important long-term effects on the value of advertising and the economic model of commercial television.

- 2.8 The growth of broadband internet services has opened another important channel for receiving PSB content, whether watching or listening at a moment of choice or being able to go deeper into areas and issues that attract attention and interest. This has been recognised by OFCOM in its proposal for a public service publisher. It also means more competition for PSB content by opening up alternative forms of entertainment to broadcast material. Video games and interactive gaming are taking an increased share of the attention of younger people.
- 2.9 Portable listening and viewing devices open up other routes to watching high quality programming at a time of choosing but they also provide alternative channels for receiving news, current affairs and a range of “public service” content.
- 2.10 Audiences for broadcast content are themselves likely to change. Society is becoming more fragmented, culturally diverse and the population is ageing. This is likely to lead to demands for more diverse kinds of programming whilst audiences are likely to become both more fragmented and more sophisticated in their use of a variety of media. Even though the population is ageing, the premium attached by advertisers to programmes appealing to younger audiences is likely to increase.
- 2.11 Although this is today’s consensus it does not mean that it will be right in all respects, as there remain many uncertainties. But these are all factors that should be taken into account in designing the purpose and remit for the next Charter and they provide some interesting challenges to the method of funding the BBC in the longer term.

3 Clarity of purpose and remit

The Existing Charter and Agreement

- 3.1 The current Royal Charter outlines the BBC's core objectives and purposes in very broad terms. The main objectives are to provide, as public services, sound and television programmes of information, education and entertainment for general reception. The BBC can also collect news and information in any part of the world, and subject to prior approval, provide ancillary services and commercial services.
- 3.2 The Charter is supplemented by an agreement between the BBC and government, which sets out the BBC's obligations and structures in more detail. The agreement addresses the number of public television and radio channels for national and local reception and states the BBC's editorial independence. Other aspects of the agreement include keeping high general standards and offering a wide range of subject matter, including impartial coverage of news and current affairs, drama, comedy, music, sport and education. The agreement also specifies that programmes should meet the needs of a wide variety of audiences.
- 3.3 In the past this general formulation has given the BBC a considerable degree of freedom to develop in the face of technical and market change. During our seminars there was general agreement that the BBC's remit should continue to be sufficiently flexible to enable it to respond to changes in technology, markets and viewing habits. However, there was also agreement on the benefits of greater clarity about the BBC's role in this changing environment. The areas identified most often for greater clarity were its contribution to PSB, the distinctiveness of its output, its attitude towards the wider marketplace, and how we might measure its performance and success.
- 3.4 The BBC faces related questions about its market impact and its public service impact. An over-competitive BBC can prevent a commercial competitor from providing a similar commercially funded service. It can also discourage commercial competitors from risking programmes of public value. The rest of this section discusses these issues.

The Continuing Role Of Public Service Broadcasting

- 3.5 In the past there has been a tendency to say that PSB is what the BBC does or even that everything the BBC does is PSB. As a result the BBC has often sought to exploit its brand and maximise its impact across content, channels, schedules and viewing figures.
- 3.6 At our seminars, there were some concerns from commercial competitors that new technologies and declining costs of entry in some markets would tempt the BBC to seek to widen its scope and remit, particularly outside traditional broadcasting activities. With the advent of digital, there are fewer technological limits to the BBC consistently increasing its range of services.
- 3.7 We consider that in some circumstances this expansion could happen and therefore the new Charter should require the BBC to focus clearly on its core PSB purpose and the areas where it can generate value for audiences in addition to that provided by the rest of the market. Consistent high quality programming should be evident in characteristics such as rigour, accuracy, balance, fairness and innovation.
- 3.8 In phase 1 of its review of public service television broadcasting OFCOM defined PSB in terms of high-quality material of a kind and on a scale, which the market, if left to itself,

would not provide. In phase 2, Ofcom went further in defining the purposes of PSB in the following terms; underpinning an informed society through news and the analysis of current events; stimulating our appetite for knowledge in arts, science, history etc; reflecting and strengthening our cultural identity partly through shared experiences; and increasing our awareness of different cultures and viewpoints.

- 3.9 OFCOM also suggested that PSB programmes should have some distinctive characteristics, including being of high quality, original, innovative, challenging, engaging and being widely available.
- 3.10 This approach is similar in many ways to that of the BBC in “Building Public Value”, which provides an expression of purpose at a high level of generality in relation to democratic value, social value, cultural and creative value, educational value and global value.
- 3.11 The public consultation supports this and we are satisfied that between these approaches there is sufficient material to define the high level purposes of the BBC for the next Charter period although we are concerned that in the process it should not squeeze out what might be loosely termed “entertainment” programming. In particular, the BBC’s ability to invest in narrative comedy, a high costs genre where success is likely only in the longer term, is a cultural benefit that is under-provided in the commercial UK market (if not in the US market).
- 3.12 At our seminars a constant theme has been the need to engage audiences, to distinguish between popularity and populism and to continue to produce “great telly” and “great radio”. A diet of worthy television and radio, which simply fills in the gaps not provided by commercial suppliers and which only plays to small audiences because of a failure to engage, will not maintain the support the BBC has enjoyed until now. At the same time, the challenge of engaging audiences should not result in the imitation of successful formats supplied elsewhere. This is a particular challenge in factual entertainment. BBC output should be distinctive and clearly recognisable and the definition of purpose should enable us to identify types of programming we would not expect the BBC to do, as well as those types of programming we would welcome.
- 3.13 We would like to see the BBC’s remit set out in a way that makes it clear that it has a mandate to maintain a powerful presence over a range of content and platforms, but at the same time sets out the limits of that mandate. In order to achieve this, we believe that the BBC’s remit needs the external discipline of being assessed by measures independently defined, that can judge its distinctiveness in relation to the commercial market’s provision.
- 3.14 The BBC also has a role to play in being a trusted provider to help guide and structure viewing by offering a mixed schedule and using the popularity of its channels to introduce viewers to new ideas and new types of programme, accompanied by signposting them to other relevant media and resources. It can also help people from all sections of society to keep up with the possibilities of the new technology through its role as mentor and guide. It has introduced many people to the power of the internet through its on-line service and there will surely be other similar opportunities. We are content that the BBC’s remit should include playing an important part in helping to achieve digital switchover as quickly and smoothly as possible.

The Relationship With The Market Place

- 3.15 A consequence of this approach is the need to position the BBC in relation to the rest of the market place. We are persuaded that a BBC financed primarily by public money has

constantly to make the case that it is offering something distinctive from what is available on other channels. We are also persuaded that changes to the digital market place mean there will be some things the BBC should do less because the market will do them; and there are some things the BBC should do more because the market will provide less of them.

- 3.16 This suggests that the remit of the BBC should be positioned more clearly within the wider PSB and broadcasting ecology. The BBC's manifesto "Building Public Value" recognises this but leaves unclear the question of by what criteria that position should be determined. We agree with OFCOM that the lesson of history is that plurality and competition are an important aspect of PSB provision if we are to see continuing innovation, fresh ideas and value for money. But in the future the BBC should see itself less in direct competition for specific audiences with other PSB broadcasters. Instead the BBC should make an explicit commitment to play a more complementary role with respect to the Public Service content of other broadcasters.
- 3.17 Some practical implications would follow from this approach. One is that the BBC should measure its success in PSB programming not only in relation to its own audiences and reach but also in relation to its contribution to increasing the amount of PSB in the market as a whole. In part it can do this by delivering programmes of high quality, originality and innovation that set standards for other broadcasters. But it can also help by engaging in a more positive exchange between itself and competitors. This could lead to a more open and transparent approach to its future plans and schedules, including a process of consultation where major changes were involved, and by taking greater account of the plans of others when designing its own schedules. Following this approach, it might avoid certain types of copycat programming, or head-to-head scheduling of particular genres of programme. Within any organisation there is a natural desire to maximise audiences and impact, and a change in approach might require the conscious introduction of some more market-wide measures of success.
- 3.18 A second implication is that the BBC would be more willing to exit programming which it had originated but which had subsequently become widespread and more of a commodity, for example "make-over" programmes or certain types of game-show. As the BBC has itself recognised in the seminars, there should be a clear sense of where the BBC should not be engaging in particular markets or type of programming. And the BBC might also be more cautious in bidding for talent from commercial providers if it is simply going to reproduce programmes that are adequately provided commercially.
- 3.19 Some of these principles are very evident in the sphere of the BBC's commercial services. Successive governments have encouraged the BBC to develop commercial services to generate a secondary source of income. In addition it has enabled the BBC to extend the appreciation of BBC content through books, magazines and DVDs as well providing a shop window for UK talent and cultural values.
- 3.20 It was evident from our seminar that the way the BBC operates gives rise to some resentment amongst its direct and indirect competitors. The focus of their attention was the lack of clarity over the boundaries of the BBC's commercial activities, particularly where they were not closely aligned to its public purposes, as well as "unfair" support from on-air trailing and other forms of advertising and marketing support. It was also noted that the current and historical returns from Worldwide seem very poor, compared to the nearest commercial equivalents.

- 3.21 The BBC has sought to address these concerns in our seminars. We are agreed that it is important to set out the purposes of the BBC's commercial services with more clarity in future. These purposes should be aligned to its public purposes generally and recognise that the BBC is only one element in a complex market for these products.
- 3.22 Commercial radio companies raised similar concerns about boundaries and the alignment of BBC programmes to its public purposes in our seminars. There was general agreement that BBC radio has been successful in establishing a distinctive presence with most of its services that were often complementary to the commercial sector, notably Radio 3 and 4. But in some cases the commercial sector argued for a clearer remit for BBC radio services, such as Radio 1 and 2, and a consultative process in the event of a desire to change the remit.
- 3.23 There are other areas where the principles of taking account of the wider market apply, for example in relation to the BBC's commissioning power and the part it has played as a major trainer of talent for the broadcasting industry. Again, in our view a more explicit remit should be provided in the next Charter. There is a careful balance to be struck in optimising the balance of in-house and external production. There are creative gains from working with independent and commercial producers although in some areas there are clear efficiency gains in using internal BBC resources. The existing quotas have helped to kick-start an emerging independent sector although for the longer term we regard quotas as a blunt weapon. We would not be surprised if a larger share of external production was the outcome of a careful, fully costed approach, taking account of the long-term benefits of stimulating the wider PSB market. At the same time we recognise that a smaller share of in-house production would probably lead to less training being provided by the BBC.
- 3.24 If the next Charter is to include more specific high level purposes and the BBC is asked to take greater account of the wider market place there will be a clear need for a set of measurable goals to inform the conduct of the management and to enable the Governors to assess afterwards whether the objectives have been achieved.
- 3.25 At the moment Building Public Value outlines some high level purposes but more work is necessary if they are to be translated into how the BBC operates on a day-by-day basis and they need to be set out in a way that makes management accountable for the delivery of these purposes.
- 3.26 This requires an objective system for making judgements about performance. This will not be easy as measurement is very difficult in a world where content production and dissemination is a creative process. On the other hand, some of the quantitative measures that are available to us, such as audience share, have a tendency to deliver perverse results, as they do not capture the essence of PSB. In our view any system of judging the BBC's performance should be based on a wide range of factors, some of which might be quantitative, others qualitative. Audience ratings should clearly play a part, as there is no point in making programmes that no-one watches or listens to, but they should be just one of a basket of indicators, which might include peer review, audience reach, appreciation, memorability and wider measures like the contribution to "learning" purposes. The BBC is aware of this challenge and we do not suggest this will be easy. But it will be important to make progress before Charter Review is finished to give confidence in the delivery of a more specific remit and purpose.
- 3.27 The BBC's public value test is a possible way forward in clarifying the framework for reaching such judgements. But, in our opinion, if such a test is defined solely by criteria set by the BBC, using data and measures defined by the BBC, it will lack conviction. There is a

clear need for an independently determined set of objective measures, applicable to the whole of the broadcasting industry, which the BBC should use when making such judgements. The achievement of OFCOM, in assembling its data for the Public Service Television Review, demonstrates the value of such an independent approach.

- 3.28 Whatever the final form of the system, it will need to bear both the weight of helping to define in advance the type of programming that should be commissioned; and to provide criteria for testing afterwards whether or not it had been achieved. It should be capable of dealing with those things that have been criticised in the past (eg makeover and “me-too” programming, repeats); and it should be able to define the type of past programming that would not survive. At our seminars it was sometimes suggested it was only the process of Charter Review that concentrated the BBC’s mind. We would judge the success of the process for the future in terms of whether it provided an ongoing set of tests equivalent to the focus brought about by Charter Review, while allowing the BBC the creative freedom which has been so important to it in the past.

4 Paying for the BBC – and PSB – now and in the future

- 4.1 Currently the BBC is funded principally through the licence fee, with a relatively small addition from commercial activities and a proportion of direct Grant-in-Aid funding for BBC World Service Radio.
- 4.2 For most of the BBC's history the licence fee has been a very buoyant source of revenue, largely because of the growing number of licence-payers. There have also been step changes in the level of the licence fee, for example at the time of the introduction of colour television when a higher licence fee was introduced. The Government also accepted the recommendation of the Davies Committee, in February 2000 in its interim review of funding, that there should be above-inflation increases in the licence fee.
- 4.3 Other public service broadcasters are funded differently. ITV, Channel 4 and Channel 5 have been funded mainly through advertising. However, Sky has emerged as a major UK broadcaster funded from a mixture of both subscription and advertising.
- 4.4 In 2003/04, the licence fee raised almost £2.8 billion, which was supplemented by revenue from the BBC's Commercial Businesses and Grant-in-Aid World Service to a total income of over £3.7 billion. This compares to the nearly £3.5 billion raised by advertising in the UK broadcasting market in 2003 and over £1.6 billion in subscription.
- 4.5 As a charge for the right to watch television programmes, the licence fee has considerable merits as a way of funding broadcasting. The DCMS public consultation found that the licence fee was widely considered to be the best – or the “least worst” – way to pay for the BBC for the next Charter. In our seminar there was also general support for the continuation of the licence fee during much of the next Charter although there was some strong support for the view that after digital switchover the balance of some of the arguments is likely to change.
- 4.6 For the supporters of the licence fee, its main strength is that it has provided the BBC with a stable funding profile, whilst insulating it from political and commercial pressures.
 - A guaranteed level of funding, free of short-term political pressures, has enabled the BBC to make long-term commitments.
 - At the same time, the commissioning and scheduling of programmes has the opportunity to be independent of short-term political pressures.
 - It frees the BBC from immediate concerns with the size of the audience and therefore allows it to make programmes of quality and content which might not be available commercially.
 - For some supporters of the licence fee, the fact that programmes are free at the point of use is seen as an important advantage, particularly for merit goods such as high quality news, information, innovative programming and some kinds of entertainment. It provides a way (though not the only way) of dealing with the outstanding economic feature of broadcasting, namely that the costs of producing a programme can be very high while the costs of watching are, in effect zero. If a charge for viewing is imposed (for example, through pay-per-view) people may be discouraged from watching though they would have watched the programme if the cost had been zero.

- For others a key argument in favour of the licence fee is the opportunity to strengthen citizenship by continuing to provide programmes that do not simply match the immediate preferences of viewers. And it may provide the licence-payer with a sense of identification with the BBC.

4.7 However, for many participants at our seminar these arguments are contentious and support for the licence fee for the immediate period ahead was often qualified.

- The licence fee is highly regressive in two important ways; the charge is the same for everyone and hence is a larger proportion of expenditure for those on low incomes; and for families on low incomes, BBC programmes tend to make up a smaller proportion of their total watching and listening.
- The charge is also the same regardless of level of usage or number of sets
- The costs of administration and enforcement are high with enforcement often perceived to be draconian and clumsy, leading to the criminalisation of non-payers for what would normally be regarded as a civil matter.
- It raises more than is necessary to fund public service broadcasting (unless one believes that all BBC production is, by definition, public service broadcasting).
- Most broadcasters and others involved in media production have to cope with uncertain sources of funding and the quality of their product does not necessarily suffer. It was also pointed out that no other public institution benefits from long-term stability of income even though they are required to make long-term commitments in their fields.
- It was also argued that the case in terms of political and commercial independence was overstated. Since the licence fee has to be set by the government, political considerations are inevitable. Also there have been examples of institutions that preserve considerable independence despite direct government funding. The judiciary is the prime example outside broadcasting and the World Service is in receipt of a government grant without suggestions that it lacks political independence. As for commercial pressures, if the BBC operates to seek to maximise its audience share it may behave in a similar way to broadcasters who fund themselves through commercial revenues.
- Some were also unimpressed by the “market failure” case for the licence fee and the suggestion that we should not exclude people from receiving services when the marginal cost is zero. They point out that in a digital age many services have this characteristic but a licence fee does not fund them. The challenge is to find a way of paying for the fixed costs of the service and a licence fee is not necessarily the best answer.
- It removes a direct link to consumer preferences.

4.8 These reservations about the licence fee have been with us for some time but in the past the benefits from the universal licence have been judged to outweigh them. In addition, commercial radio and television companies broadly support the licence fee as it introduces another form of funding which does not compete with either the market for advertising or subscription.

- 4.9 However, for some people the impact of the growth of digital television and the prospect of digital switchover has changed the balance of some of the arguments.
- The possibility of conditional access opens up the option of denying service to those who are unwilling to pay for access to television services rather than pursuing them through the courts. Once a subscriber has paid the subscription individual programmes are available free at the point of use. The licence fee could become a “compulsory subscription” for anyone who wants to watch any television; it could apply only to BBC television, or to some combination of the two.
 - Sky and cable viewers are becoming familiar with the principle of paying for channels and services by subscription.
 - The spread of multi-channel viewing is likely to mean a declining share for BBC television services and it will be more difficult to sustain the principle of a universal licence for access to non-BBC services unless part of the licence fee is used to finance public service broadcasting on other channels. This is likely to lead to a search for market methods of funding and a reduced emphasis on the licence fee.
 - People will be able to view programmes through means other than television sets.
- 4.10 We are conscious that these arguments do not apply to radio where conditional access is not available and there is no experience of paying for radio services. Whatever form of funding develops for television it is likely to continue to be necessary to have a stream of public funding for BBC radio.
- 4.11 The seminar on funding revealed an issue that is central to discussions about the licence. On the one hand it was suggested that the key problem of market failure, namely the difficulty of responding to viewers preferences, could be solved after digital switchover through subscription or pay-per-view. On the other hand, it was argued that maybe we did not wish the BBC to move closer to consumer preferences. In other words the licence fee was valuable precisely because it allowed the BBC to decide what programmes to show, without being driven by consumer preferences. This is possibly what some people mean when they say that the BBC should be free from commercial pressures. Those who emphasise the importance of the BBC in strengthening citizenship are particularly likely to favour a system like the licence fee. But even that group has to consider whether the licence fee can survive in its present form.
- 4.12 Our view is that for the longer term, i.e. beyond the next Charter, the choice will be between maintaining the present type of licence fee and moving to a more mixed form of funding the BBC. Any move away from the licence fee is likely to involve a move to subscription. If the subscription is voluntary some people will choose not to pay and there will be less money going to the BBC unless alternative sources of funding are found. This mixed funding might include some of the following:
- A continuation of a licence fee but at a lower level than now. This could either be in the form of the present licence fee or as a subscription to a conditional access system to enable people to watch any of the services that are broadcast.

- A subscription payment for BBC television services. This would permit the extension of innovative market segmentation, which is currently operated by Sky, to BBC services, for example, whereby people pay different subscription levels for first run programmes, or programmes without adverts. It could also work with bundles of channels and potentially offer the public much greater choice about the broadcasting they receive.
- A government grant financed from taxation, say, to fund some elements of public service broadcasting, particularly news and current affairs. Of course, there are concerns about a relationship of dependence with the government when so much of the output of news and current affairs relates to the government and attention would have to be given to establishing the BBC's especially robust independence in these circumstances.
- Some advertising might be possible although we are conscious of the consultation findings, which showed that one of the things that people value most about the BBC is the provision of advert-free content. Some advertising would help to sustain the provision of some services free at point of use and which do not exclude anyone. And conceptually, it is not clear why carrying advertising on television services is so different from other forms of commercial income, for example magazine publishing. We notice that some of the BBC's commercial television services, eg BBC America, BBC Prime, are funded, at least partially, by advertising. We are cautious about the use of advertising because we are persuaded that decisions about programme commission and design do change if aiming towards an advertising market with the consequent impact on content and the types of programme that are made.

- 4.13 We agree that the balance of the debate lies in favour of the licence fee for the time being. However, we are impressed with the arguments that suggest it will become increasingly difficult to sustain the licence fee in the long term when conditional access is available. This suggests to us that it will be necessary before the end of the next Charter to have a detailed examination of the way in which conditional access might be developed to deal with circumstances where support for the licence fee is questioned. We have suggested that this would involve a combination of funding methods – a mixed funding model comprising public funding, subscription and income from advertising. This detailed examination might take place half way through the next Charter period.
- 4.14 A further issue that emerged was whether the licence fee should be for the exclusive benefit of the BBC or whether it should be used in part to fund PSB in other channels to ensure that the BBC does not have a monopoly of PSB.
- 4.15 If competition in public service broadcasting is to remain a government objective, then we have to address the fact that the technological and economic conditions that produced such an outcome in an age of spectrum scarcity cease to apply in a world of limitless digital spectrum. OFCOM has calculated a £400m deficit in PSB provision emerging over the period leading up to switchover. It follows that, if the BBC is not to be left a monopoly provider of such programming, a new economic model or funding structure must be available to incentivise commercial public service broadcasters. An element of competition for licence fee funds is one model that could ensure the continuation of “competition for quality” that has defined the UK broadcasting system to date.
- 4.16 We suggest that this should continue to be considered in the context of the discussion of governance and regulation.

5 Governance and regulation

- 5.1 Of all the issues that fall to be considered in the Government's Review of the BBC Charter, the question of how to establish an appropriate system of governance and regulation for the next decade has assumed the greatest significance in the panel's discussions, because a number of other issues addressed in the seminars hang together around governance and regulation. It is also the question on which the differences of opinion among those who have commented are the widest. It is therefore particularly important for the panel to give the best advice possible to the government on this central issue, so a second seminar, devoted exclusively to governance and regulation, will take place on 3 December. This section describes the background to the issues as we see them, and will in effect be the agenda for that discussion.
- 5.2 The eventual decisions on governance and regulation will also influence other issues in the Charter Review. For example, the nature of the governance and regulatory regime has implications for the scope of the BBC's commercial services and vice versa. The credibility of the measurement criteria used to assess the BBC's distinctiveness from the rest of the broadcast market will also depend on the nature of the regulatory regime responsible for them.
- 5.3 There is a link to funding, too. The licence fee may be sustainable for longer if there is public confidence that the regulatory environment will ensure that the BBC uses the public funding at its disposal in the public interest. This might include a mechanism that removes the BBC's current guaranteed 100% of the licence fee, perhaps allowing for a form of contestability as an incentive for the BBC to continue to deliver fully against its remit. The view that public organisations must have their own source of secure long-term funding in order to deliver against their objectives, whilst once more widely applied in the public sector, is now more or less unique to the BBC.
- 5.4 This section, which reflects the panel's thinking so far, on the basis of submissions put to it, sets out a range of options for the future. Although some in the seminars have argued that the old model has worked satisfactorily, the great majority of commentators think that some change is required. There are a number of reasons for reaching that conclusion.

Developments in corporate governance and regulation elsewhere

- 5.5 The current systems of BBC governance and regulation would be recognisable to the founders of the Corporation, back in 1927. Meanwhile, in the wider world, corporate governance and regulation practice has developed hugely even since the last Charter review, with the work of Cadbury (1992), Hampel (1998), Higgs (2003) and others. These have influenced both public and private sectors, with much greater importance placed on transparency and independence.
- 5.6 Those changes have developed as a result of a number of pressures, including:
- Increasing demands for accountability and external scrutiny.
 - Greater openness and more consultation in handling major decisions.
 - A move away from self-regulation in areas where regulation is needed.

- Concerns about the handling of conflicts of interest and the design of processes to minimise or avoid them.
- Clearer definition of the responsibilities of non-executive directors, or lay governors, for the organisation.
- Greater clarity about the relationship between executive and non-executive directors or governors.
- Creation of clear links between accountability, performance and funding.

5.7 Another change has been the introduction of a greater range of regulatory regimes, which are intended to secure both public confidence and corporate accountability. Again this has occurred in both private and public sectors. As a consequence a clear distinction is drawn between governance and regulation, with the latter normally applying to whole industries not to single organisations. In the case of the BBC, where at its inception it was a monopoly broadcaster with a form of governance that reflected this, now it is clearly part of an industry, which will become larger and more diverse over the next decade. Questions of regulation as well as governance therefore have to be on the agenda.

Changes in the competitive environment

5.8 The competitive environment will be considerably different in the future, partly driven by technological change. As we have discussed, a more diverse broadcasting market means that commercial broadcasters, who previously benefited from local monopolies of television advertising, can no longer easily fund public service broadcasting. The recent second Ofcom review of public service broadcasting explains the background well. In addition, the very existence of Ofcom as a broad-based regulator of the communications and broadcasting industry poses a question about its relationship with the BBC in the future.

Complaints

- 5.9 In any future system of governance and regulation, it is clear that there will be a need for a robust mechanism for handling complaints, particularly from individual members of the public, with adequate arrangements for external appeal. At present, in some cases, there is no appeal mechanism outside the BBC, once the Governors have adjudicated.
- 5.10 Elsewhere, arrangements along these lines have increasingly been abandoned. In the financial sector, for example, the regulator requires companies to have their own complaint handling mechanism in operation. The regulator sets parameters for the time in which complaints should be handled, and the way in which customers should be treated. Those systems of complaints handling are monitored from time to time as part of routine regulatory oversight.
- 5.11 In addition, there is a separate independent ombudsman scheme, outside both the firms themselves, and the regulator, which may take individual cases put to it by complainants where it believes that the company has not dealt adequately with the complaint in question. Firms through a combination of a levy and a case fee also fund that ombudsman scheme separately. The decision of the external ombudsman, who can recommend compensation up to an agreed amount, is final. Some have argued that a scheme with some of the above

features could be incorporated in any framework of regulation and governance for the BBC agreed for the future.

Options for the Future

- 5.12 The BBC's new chairman, Michael Grade, has himself been quick to acknowledge that the old model needs reform. He has proposed a new system, under the general heading of "building public value", which involves a significant separation of the Governors and the BBC's management. This is the first model we examine, followed by two others – involving separate regulators outside or inside the BBC, each of which has possible sub-variants – which we think are also worthy of consideration. Following the seminar on 3 December, the panel will finalise its advice to the government as an input to the Green Paper, expected early in 2005.
- 5.13 Before describing the models, whose essential characteristics are summarised below, it is worth setting out what we think are the criteria a new system should meet. Our first public seminar on the principles of governance and regulation was a key source of evidence in formulating these criteria.
- 5.14 The aim should be to find a system of regulation and governance which:
- Is founded unequivocally in the public interest.
 - Preserves and protects the independence of the BBC.
 - Is genuinely open, transparent and objective.
 - Ensures appropriate accountability for public money.
 - Commands public confidence, and involves the public adequately in decision-making.
 - Provides adequate protection for those outside the corporation who may be affected by the BBC's activities (principally, although not confined to, its private sector competitors).
 - Uses assessment criteria which can be compared directly with the rest of the broadcast market.
 - Is clear about the distinction between governance and regulation and has structures which support both.
 - Is clear about the respective roles of executives and non-executives and embodies this in ways of working.
 - Incorporates adequate mechanisms for audit, complaints etc.

Model 1: Building Public Value

- 5.15 The new Chairman of Governors, Michael Grade, has explained the essence of the change he is making to the BBC's governance. Participants in our public seminar on 3 December – Models of Governance and Regulation - will wish to review the BBC's own documentation

on BPV to gain a full understanding of what is involved (View the document at: <http://www.bbc.co.uk/thefuture/bpv/prologue.shtml>).

- 5.16 The principal feature is some increased separation between governance and regulation. Broadly, the proposals maintain the existing legislative framework, and the formal responsibilities of the Governors are unchanged. But the new arrangements will involve a physical separation between the Governors and the management of the BBC and give the Governors independent support in carrying out their responsibilities. In other words, they would no longer be wholly dependent, as before, on advice also available to (and largely generated by) the BBC's management.
- 5.17 Within this framework there would be a new system of 'service licences'. Over time, all the main elements of the BBC's output would be operating within a service licence proposed to, and agreed by the Governors, which would set out the parameters and constraints. Those licences would, as we understand it, be published, and they would demonstrate the ways in which a channel or a station would be delivering elements of public service broadcasting and generating "public value", as defined by the Governors themselves.
- 5.18 The advantages of this model are well explained in the BBC's own documentation:
- It preserves key elements of the status quo, including the integrity of the Governors, which have in many respects served the corporation well throughout its life.
 - But it also adds an innovative element of challenge to the relationship between the corporation and the Governors, through the service licence approval process. The Chairman has said he hopes that this system will reduce or remove the need for externally imposed reviews, which have become an increasing feature of the landscape in recent years.
 - If the Governors, who are also involved in the day-to-day management of the BBC, are the de facto regulators they can, at least in principle, intervene earlier. The BBC argues that all other regulatory models are ex post – allowing intervention only after things have gone wrong.
- 5.19 But the model also presents a number of disadvantages, which include the following:
- The dual role of the Governors as both critical friend of management and defenders of the BBC, on the one hand, and regulators on the other, is maintained. In many other parts of the public sector, and in the private sector, this model has been considered no longer to represent good practice, or to promote public confidence.
 - It does not meet the criterion of clarity between governance and regulation and relationships with Ofcom are unclear.
 - The new concept of service licences is designed to strengthen value for public money but it is unclear how this process would work. If a proposal from the management is inadequate, or not delivering sufficient public value for the public investment involved, what happens? The governors cannot allocate the licence fee for uses beyond the BBC. There is no obvious sanction that may be invoked, except to try again, until the requirements are met.

- It may be argued too that the separation of the Governors from the BBC is more presentational than real, and that if the BBC ran into a major problem in the future, the arrangements would be no more robust than is the existing regime. It is unlikely that the government would eschew external reviews in the future, in these circumstances. Thus it only partially promotes and protects the independence of the BBC.
 - And the question of complaints handling has not been resolved. The Governors remain the ultimate arbiters of complaints against the BBC, for which they are also responsible in a management sense.
- 5.20 As technology changes, and it becomes possible to switch off those who do not use the BBC's services, it may be more difficult to defend the continuation of a system which gives the BBC almost £3 billion of public funding, to use in a manner which is defined exclusively by itself, especially in circumstances in which the other elements of public services broadcasting in the past are under financial threat.
- 5.21 The BBC acknowledges that this model is under development and it may be that some of these disadvantages could be mitigated by further changes. The service licence structure will certainly develop, and may generate public confidence as it does so. The BBC's management have said that the Building Public Value framework will mean that the BBC will focus more tightly on its public service remit in the future, and that some programmes for which it has been criticised in the past as not fitting easily into any PSB definition, however broad, will not in future be made. The BBC could help to illuminate that debate by saying specifically which programmes from the past it would not make in the future, to allow outsiders to understand what Building Public Value means in practice.
- 5.22 Also, the way in which the Governors behave within this framework will be critical. They will need from time to time to be seen to be imposing their will on management. But it seems clear that they cannot develop into what we would normally think of as an external regulator, without creating a corporate governance deficit in the corporation – that group of functions which involve strategic leadership, lending critical support to the management and defending the BBC from external challenge, including that of a regulatory nature.
- 5.23 It is also clear that unless the Governors are prepared to envisage making funding available to alternative service providers – opening up the opportunity to run BBC services to those outside existing BBC structures – the service licence concept becomes a purely internal construct.

Model 2: External Regulation: Ofcom or Ofbeeb

- 5.24 A number of commentators, including some who have worked at the top of the BBC in the past, have argued that it is simply not possible for the Governors to perform the dual role of champion and regulator, that they will not retain public confidence in the future if they seek to continue to do so, and that in the event of difficulty, the Governors will, as they have in the past, swing between being supporters of the BBC and critics of it, and do neither job effectively. It is therefore argued that it would be better to give a number of regulatory functions, including essentially the appropriate definition of public service broadcasting, to an external regulator, leaving the Governors to focus on a developed corporate governance role.
- 5.25 Supporters of this broad option then subdivide into those who think that Ofcom should perform the role and those who believe that a separate regulator, focusing exclusively on the

BBC, would be more appropriate (Ofbeeb). Those who argue for Ofcom maintain that it would be strange to set up a regulator for communications and broadcasting in general, and then to exclude the BBC from its remit indefinitely, and that it is vitally important for the future of PSB that someone is able to look at the whole of the broadcasting ecosystem. In its recent publications on public service television Ofcom has demonstrated that it has already developed a good understanding of the issues. It has framed the BBC's performance within the wider provision of PSB, thus providing for the first time an accurate measure of the BBC's contribution to the whole. The BBC has not offered this in previous accounts of its own performance.

- 5.26 Proponents of the Ofbeeb option maintain, by contrast, that Ofcom will inevitably be most focused on the commercial market, and may not be in a position to take full account of what they claim to be the wider, perhaps somewhat intangible issues associated with a publicly funded organisation. It would therefore be far better to have a separate regulator with a close understanding of the particular objectives and culture of the BBC.
- 5.27 Supporters of this option also subdivide on the extent to which they would see the regulator as having a role in the distribution of funding. Some see that the regulator would receive licence fee income and then distribute it to the BBC (perhaps on some version of the service licence methodology), or elsewhere if more persuasive bids were to emerge from other broadcasters. Others argue that this funding role is not compatible with the regulatory function, and would see a separate entity performing the funding responsibility, perhaps some version, larger or smaller, of the "Public Service Publisher" idea advanced by Ofcom in its most recent paper on public service broadcasting.
- 5.28 The advantages of this model clearly depend to some degree on the choices made on the key issues described above, but may include the following:
- In general terms, the principal advantage is one of clarity of function and accountability. The Governors would be freed to concentrate on their role in relation to the management of the corporation, ensuring that it delivered effectively on the undertakings it had given to the regulator, and was managed efficiently. Those responsibilities for execution would not be confused with the responsibility for the definition of the remit itself.
 - The creation of an external regulator would also insulate the corporation, to a greater degree than now, from direct interference by Government. It would then be more difficult for the Government to establish its own reviews of the BBC's activities. If a regulator set up by Parliament for the purpose was content with the BBC's performance, it would be difficult for the government to substitute its own judgment.
 - Also, and perhaps most importantly, the existence of a regulator with the responsibility of maintaining public service broadcasting might in the long run be an effective guarantor of the continuation of a robust form of income, including a continued licence fee.
 - If the regulator could also direct funding this would create the link between performance, accountability and funding which characterises other public sector organisations.
- 5.29 But there are clearly disadvantages too, which would depend, in detail, on the precise formulation chosen and which might include:

- They could generate a more costly and more cumbersome system, involving negotiations between the BBC and its regulator, which could be complex and difficult.
- Using Ofcom might be thought to generate an excessive concentration of power in one body, while the creation of Ofbeeb might generate a regulator that could be captured by the corporation, negating the value of its separation and apparent independence. It is increasingly regarded a poor regulatory practice to institute regulators with only one “client”: this model has been tried and rejected in the energy sector, for example.
- There may be a requirement for legislation (although there are alternatives, such as incorporating any new body by means of a parallel Charter).

Model 3: A Hybrid: “InBeeb”

5.30 There is one other generic option worth considering, which we have characterised as “InBeeb”. What is meant by this is that the Governors become the corporation’s regulators, but can perform this function more straightforwardly than at present because they leave their management and governance responsibilities to a separate management board, with different membership, including non-executive directors, and a different externally appointed chairman.

5.31 The Governors could issue service licences, building on the first model described above, but would not be on both sides of the deal, so to speak. The governors would set out their PSB requirements, while the management board would explain how it proposed to meet those requirements. The management would propose: the Governors dispose. The management board would be the defenders of the BBC within the remit set out by the governors.

5.32 Among the advantages of this model are the following:

- It builds on what are seen as some of the most positive features of model 1, but without the confusion inherent in that structure.
- It would be possible to appoint different types of people to the two bodies, reflecting the needs for different types of representativeness and expertise. The governors could be people able to focus on, for example, the definition of PSB and regional delivery and might incorporate expertise in methods for gauging the “public interest”. On the management board it would be right to put people able to contribute most effectively to the month-to-month management of a multi-billion pound media business.
- It might also generate greater confidence that the BBC was delivering public value and might therefore buttress a continued role for the licence fee.

5.33 The disadvantages might include the following:

- It would not have the clarity of model 2.
- It would be difficult to incorporate any element of contestable funding into this model, should that be required in the mid- to long term – it is hard to envisage the BBC Governors distributing funds to other public service broadcasters.

- There would be a risk of conflict between the two boards, especially at the outset, and this model would require clarity of presentation to the public with a clear explanation as to the purpose and responsibility of each of the two boards.

Next steps

- 5.34 The arguments are clearly finely balanced and need further and detailed scrutiny. Charter review still has some time to run, with Green and White papers on the way and, as the Secretary of State has made clear, some form of Parliamentary scrutiny.
- 5.35 The first stage of that debate will be the second seminar on governance and regulation that we will hold on 3 December. The aim will be to test the models we have discussed against the criteria set out above, and taking into account the arguments of previous sections. The results of that work will be used to inform the remainder of the process, with the principle focus on the Green Paper.

ANNEX A

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