

## Question 5: What are the options for future funding of PSM and are there lessons we can learn from other countries' approaches?<sup>1</sup>

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As explained very clearly in the consultation document, all the UK public service broadcasters (PSBs)<sup>3</sup> face growing competition and higher content, technology and distribution costs,<sup>4</sup> mainly driven by US SVoD companies. But, despite these cost increases, the BBC has had its real (inflation-adjusted) public funding *cut* by 30 per cent since 2010, with more cuts to come,<sup>5</sup> while the commercial PSBs (ITV, C4, C5, STV and S4C) have lost advertising income, especially to Facebook and Google. If the Government genuinely wants to ensure the long-term health of our very successful broadcasting ecosystem, with the PSBs at its heart, what should it do?

1. **Reverse the main cuts in BBC funding**, especially by taking back the cost of free TV licences for the over-75s, introduced as a taxpayer-funded concession by Gordon Brown in 2000 and clearly a welfare benefit like the Winter Fuel Payment, which costs much more,<sup>6</sup> and should never have been forced on the BBC (with no published analysis, public consultation or parliamentary debate). Unless this happens, even with

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<sup>1</sup> The main text of this submission is based on a recent article co-authored with Peter York, 'How should public service broadcasting be funded?', *VLV Bulletin* 130 (Spring 2021), page 8, <https://www.vlv.org.uk/wp-content/uploads/VLV-Spring-Bulletin-2021-No-130-colour-final.pdf>. The appendix is based on a recent chapter on long-term funding models for the BBC. BBC funding is discussed in more detail in Patrick Barwise and Peter York, *The War Against the BBC*, Penguin, November 2020.

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<sup>3</sup> I here use the familiar term 'PSB', rather than 'PSM' (or 'PSMO', for public service media organisation), since these organisations' main activity will still be broadcasting for the foreseeable future. Ever since the launch of *Radio Times* in 1923, they have also done other things as an adjunct to broadcasting. Their online services are now increasing the proportion of non-broadcasting activities, although this is partly a question of definition, eg it depends on whether online TV is seen as (i) broadcasting using online, on-demand distribution, or (ii) something categorically different. My personal view is (i) but the label – PSB vs PSM - is not a big issue for me.

<sup>4</sup> The higher distribution costs come from having to support both traditional broadcast channels and new online distribution channels at the same time.

<sup>5</sup> VLV, 'After a decade of cuts, serious dangers lie ahead', *VLV Bulletin*, Spring 2020, page 6, <https://www.vlv.org.uk/wp-content/uploads/VLV-bulletin-Spring-2020-FINAL-colour-March-9.pdf>; the detailed data are here: <https://www.vlv.org.uk/wp-content/uploads/RESEARCH-DATA-VLV-research-into-BBC-public-funding-March-2020.pdf>.

<sup>6</sup> The annual cost of free TV licences for all households with one or more members aged 75-plus is £745m. The annual cost of winter fuel payments is £2bn: Djuna Thurley, Rod McInnes and Steven Kennedy, *Winter Fuel Payments*, House of Commons Library Briefing Paper CBP-6019, 5 November 2019, page 5.

further efficiency gains and commercial income growth, the BBC will have to cut about 20 per cent of its UK services.<sup>7</sup> The National Audit Office recently confirmed that ‘there is little scope for further significant savings’ through cuts in BBC executive and presenter pay<sup>8</sup> - a minor factor anyway. The only options for funding free TV licences for all over-75s are restoring the government funding or significantly cutting the BBC’s services.

2. **Replace the TV licence with a universal household levy, as in Germany and, now, elsewhere:** BBC funding based on TV set ownership is becoming anachronistic and all the other options are worse. With subscriptions, the BBC would no longer be universal – a key issue endorsed by Tim Davie – and, to maintain the level of content investment, the average subscription would need to be *much* higher than the licence fee to cover marketing, billing and customer service costs (Sky’s sales and general overhead costs alone are about 80 per cent of the BBC’s total licence fee revenue!) and to make up for the lost income from households that chose not to subscribe. Advertising, the other widely touted funding option, would distort the BBC’s incentives, increase its overheads, severely damage other advertising media (including the commercial PSBs) and add unwelcome commercial interruptions during BBC broadcasts. (These issues are analysed more fully in the Appendix).
3. **Prominence and listed events.** The PSBs can also be supported by increasing their programmes’ prominence in electronic programme guides (EPGs) and expanding the number of listed sporting events for which broadcast rights must be offered to universally available free-to-air broadcasters at a fair and reasonable price.
4. **Tax the UK sales of the US technology companies and use some of the proceeds to support continuing investment in original UK public service content.** The technology companies are still barely taxed and almost completely unregulated.
5. **Equalise the commercial airtime minutes for all TV advertising channels.** For obscure and contested historical reasons, the commercial PSBs are disadvantaged by being allowed to sell fewer minutes per hour of advertising on their main channels (such as ITV1) than is allowed on all other commercial channels.<sup>9</sup> This anomaly should now be ended by ‘splitting the difference’ so that the total number of commercial exposures (and, therefore, the total value of the TV advertising market)<sup>10</sup> is roughly unchanged. The net effect would be a shift of income (several tens of millions per annum) from the non-PSB broadcasters to the commercial PSBs, helping to sustain their investment in original UK programmes.<sup>11</sup>

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<sup>7</sup> Alex Barker, ‘BBC examines how to cut fifth of output as ‘financial challenge’ grows’, *Financial Times*, 20 January 2021.

<sup>8</sup> National Audit Office, *The BBC’s Strategic Financial Management*, January 2021, page 36.

<sup>9</sup> Including the commercial PSBs’ own portfolio channels (ITV2, More4, 5Star etc).

<sup>10</sup> Regardless of the exact price elasticity of total TV advertising.

<sup>11</sup> This would increase total UK content investment because the commercial PSBs invest a much higher proportion of their income than the non-PSBs in original UK programmes.

At some point, the Government should also review the commercial PSBs' public service obligations. The long-term reductions in traditional TV viewing and advertising are structural and most likely irreversible, putting steadily growing pressure on advertising-funded PSBs' ability to meet their obligations, especially in the case of C4, which has the strongest remit. The US SVoDs, of course, have no comparable obligations. Covid-19 has added further short-term financial pressure. However, the commercial PSBs have managed to sustain their income much better than many people expected and, in my view, their current public service obligations should remain in place for now but should be reviewed within five years.

## **Appendix: What's the Right Long-Term Funding Model for the BBC?<sup>12</sup>**

Technically, there's no urgency to find a new BBC funding model: under the current Charter, the licence fee (although not its level) is guaranteed until 2027.

Nevertheless, linking the BBC's core funding to households' ownership of a TV set<sup>i</sup> is already anachronistic and becoming more so every year. The Government should therefore set up a genuinely independent review of the alternatives, similar to the 1985-86 Peacock Committee which looked at a BBC advertising model and firmly rejected it - despite both its chairman, Alan Peacock, and the PM, Margaret Thatcher, having initially favoured it. If, on the basis of rational evidence and analysis, a '*Peacock II*' committee recommended switching to another funding model before 2027 – which we think it would – and if both the BBC and the government agreed, the Privy Council would surely agree too.

So, what are the pros and cons of the licence fee, what are the alternatives, and what's the right long-term model?

### **The Actual and Mythical Pros and Cons of the Licence Fee**

In 2015, the House of Commons DCMS committee discussed the licence fee's pros and cons. They said its advantages were that it was simple, secure, predictable, associated in people's minds with paying for the BBC, protected its commercial and political independence, and enabled its services to be universally available. None of these is seriously contested. They said its disadvantages were that it was regressive (the same for rich and poor households), compulsory - including for TV homes that 'do not use [the BBC's] services' - 'expensive to collect' and had a 5.5 per cent evasion rate.<sup>ii</sup>

However, only the first of these supposed disadvantages – 'regressive' – is actually valid (although, at just three pounds per household per week, it's not in the same league as, say, the 1989 poll tax<sup>iii</sup>): like all taxes, the licence fee is, of course, compulsory - but, unlike with many much higher ones, the number of households that pay but don't benefit is, in reality, either zero or negligible;<sup>iv</sup> and the combined collection cost (2.8 per cent of licence fee revenue in 2018-19<sup>v</sup>) and evasion rate (5.5 per cent) - totalling 8.3 per cent - is, as we'll show,

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<sup>12</sup> Based on Patrick Barwise and Peter York, 'What's the Right Long-Term Funding Model for the BBC?', Chapter 9 in John Mair, ed., *The BBC - A Winter of Discontent?*, Bite-Sized Books, 2020, pages 66-76.

*much* less than the equivalent income generation and customer support costs for advertising or subscriptions.

### **What Are the Alternatives?**

The DCMS committee listed four alternatives to the licence fee: advertising, subscriptions, a revised licence fee (or another earmarked tax) and general taxation. They also briefly considered a mixed/hybrid funding model but, rightly, rejected it: each funding method involves significant fixed costs, greatly reducing the efficiency of combining them.

**Advertising** is a non-starter. Peacock's two reasons for rejecting it in 1986 - that it would damage other advertising-funded media and distort the BBC's incentives – apply even more today, with most commercial media under serious financial pressure and the BBC facing more competition than ever. Two further reasons – not even considered by Peacock<sup>vi</sup> – are, first, that (other things being equal) audiences demonstrably prefer not to have their viewing and listening interrupted by commercials; and, secondly, the substantial hidden overhead costs of broadcast advertising.<sup>vii</sup> We estimate these as at least 20 per cent of advertisers' total campaign expenditure – more than double the 8.3 per cent figure for the combined collection and evasion costs of the licence fee.

Politically, the most widely touted alternative to the licence fee is a **subscription** model, although those doing the touting have – for over thirty years - been remarkably shy about revealing any specific proposals and their likely outcomes. If – and it's a big if – the government sets up a genuinely independent '*Peacock II*' review, perhaps our curiosity will finally be satisfied. At that point, we think the idea of subscriptions will, like the advertising option, come crashing to the ground. For starters, a subscription model would require every device used to access BBC TV (or any BBC service?) to have conditional access technology, so that those who had not paid could be excluded. It's unclear how long it would take, and how much it would cost, to achieve this. A subscription model would also give the BBC a financial incentive to prioritise the needs of those better able to pay - to 'segment and focus' like commercial broadcasters. And, crucially, it would no longer be a universal public service, shared by all - the core of the BBC's promise to the nation for nearly a hundred years.

To maintain the same level of content investment – the highest in the UK by far and overwhelmingly by and for Brits - the average subscription price (however structured<sup>viii</sup>) would also need to be *much* higher than the licence fee. There are two reasons. First, because not everyone would subscribe, those who did so would each need to pay more to generate the same revenue. Secondly, less of this revenue would be available to invest in programmes because, like advertising, subscriptions involve much higher overhead costs<sup>ix</sup> than the licence fee. Ask Sky. Even worse, these two factors would create a vicious circle: because less of the revenue would go into programmes, more households would choose not to subscribe, further reducing the revenue, and so on.

No one knows what the eventual outcome would be, and those proposing a subscription model certainly haven't said - or even published some hypothetical scenarios. But, to maintain the current level of total - and original UK - content investment, it's hard to see anything less than a 50 per cent increase in the average cost of the BBC's services for those

choosing to subscribe. If those proposing subscriptions have some better projections than ours, now's the time to reveal them – show us we're wrong!

**General taxation** is attractive in theory, but other countries have found it even harder than other funding methods to keep politician-proof. The DCMS committee therefore rejected it, concluding that the licence fee - perhaps with some modifications - was the 'least worst' short-term option, but the best long-term funding method would be another hypothecated tax. We agree.

### So What's the Right Long-Term Funding Model?

Like the DCMS committee, we think a **universal household levy** (i.e. regardless of whether the household has a TV set or any other specific device) would be better than the licence fee: the collection and evasion costs would be even lower and the fee could be made progressive, with larger and/or better-off households paying more. One option would be to collect it separately, as in Germany<sup>x</sup> and, now, elsewhere. The alternative would be to include it with households' council tax or electricity bills, which would automatically mean that bigger, richer households paid more.

In our view, the right long-term funding model for the BBC is one of these options, that is, a **device-independent universal household levy**. Our own preference is for a progressive version, such as a small percentage supplement to council tax or electricity bills. It's worth some really clever thinking to maintain the BBC's investment in content, especially original UK content, and its 'promise to the nation' to be universal, independent and impartial in an age of fragmentation and toxic hyper-disinformation. Our democracy depends on it.

This is a perfectly soluble problem – if the options are looked at in a rational, evidence-based way. How likely that is falls outside the scope of this chapter.

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The authors' *The War Against the BBC: How an Unprecedented Combination of Hostile Forces Is Destroying Britain's Greatest Cultural Institution...And Why You Should Care* will be published by Penguin Books on 26 November 2020.

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<sup>i</sup> Or, in principle, any screen that enables them to watch TV and video.

<sup>ii</sup> House of Commons, DCMS Committee, session 2014-15, 'Future of the BBC: fourth report of session 2014-15', 26 February 2015, page 71. The report also listed free-riding by some online-only homes (the 'iPlayer loophole') as another disadvantage. This loophole was closed, at least in principle, in the current Charter.

<sup>iii</sup> Or, say, SkySports.

<sup>iv</sup> No one knows how many of these households there are, but the number is certainly tiny. The last time household consumption of the BBC's services was measured, in 2015, it was found that 99 per cent of households consumed at least some BBC content *in a single week*. (BBC, *BBC's response to DCMS green paper: BBC charter review*, Audience appendix, 2015, [http://downloads.bbc.co.uk/aboutthebbc/insidethebbc/reports/pdf/bbc\\_charter\\_review\\_audiences\\_appendix.pdf](http://downloads.bbc.co.uk/aboutthebbc/insidethebbc/reports/pdf/bbc_charter_review_audiences_appendix.pdf)). The idea that a significant number of households are forced to pay the licence fee but consume no BBC services *over a whole year* is a myth.

<sup>v</sup> £103m out of £3,690 m total LF income: BBC Annual Report and Accounts 2018-19, pages 61, 208.

<sup>vi</sup> The Peacock Committee sat for over a year and its report runs to 223 pages. Yet, amazingly, it appears not to have considered these additional factors.

<sup>vii</sup> Creative agency fees, media agency fees and commercial production costs plus the internal direct and support costs of the broadcaster's commercial airtime sales operation.

<sup>viii</sup> There are lots of options. The main ones are (i) a single monthly fee for all BBC services and (ii) a tiered system with a lower-priced basic package and one or more higher-priced premium packages. None of this changes the fundamental problems highlighted here.

<sup>ix</sup> Marketing, installation, billing and customer support.

<sup>x</sup> The German system is a universal flat fee (Euros 17.50/month - about 19 per cent higher than the UK licence fee) paid by every household, company and public institution, with exemptions for second-home owners, students and some welfare recipients.