



BBC Content Production Options

Ofcom's advice to the Secretary of State for Culture,
Media and Sport

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About this document

The Secretary of State for Culture, Media and Sport has asked Ofcom to provide input into the Government's assessment of the market impacts of options for reforming the BBC's approach to content production¹. This document sets out our analysis. We have identified the likely parties affected by change and outlined, at a high-level, potential market impacts.

The options for reform were set out in the Government's Green Paper on BBC Charter Review². These options are: amending the BBC's existing content production quotas; a proposal set out by the BBC Executive to transform the BBC's in-house production unit into a commercial subsidiary called BBC Studios; and scaling back BBC in-house production.

Our work is intended to support the Government's wider review of the BBC's Royal Charter³.

¹ Letter from John Whittingdale, Secretary of State for Culture, Media and Sport, to Sharon White, Chief Executive of Ofcom, 18 August 2015,

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/466487/SW.pdf

² BBC Charter Review: public consultation, 16 July 2015,

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/445704/BBC_Charter_Review_Consultation_WEB.pdf

³ The BBC is established under a Royal Charter, which is renewed every ten years after a period of review. The current Charter came into effect on 1 January 2007 and will expire on 31 December 2016, from which point a new Royal Charter will be established by the Government.

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Section 1

Executive Summary

- 1.1 The Secretary of State for Culture, Media and Sport wrote to Ofcom in August 2015⁴ requesting that we provide input to an assessment considering proposed changes to the BBC's approach to content production. We were asked to consider three options:
- The BBC Studios proposal, as set out by the BBC Executive;
 - Amending the existing content production quota system; and
 - Directly scaling back BBC in-house production.
- 1.2 The main focus of this report is on the BBC Studios proposal as, while this is incomplete, it is still the most detailed of the three areas where we have been asked to provide advice. Specific proposals for amending the existing quotas or for scaling back in-house production have not been made, so we have considered these at a higher level.
- 1.3 This report is intended to be an input to the wider work DCMS is conducting as part of the BBC Charter Review⁵.

The BBC has developed a proposal to move BBC in-house production into a commercial subsidiary called BBC Studios

- 1.4 The BBC Executive has developed the BBC Studios proposal because it believes that owning content production and intellectual property ("IP") is vital if the BBC is to compete in an increasingly globalised market. The proposal aims to secure a stable source of content for the BBC, by offering greater creative and commercial freedom in order to attract talent. This would in turn generate sources of IP that can be exploited internationally, the resulting revenues being reinvested into content and services for UK licence fee payers.
- 1.5 If successful, the proposal could be a positive development for the UK creative industries, both in terms of maintaining a critical mass of PSB production capability, by opening up new commissioning opportunities for the independent production sector and through supporting the UK production sector's ability to operate on a global scale.
- 1.6 The proposal focuses mainly on TV production (with minimal changes for radio and online). It proposes moving the majority of BBC in-house production into an entity called BBC Studios, which would be a wholly-owned commercial subsidiary of BBC Group and would have revenues of approximately £400m at launch. The proposal is at a relatively early stage and the BBC Executive is yet to develop a finalised business case.

⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/466487/SW.pdf

⁵ The BBC is established under a Royal Charter, which is renewed every ten years after a period of review. The current Charter came into effect on 1 January 2007 and will expire on 31 December 2016, from which point a new Royal Charter will be established by the Government.

- 1.7 Under the current proposal, BBC Studios would be able to compete in the open market for commissions from other broadcasters in the UK and abroad. At the same time, the BBC would make commissions currently guaranteed to in-house production open to competition from third parties, excluding the genres of news, current affairs, sport and children's⁶. However, at launch, returning series currently produced in-house would be transferred to BBC Studios and the associated hours would not be opened to competition until the series was decommissioned.
- 1.8 Removing the in-house guarantee in the genres affected by the proposal will increase the percentage of BBC commissions open to third-party competition from 50% to 80%, before returning series are taken into account⁷. The BBC has agreed with Pact⁸ in a joint statement released on 21 December⁹ that a minimum of 40% of the current in-house guarantee will be made available within two years, leading to 70% of BBC commissions being open to third parties, even after returning series retained by BBC Studios are taken into account¹⁰. This should provide a significant boost to competition within TV production.
- 1.9 Some stakeholders have expressed concerns with the proposal. These mainly relate to the amount of returning series transferred to BBC Studios at launch. Some felt that these series would mean fewer BBC commissions would be available to third parties than the BBC Executive indicated (although the BBC has since agreed a minimum guarantee, as noted above). Stakeholders also queried whether BBC Studios would compete fairly without gaining advantages from its position in BBC Group.
- 1.10 The proposal is made in the context of a wider range of changes in the production sector. There has been structural change among producers (such as increased consolidation and a trend towards integration with broadcaster groups) and the Government is considering a range of options for reforming Channel 4, which could result in changes to its ownership structure and commissioning strategy. At the same time, the Government is carrying out a review of the BBC's Royal Charter. We have recognised the level of uncertainty associated with these contextual factors when providing our input and have also completed a separate review of the wider television production sector.

While impacts in the short term appear limited, longer term impacts could be significant but are more difficult to quantify

- 1.11 In the short term, particularly within the initial 2-year window agreed by the BBC and Pact, the scale of any market impact is likely to be small. This is because of the level of returning series and existing commissions that both the BBC and commercial broadcasters have in place, as well as the exclusion of certain genres from the proposal, notably news and current affairs.

⁶ The BBC have agreed with Pact to increase the independent production quota and decrease the in-house guarantee in both children's and current affairs to make 25% more hours available to external producers.

⁷ Under the current BBC Framework Agreement, 50% of TV programming hours are reserved for BBC in-house production. The BBC is proposing to remove this guarantee, apart from in the genres of sports, news, current affairs and children's, which account for 20% of BBC hours.

⁸ The Producers Alliance for Cinema and Television

⁹ BBC & Pact Joint Statement <http://downloads.bbc.co.uk/mediacentre/bbc-pact-joint-statement.pdf>

¹⁰ 40% of the in-house guarantee is equivalent to 20% of BBC commissions.

- 1.12 Based on a high-level analysis of BBC commissioning spend, we estimate that the BBC Studios proposal could make up to £157m per year available to competition from external producers after the first two years¹¹, based on 2014 figures. This would represent roughly 10% of UK independent producers' £1.6bn UK primary commissioning revenue in 2014¹².
- 1.13 We also note evidence from recent years of the WOCC¹³ that suggests BBC in-house production is currently less effective than other producers at developing and selling new series¹⁴. This suggests that, at least in the short term, BBC Studios would win a modest proportion of third party commissions.
- 1.14 In the longer term, we would expect there to be significant benefits associated with the proposal: producers could win more BBC commissions, and increased competition in the sector could lead to a wider range of choice for commissioners. This could benefit viewers by helping to deliver better some of the public policy goals associated with public service broadcasting, such as increasing the range of original programming in the UK.
- 1.15 However, these benefits could be offset if BBC Studios is disproportionately successful at winning commissions outside of the BBC. Whilst recent evidence from the WOCC suggests that the success rate of BBC Studios in the short term would be modest, the greater commercial freedom available to it should over time increase its effectiveness. Such success would of course be generally beneficial, but could become a concern if the advantages BBC Studios has due to its scale, breadth of genre expertise and brand discourage market entry by new commercial production companies, limiting the range of producers in the market.
- 1.16 The proposal reflects a wider industry trend towards larger production companies that are vertically integrated with broadcasters (such as ITV Studios and the acquisition of All3Media by Liberty Global and Discovery). While this may be an efficient market structure that could be necessary for the UK to remain competitive in an increasingly globalised industry, there may be risks of fewer opportunities for smaller independent producers. However, as we have noted in our TV Production Sector Review, there remains a robust independent production sector within the UK and the regulatory regime continues to provide the opportunity for new entrants to enter the market¹⁵.

Potential negative market impacts could be exacerbated if BBC Studios is not properly separated from the rest of BBC Group

- 1.17 As noted above, stakeholders have raised concerns around how separate in practice BBC Studios will be from other parts of BBC Group. We would expect BBC Studios

¹¹ This figure is based on a high-level analysis of BBC commissioning hours and spend in 2014, with those hours made available to external producers valued at current BBC cost per hour. It should be taken as highly indicative.

¹² The Pact Census Report. <http://www.pact.co.uk/news/news-detail.html?id=smaller-indies-win-larger-share-of-uk-commissioning-spend-in-tougher-market>

¹³ The WOCC, or Window of Creative Competition allows BBC in-house production and external producers to compete for 25% of BBC commissioning hours.

¹⁴ BBC in-house won 22% of WOCC hours in 2014/15, down from 28% in 2010/11.

¹⁵ The Secretary of State asked Ofcom to carry out this assessment and at the same to review the operation of the TV production sector; we have conducted these processes in parallel. Our conclusions following the review of the TV production sector are available at <http://stakeholders.ofcom.org.uk/broadcasting/reviews-investigations/TV-production-sector-review>.

to compete on fair terms. We note the processes put in place to address concerns relating to BBC Worldwide's ("BBC WW") relationship with the BBC and understand the BBC would expect to apply the same principles to BBC Studios.

- 1.18 The proposal could introduce new risks of BBC WW or the BBC Public Service cross-subsidising BBC Studios. While we would expect BBC commissioners to focus on the best ideas, there may be a tension between this and the need for BBC Group to maximise BBC Studios revenues. Separation will need to be implemented effectively, to ensure that any advantages BBC Studios could have do not distort competition.
- 1.19 The BBC Executive has said there would be a periodic review of BBC Studios to assess compliance with the Fair Trading policy. We note that the BBC Trust is currently reviewing this policy and the Clementi Review is considering the future of BBC governance and regulation. Although the Fair Trading Guidelines could mitigate some concerns, additional safeguards may be required, specifically to address the risk of cross-subsidies.
- 1.20 The BBC Executive and Pact have agreed principles and a regulatory framework that aims to address some of the concerns identified in relation to separation, although their effectiveness will depend on further detail concerning how they would be implemented¹⁶.

The full detail of how the BBC's proposals will operate is not yet clear, therefore a number of issues are likely to require further scrutiny

- 1.21 Although we consider impacts in the short term would be limited, the longer term effects are likely to be significant, both positive and negative. There is the potential that the proposal could benefit viewers by increasing choice for commissioners, but there is also the risk that BBC Studios could make market entry more difficult for new disruptive players if it is disproportionately successful at winning non-BBC commissions.
- 1.22 It is difficult now to determine the overall effect, so a further assessment could be necessary once the proposal has been finalised by the BBC Executive. Further assessment could consider:
 - Market impacts in greater detail once firmer numbers are in place;
 - Assessment of separation issues and how they might be addressed once it is clearer how BBC Studios would interact with other parts of the BBC; and
 - Further consideration of regulatory scrutiny following the Clementi Review, to establish what oversight would be required.
- 1.23 As the longer term impacts of the proposal are difficult to predict, we believe that if the proposal is accepted, it may be necessary to review both how well the framework for BBC Studios is operating as well as the wider impact of BBC Studios on the production sector. The exact timing of these reviews should be determined following the Clementi Review and once it is clear how long it will take the BBC to establish the new arrangements and make them operational. If the review process found that BBC

¹⁶ BBC & Pact Joint Statement <http://downloads.bbc.co.uk/mediacentre/bbc-pact-joint-statement.pdf>

Studios is not operating as expected, interventions could be taken if necessary to protect independent producers, for example increasing the independent producer quota.

Other proposals on the future of BBC content production

- 1.24 Both of the other options considered in the Green Paper (amending quotas to increase the amount of BBC commissions open to competition and scaling back in-house production) may be beneficial for the TV production sector in the short-term, through increased revenues to independent producers. However, questions may remain about whether the wider market could supply BBC production needs in more specialist genres and particularly in radio. Scaling back in-house production may have wider and more uncertain effects within the creative industries, particularly given BBC in-house production's role in national and regional representation.

Section 2

Introduction

Charter Review and BBC proposals

- 2.1 DCMS published a consultation on the BBC's Charter Review on 16 July 2015¹⁷. The Green Paper outlines a number of general options for reform of the BBC. As part of this, the Green Paper identifies three potential options for reforming the BBC's approach to content production. On 18 August 2015, the Secretary of State wrote to Ofcom, requesting input into the evidence base for Charter Review¹⁸.
- 2.2 On 17 September 2015, the BBC published a paper setting out detail around the BBC Studios proposal of opening up BBC commissions to more competition and of permitting the BBC to produce programming for third parties¹⁹.

Scope of our work

- 2.3 This document provides input on the likely market impact of the three options for reform identified by the Government, as set out above. Our main area of focus has been the BBC Studios proposal. Our analysis is based on the BBC Studios paper published by the BBC Executive in September 2015, as well as the agreement between the BBC and Pact published in December 2015. The scope of our work also includes considering amending the existing quota system and directly scaling back in-house production, however, due to the lack of details on these options we have only provided high-level input on the associated impacts.
- 2.4 We also note that the Secretary of State requested that Ofcom review the operation of the television production sector. The conclusions have been set out in a separate report; where appropriate, we have cross-referred to this work.

Our approach

- 2.5 The approach and methodology we have used has some similarities with that used by Ofcom for MIAs and significance tests for the BBC Trust when the BBC Executive proposes new services or changes to existing services. Our focus has been on the effects these proposals would have on the wider market, and we have considered the likely effected parties as well as the type of impact they will face and the magnitude of these impacts. However, given the level of information available at this stage, this document reflects initial comments on the proposals rather than the extent of analysis we would undertake in a MIA process.
- 2.6 Due to the short timescales for delivering this work, we have not commissioned new research or undertaken a public consultation. Instead, we have made use of existing

¹⁷ BBC Charter Review: public consultation, 16 July 2015, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/445704/BBC_Charter_Review_Consultation_WEB.pdf

¹⁸ Letter from John Whittingdale, Secretary of State for Culture, Media and Sport, to Sharon White, Chief Executive of Ofcom, 18 August 2015, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/466487/SW.pdf

¹⁹ British Bold Creative BBC Studios: Strengthening the BBC's role in the creative industries, 17 September 2015, <https://downloads.bbc.co.uk/aboutthebbc/reports/pdf/futureofthebbc2015.pdf>

information held by Ofcom and our knowledge of the TV production sector. We have met twice with the BBC Executive to understand the proposals, and we have taken into account its evidence. The BBC Executive has provided us with high-level information on its proposals and its initial views on how BBC Studios might perform in the future²⁰, which have also informed our thinking.

Summary of the BBC proposals

- 2.7 The BBC Executive believes that owning production and intellectual property is vital to ensuring BBC production remains competitive in an increasingly globalised content market. The BBC Studios proposal aims to secure a stable source of content for the BBC, which it states would allow it to bring “UK creativity to the world”, by allowing the BBC to better retain and attract talented programme makers. BBC Studios would also be a long-term source of intellectual property (“IP”) assets for the BBC, which could be exploited internationally by BBC Worldwide, with the resulting income reinvested in content and services for UK licence fee payers.
- 2.8 The proposal is in part deregulatory, removing specific content production quotas and opening up the BBC’s commissioning spend to competition. Specifically, the BBC proposes making the following changes to its TV content production strategy:
- transforming the majority of its in-house production unit into BBC Studios, a wholly-owned subsidiary of BBC Group;
 - allowing BBC Studios to produce programmes for the BBC and other broadcasters in the UK and internationally;
 - removing the current guarantee that 50% of BBC network television hours are produced in-house;
 - granting the right to BBC Studios to continue to produce continuing series that BBC in-house production currently makes; and
 - potentially changing the 25% qualifying independent production quota for BBC1 and BBC2²¹.
- 2.9 Underlying IP for new programmes created by BBC Studios for the BBC or other commissioners would remain within BBC Group, allowing BBC Group to generate additional value through the sale of secondary rights. We note that at this stage the BBC has not clarified which part of the wider BBC Group would control this IP.
- 2.10 The proposals do not apply to the news, current affairs, sport and children’s genres, which would remain in the BBC Public Service. However, the BBC have agreed with Pact to reduce the in-house guarantees in children’s and current affairs to 40%, while increasing the independent production quota to 40%²². There are also more minor changes to radio and online commissioning.

²⁰ Some of this information and forecast projections are confidential.

²¹ The BBC and Pact have noted in a joint statement that this change would be to allow the channel quotas to be met over a two-year period.

²² BBC & Pact Joint Statement <http://downloads.bbc.co.uk/mediacentre/bbc-pact-joint-statement.pdf>

- 2.11 The BBC has agreed with Pact that a minimum of 40% of the current in-house guarantee will be made available within two years,²³ leading to 70% of BBC commissions being open to third-party competition²⁴ (including the 50% currently available through the WOCC²⁵ and independent production quota).
- 2.12 The BBC has estimated that BBC Studios would have revenues of approximately £400m in the first year of operation. While the majority of this is from primary production revenues, it also includes a proportion of commercial revenues from co-production and up-front investment.

Market context

The television independent production sector

- 2.13 The UK has had a thriving TV independent production sector for many years. The sector has grown rapidly, generating UK and international TV revenues of £2.7bn in 2014, up from £2.0bn in 2009 in real terms²⁶. It is a diverse sector made up of a variety of business models ranging from small independent companies, typically with revenues under £10m per year, to large producers, five of which had UK revenues of over £100m in 2014. A total of 259 different companies had at least one programme on air on a PSB network channel in 2014, although this has fallen from 442 in 2006²⁷.
- 2.14 Early consolidation in the UK production sector began in the mid-1990s, but has increased at pace since the Communications Act 2003 (“the Act”) put in place interventions that allowed independent producers to control and exploit their own IP rights, making them attractive targets for mergers and acquisitions. Major global media companies, mainly from the US, have acquired several of the largest UK producers since 2008. These large, global, foreign-owned companies now account for around 80% of UK revenue generated by the top-ten producers. Despite the rise of large external producers, the BBC and ITV remain the largest producers in the UK.
- 2.15 The PSBs are subject to a quota under the Act requiring them to commission at least 25% (by hours) from ‘qualifying independent producers’ (“the TV independent production quota”), which makes sure that these interventions apply only to production companies who are no more than 25% owned by any company that also owns a UK broadcaster. The BBC is subject to further quotas requiring it to guarantee 50% of its commissions for its in-house production unit (“the in-house guarantee”) and to open the remaining 25% of commissions to competition between in-house and external producers, both qualifying and non-qualifying (“the Window of Creative Competition” or “WOCC”).
- 2.16 Although the proportion of all PSB investment in programmes made by independent producers has remained broadly flat since 2008, spend has declined in real terms (in part due to increased productivity and falling input costs). Between 2008 and 2014, total PSB levels of investment in new UK-originated content by the PSB channels fell by £440m in real terms.

²³ BBC & Pact Joint Statement <http://downloads.bbc.co.uk/mediacentre/bbc-pact-joint-statement.pdf>

²⁴ 40% of the in-house guarantee is equivalent to 20% of BBC commissions.

²⁵ The WOCC, or Window of Creative Competition allows BBC in-house production and external producers to compete for 25% of BBC commissioning hours.

²⁶ Ofcom Communications Market Report, 6 August 2015, http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr15/CMR_UK_2015.pdf

²⁷ Attentional, Oliver & Ohlbaum analysis

- 2.17 There are wider contextual changes that could have future impacts on the market. The Government is currently considering a range of options for reforming Channel 4, which could result in changes to its ownership structure and commissioning strategy. The Government is also carrying out a review of the BBC's Royal Charter, exploring a number of areas of possible change. This broader context is important; the PSBs are the largest buyers of UK TV programmes²⁸ and significant changes to their funding levels, structure or operation could impact the TV independent production sector in a significant way.

Independent producers for radio and online

- 2.18 The BBC has quotas for radio and online: the radio independent production quota, which requires it to commission 10% of programmes from external producers; a quota requiring it to open a further 10% of radio commissions to competition ("the radio WOCC"); and an online independent production quota, requiring it to commission 25% of eligible online spend on content and services from independent suppliers.
- 2.19 The radio independent production sector is smaller than for television, made up of around 150 SMEs across the UK²⁹. The sector generates radio programme production revenues of £19.8m³⁰. This compares to the BBC's total expenditure on radio content of £474m³¹. BBC commissions make up the vast majority of total commissions won by the radio independent production sector – only 14% of radio independent producers reported any non-BBC commissions³². Capacity in the sector also seems to be more limited than in the TV independent production sector: the majority of independent producers tend to be quite small (the smallest 80% of producers are responsible for only 15% of total radio programme turnover) and many generate revenues from areas other than radio programme production, for example podcasts and media training³³.
- 2.20 Online production is a diverse sector with a wide variety of participants in both supply and demand. The BBC represents a much smaller proportion of online spend than it does within television and radio, with total spend on eligible activities³⁴ of £64m in 2013/14, compared to an estimated total UK spend of £450m on online public service content³⁵. The majority of the BBC's eligible online spend is spent in-house³⁶.

²⁸ Public Service Content in a Connected Society, 15 December 2014,

<http://stakeholders.ofcom.org.uk/binaries/consultations/psb-review-3/summary/PSBR-3.pdf>

²⁹ Radio Independents Group, The BBC and the Future of Public Service Audio Content, October 2015 <http://www.radioindies.org/images/2016charter/rig-cr-green-paper-response-final.pdf>

³⁰ Radio Independents Group Indie Business Census/Enders Analysis, March 2015, <http://www.radioindies.org/images/census/Indie%20Business%20Census%20Survey%202015%20-%2010.03.15.pptx>

³¹ The BBC's Annual Report and Account 2014/15, Full Financial Statements, <http://downloads.bbc.co.uk/annualreport/pdf/2014-15/BBC-FS-2015.pdf>

³² Radio Independents Group Indie Business Census/Enders Analysis, March 2015,

³³ Radio Independents Group Indie Business Census/Enders Analysis, March 2015, <http://www.radioindies.org/images/census/Indie%20Business%20Census%20Survey%202015%20-%2010.03.15.pptx>

³⁴ Details of eligible activities for external spend is given in the BBC Online Outturn Report, available at http://downloads.bbc.co.uk/commissioning/site/bbc_online_outturn_report_2013-14.pdf

³⁵ BBC Trust, The supply arrangements for the production of the BBC's television content, radio content and online content and services, 19 June 2015,

http://www.bbc.co.uk/bbctrust/our_work/services/programme_supply/content_supply_review

Section 3

Potential impacts of BBC Studios proposal

Introduction

- 3.1 In this section, we consider the potential impacts of the proposed BBC Studios service on third parties. While the BBC is best positioned to judge the impacts of the proposal on itself and its audience, we note that, if successful, the proposal could be a positive development for UK creative industries, both in terms of maintaining a critical mass of PSB production capability, by opening up new commissioning opportunities for the independent production sector and supporting the UK production sector's ability to operate on a global scale.
- 3.2 Given the limited availability of information, as the BBC Studios proposal continues to be developed, we set out our initial comments on the proposals. We believe that a more detailed analysis of the likely impacts will be required when a full proposal is produced, including a full analysis of the expected sources of BBC Studios' commissions and detailed impacts resulting from opening up the BBC schedule to more competition.

Performance of BBC Studios

- 3.3 The success and size of BBC Studios would affect the scale of the market impacts. Although the BBC estimates that BBC Studios would start with an initial turnover in the region of £400m³⁷ as discussed in paragraph 2.12, it is currently unclear how this might change over time. We set out some of the key drivers that could affect the performance of BBC Studios below.
- **Certainty of future revenue streams:** the returning series transferred to BBC Studios at launch would give it a high degree of certainty over its revenue in initial years. If it could produce existing commissions profitably this would also underpin some of BBC Studios' risk in investing in new programme concepts.
 - **Scale and economic efficiencies:** annual revenues of £400m would make BBC Studios one of the largest production companies in the UK³⁸. It might be able to use economies of scale to reduce costs and drive efficiencies. It may also be in a better position to provide up-front gap funding³⁹ using revenues from existing commissions or secondary distribution, or to invest in international production.

³⁶ BBC Online Outturn Report 2013/14,

http://downloads.bbc.co.uk/commissioning/site/bbc_online_outturn_report_2013-14.pdf

³⁷ Including commercial up-front investment in programming

³⁸ Only ITV Studios would be larger in terms of UK revenues, however, O&O analysis reported seven additional production companies (Endemol Shine, All3Media, IMG, Tinopolis, Fremantle, Zodiak Media and NBCU) with revenues over £100m per year.

³⁹ Also known as deficit funding, gap financing refers to a practice where the producer of content invests in the primary development, in order to fill a gap in funding from the commissioner. This is normally accompanied with an expectation of additional revenues from secondary rights such as merchandise, overseas sales, secondary windowing or format sales.

- **Development of new programmes:** BBC Studios' success would be driven by its ability to produce content where it has some competitive advantage, such as specialism in genres that are difficult or expensive to produce.
- **Ability to acquire, develop and retain skills:** the strength of the BBC reputation and economies of scale may give BBC Studios advantages in attracting talent compared to the wider sector.
- **Strength of the BBC brand:** the strength of the BBC brand outside of the UK may be particularly effective in delivering international sales.

3.4 However, BBC Studios could have disadvantages in the following areas:

- **BBC brand:** UK broadcasters may be less willing to grant commissions to BBC Studios as a matter of corporate strategy, if they perceived doing so would strengthen a rival.
- **Regulatory and reputational issues:** due to the publically funded nature of the wider BBC, BBC Studios would likely face greater scrutiny of its structure and practices. Regulatory sign-off may require conditions to be put in place that reduce BBC Studios' operational or structural freedom. We explore some of the potential regulatory and reputational issues in paragraphs 3.30 to 3.42 below.

Assessment of potential impacts

3.5 Our view is that independent production companies and television programme distributors would feel the most significant impacts. There are likely to be positive and negative effects and the extent of any effects will partly be dependent on how successful BBC Studios is and on the strength of the drivers discussed above. Whether producers are qualifying or non-qualifying is likely to affect potential impacts as well as which genres producers and distributors focus on.

3.6 In particular, there is a possibility that the BBC Executive's estimates of BBC Studios external revenue have the potential to be significantly more conservative than actual performance due to the difficulty in accurately estimating BBC Studios' ability to win work in the wider marketplace. Although evidence from the WOCC will provide an initial indicator of potential BBC Studios success, BBC Studios' greater commercial freedom may make it more successful than predicted. We also note that there is an asymmetry between the revenue that BBC Studios could win in the wider marketplace and the more limited revenue that would be made available to independent producers by reducing the BBC in-house production guarantee.

Impacts on production companies (qualifying and non-qualifying)

3.7 Third party production companies may face the following negative impacts at a high-level:

- Loss of share of total UK commissioning spend where BBC Studios wins UK commissions, and complementary loss of secondary rights associated with primary commissioning spend;
- Reduced margins on primary commissions due to pricing pressure from BBC Studios' ability to use its scale and relationships to attract gap funding or to accept lower margins on finished programming; and

- Loss of skills where BBC Studios is better able to recruit and retain talent than BBC in-house production, due to greater flexibility over pay.
- 3.8 Producers may also face a positive impact from increased availability of BBC commissioning spend from removal of the in-house guarantee. However, we note that this spend will be reduced by the volume of returning series that will remain with BBC Studios following the changes. The BBC have agreed with PACT that a minimum of 40% of the current in-house guarantee will be made available within two years⁴⁰, leading to 70% of BBC commissions being open to third-party competition⁴¹.
- 3.9 In the short to medium term, there may be significant variation in BBC Studios' ability to win commissions by genre, and therefore in the effects on other producers. In the long term, BBC Studios could become more or less effective at developing new commissions in certain genres as a result of the proposed changes to in-house production.
- 3.10 There may be additional dynamic impacts from these changes. Independent producers may choose to exit the market and reduce diversity of programme supply to broadcasters. There may also be a wider shift in market dynamics towards greater concentration of production companies, with a small number of vertically integrated producers winning a larger share of overall work.
- 3.11 The independent production quota could reduce potential impacts on qualifying independent producers. As BBC Studios would not qualify as an independent producer, it would not be able to compete for the 25% of hours guaranteed by the BBC, ITV, Channel 4 and Channel 5 to independent producers.
- 3.12 Given the level of returning series likely to be retained by BBC Studios, as well as the volume of returning series broadcasted by other broadcasters⁴², and evidence from the WOCC⁴³ that suggests BBC in-house production is currently less effective than other producers at developing and selling new series, we consider the relative scale of any market impacts in the short term is likely to be limited overall.
- 3.13 Based on a high-level analysis of BBC commissioning spend, we estimate that the BBC Studios proposal could make up to £157m of BBC commissioning spend available to competition from external producers after the first two years⁴⁴, based on 2014 figures. This would represent roughly 10% of UK independent producers' £1.6bn UK primary commissioning revenue in 2014⁴⁵; however, this figure may fall if the BBC reduces investment in television programming as a result of changes to its scope, shape and funding coming out of Charter Renewal. Evidence from recent years of the WOCC suggests that external producers will be well positioned to win a significant proportion of this spend, having won 78% of available WOCC hours in 2014/15.

⁴⁰ BBC & Pact Joint Statement <http://downloads.bbc.co.uk/mediacentre/bbc-pact-joint-statement.pdf>

⁴¹ 40% of the in-house guarantee is equivalent to 20% of BBC commissions.

⁴² In 2014, over 60% of external spend by each PSB broadcaster was used for returning series

⁴³ BBC in-house won 22% of WOCC hours in 2014/15, down from 28% in 2010/11.

⁴⁴ This figure is based on a high-level analysis of BBC commissioning hours and spend in 2014, with those hours made available to external producers valued at current BBC cost per hour. It should be taken as highly indicative.

⁴⁵ The Pact Census Report. <http://www.pact.co.uk/news/news-detail.html?id=smaller-indies-win-larger-share-of-uk-commissioning-spend-in-tougher-market->

- 3.14 However, in the longer term, the dynamic effects could be greater and may particularly be influenced by the relative success of BBC Studios and the time frame associated with the BBC decommissioning returning series. These longer term effects are more difficult to predict given the uncertainty over BBC Studios' performance in the wider market, but have the potential to be significant for the production sector as a whole.
- 3.15 The BBC Executive states that BBC Studios would focus on serving UK audiences, but would aim to increase its global competitiveness and grow in international markets. Evidence from the Pact census suggests that international revenue from rights and finished programming has grown more rapidly than other forms of revenue for external producers since 2008 and makes up a significant revenue source for many producers. UK producers targeting international revenues as a growth area could be affected if BBC Studios was successful in competition for this spend.

Impacts on programme distributors

- 3.16 As well as effects on producers, there could be some impacts (both positive and negative) felt by distributors. BBC Studios may be in a better position than other producers to acquire secondary rights due to its ability to 'gap fund' primary production and use the relationship with BBC WW to value these rights. To the extent that BBC Studios is successful at producing new commissions for the BBC and for other producers, this would lead to a greater volume of secondary rights available for BBC Group to exploit, and a similar decrease in secondary rights available to other distributors.
- 3.17 However, if BBC Studios lost its current commissions and replacement programming was won by independent producers, the rights could become available for external distributors. Due to high audience figures associated with some BBC programming, this IP could be relatively highly valued. There may be additional opportunities for third party distributors to acquire rights if BBC Studios was unable to negotiate secondary rights for content produced for other broadcasters.
- 3.18 As discussed in paragraph 2.9, the BBC Executive has not yet detailed which part of BBC Group would control the IP for new commissions. This may have implications for the effects on distributors. If BBC Studios (rather than the BBC Public Service) controlled the IP and was able to license secondary rights to BBC WW or other distributors, it may be in a better position to offer these rights more widely.

Radio and online impacts

- 3.19 The BBC Studios proposal focuses on television and suggests only minimal concrete changes to radio or online⁴⁶. As such, any impacts would be likely to be more limited for radio and online than for television.

Radio

- 3.20 For radio, the only changes proposed relate to making the BBC's in-house Radio Comedy department part of BBC Studios, given the team is fully integrated with the

⁴⁶ Separately, the BBC announced in June 2015 its plan to open around 60% of eligible hours to competition over 6 years, eventually removing the 10% radio independent production quota. However, this proposal is not part of the BBC Studios proposal. As such, we have not considered the impact of these proposed changes.

TV Comedy team moving to BBC Studios. The rest of the BBC's Radio division would remain within the Public Service. The other Radio teams currently integrated into TV departments (Natural History and Religion) would be moved into BBC Radio.

- 3.21 Although independent producers won the majority of hours available in the WOCC in 2014/15, the vast majority (81%) of the BBC's content was produced in-house⁴⁷. According to a survey conducted by the Radio Independents Group, only 6% of all independent radio productions commissioned by the BBC were for the Comedy genre, and we note that commercial radio stations make almost their entire output in-house. This implies that if the proposed changes went ahead, there are unlikely to be significant impacts on radio producers.

Online

- 3.22 The BBC proposals for online are less developed at this stage, making consideration of potential impacts difficult. Although BBC Studios would focus on long-form television programming, under the proposal it would also have flexibility to produce "new forms of content for digital platforms". The proposal is not clear about what this could be, however, the proposal states that "the core business of BBC Studios will be creating long form television programming" and its plans for online content creation are limited, suggesting this is a potential development for the longer term rather than a concrete plan. As such, we expect the impacts for online-only content markets to be limited in the near to medium term, although impacts would vary if BBC Studios grew in this area.

Wider impacts

Impacts on other broadcasters

- 3.23 Broadcasters may feel a beneficial impact from any changes, as they would be able to commission programming from another large production company with experience in a wide range of genres, including those where fewer external producers may be operating. They may also see a relative decline in some content costs if BBC Studios was able to provide greater gap funding than other producers, either across the board or in specific genres.
- 3.24 However, broadcasters could face a decline in the plurality of programme supply if the impact of BBC Studios was to reduce some independent producers' revenue or profitability to the extent that they reduced their output. Further, those vertically integrated broadcasters with production arms (such as ITV) may face a mixture of effects across various lines of business.

Impacts on other parties

- 3.25 Online providers may feel similar impacts to broadcasters. However, they may feel fewer negative impacts as they would be less reliant on qualifying independent producers. We note that online providers may be more likely to seek to retain secondary rights of original commissions than broadcasters.
- 3.26 The BBC Studios proposal may have positive and negative impacts for on-screen and off-screen talent, depending on the structure and hiring practices employed by

⁴⁷ BBC Performance against public commitments 2014/15, <http://downloads.bbc.co.uk/annualreport/pdf/2014-15/bbc-papc-2015.pdf>

BBC Studios. It may adopt different staffing strategies to BBC production and would likely have more flexibility to reward talent than the BBC Public Service, which may increase opportunities and possibly salaries for in-demand talent.

Impact on the BBC

- 3.27 An analysis of the impact on the BBC of the changes of BBC Studios is outside the remit of this work. However, we note that as BBC Studios would be returning profits to the BBC Public Service, the relative success or failure of BBC Studios would ultimately impact the level of income that the BBC had to invest in public services.

Representation of the UK, its nations and regions

- 3.28 BBC Studios may face incentives to produce content with broader international appeal, in order to deliver increased secondary revenues. This may lead to reductions in the level of UK representation. However, similar incentives to maximise secondary revenues exist at present, and the counteracting objectives to produce content that represents the UK are likely to remain relevant given that the BBC will continue to be BBC Studios' main commissioning partner for the foreseeable future.
- 3.29 The BBC currently has television production facilities across the UK: in London, Bristol, Birmingham, Salford, Cardiff, Glasgow and Belfast. While commercial pressures may raise questions of geographic consolidation, under the proposal, the BBC Executive states that BBC Studios would have a presence across the UK and would be likely to build on existing in-house production centres wherever possible.

Separation issues

- 3.30 The above analysis assumes that BBC Studios would compete with independent producers on fair terms and would win any commissions on the strength of its ideas and expertise. However, as BBC Studios would be part of the wider BBC Group, there is a risk that competition could be distorted. The proposal could introduce new risks, or it could exacerbate existing risks. Any resulting distortions could affect the scale of potential market impacts.

The proposal could introduce the risk of unfair cross-subsidies

- 3.31 There is a risk that BBC WW could cross-subsidise BBC Studios to ensure its success in its early years of operation, allowing it to take risks that commercial competitors may not be able to and leading to competitive distortions. The BBC Public Service could also agree lower rates of return from BBC WW and BBC Studios than would be expected by shareholders of commercial competitors.
- 3.32 There is a risk that the BBC Public Service could cross-subsidise BBC Studios. A close relationship between BBC Studios and the parts of production remaining within the Public Service could dilute incentives to ensure that BBC Studios paid a fair rate for using any shared equipment, raising issues around the pricing of asset transfers such as the transfer of staff to BBC Studios at launch; the licensing fee BBC Studios paid to use the BBC brand and where the IP rights for new BBC Studios-produced content would sit in BBC Group.
- 3.33 To avoid asset transfers distorting competition and conferring a selective advantage on BBC Studios, careful thought would need to be given as to how transfers would occur under normal market conditions. BBC Group would also need to ensure that

any internal transactions between BBC Studios, BBC WW and the BBC Public Service took place at arm's length to avoid cross-subsidies.

- 3.34 Regulation, such as the Fair Trading regime, would be required. We note that the BBC Trust has a Fair Trading Policy in place to ensure asset transfers are fair and take place on an arm's length basis. As discussed in paragraph 1.19, this policy is currently being considered by the BBC Trust.
- 3.35 However, we recognise that the risk of cross-subsidy introduced by the proposal may require additional safeguards. For example, these could include new guidance on transfer charges. Regulation would need to be supported by an appropriate organisational structure and operation of BBC Studios within BBC Group to reduce the risk of improper separation.

The proposal could exacerbate existing risks

- 3.36 The BBC faces competition for viewers from a diverse range of content suppliers. As a result, it has an incentive to commission the best content to attract viewers and this incentive will remain in future whatever model of production is in place. However, commissioners could also have an incentive to commission BBC Studios to keep associated revenues and IP within BBC Group; the importance of retaining IP may become greater if licence fee revenues are significantly reduced. In principle, these mixed incentives could affect commissioners' decision-making, for example making them more likely to award commissions to BBC Studios or less likely to decommission returning series awarded to BBC Studios.
- 3.37 However, this risk is not unique to the BBC Studios proposal (commissioners could have existing incentives to commission BBC in-house production over external producers) and evidence suggests that this is not currently influencing commissioners' decision-making to a material extent, as external producers are currently more successful under the WOCC than BBC in-house production⁴⁸.
- 3.38 There is also a concern around BBC Studios' position as a seller to BBC WW. If BBC Studios' incentives are set to maximise profits for the wider BBC Group, it might be incentivised to sell content to BBC WW at a preferential rate and to use BBC WW as a distributor even if a third party commercial distributor could offer a better deal. Again, this risk may already exist, but the creation of Studios could exacerbate it.
- 3.39 To address these concerns, there would have to be appropriate separation and incentives in place between BBC Studios and the BBC Public Service, together with an appropriate level of transparency in the commissioning process. New procedures that drive management behaviour could also be required.

The BBC Executive and Pact have jointly proposed a policy and regulatory framework for BBC Studios

- 3.40 On 21 December, the BBC Executive and Pact published a joint statement proposing a policy and regulatory framework for BBC Studios⁴⁹. In part, this sought to address some of the separation issues identified above. The framework proposed:

⁴⁸ As noted in paragraph 3.13

⁴⁹ BBC & Pact Joint Statement <http://downloads.bbc.co.uk/mediacentre/bbc-pact-joint-statement.pdf>

- **Ensuring effective separation** between BBC Studios and the BBC Public Service, guaranteeing cross-subsidies would not occur and that asset transfers would be charged under a fair transfer pricing methodology;
 - **Increasing transparency and competition** in the commissioning process; and
 - **Introducing a level of oversight**, for example by requiring: BBC Studios to exhibit commercial efficiency and to publish its accounts; a sub-Committee of the new BBC Board, comprised of non-executive directors, to be set up to oversee the handling of complaints in relation to BBC Studios; the BBC's Board to audit the relationship between BBC Studios and BBC Worldwide; and a regular review of BBC Studios every two years for the duration of the Charter.
- 3.41 Further consideration would be needed as to how the BBC Studios operation should be reviewed, including the interaction between the proposed biennial reviews of the operation of the BBC Studios framework and less frequent reviews considering the overall strategy and market impact. These details can be agreed following the outcome of the Clementi Review.

State aid

- 3.42 Some stakeholders have raised concerns that the BBC Studios proposal could breach state aid rules. At the highest level, state aid rules aim to maintain a level playing field by ensuring that public funds are not used to cross-subsidise commercial activities. Stakeholders' concerns relate primarily to the funds used to help BBC Studios initially set up. However, state aid concerns could also be relevant to some of the separation issues identified above. Although we have considered broader risks relating to separation, state aid issues are beyond the scope of this report. We would expect the BBC and DCMS would want to undertake their own assessment of state aid issues when considering this proposal.

Section 4

Amending existing quotas

Summary of proposal

- 4.1 The BBC is currently subject to content production quotas for TV, radio and online. These are set out in paragraphs 2.15 and 2.18 of this document. One of the options for reforming the BBC's approach to content production we have been asked to provide input on is to amend the existing quotas.
- 4.2 We have assessed the impact of increasing the proportion of commissions open to competition between the BBC and external producers under the WOCC for both TV and radio. We have not considered the impact of changing the TV independent quota as part of this analysis as this has been considered in greater detail by our TV Production Sector Review. We have also not considered increasing the radio independent quota. This is because it is unclear whether there is currently the capacity in the radio independent production sector to meet a larger radio independent quota, as noted in paragraph 2.19.
- 4.3 The BBC is a relatively small player in the provision of online content and services in comparison to the wider market. Unlike TV and radio, it is not clear that changing the online independent quotas would particularly impact the wider sector. We have therefore considered, at a high-level, the effect of deregulation in this area.

Assessment of impacts

- 4.4 **Television** – reducing the in-house guarantee and introducing a larger TV WOCC would increase opportunities for the independent production sector and choice for BBC commissioners. Current WOCC evidence could suggest that external producers would be effective at winning commissions in competition with BBC in-house given the opportunity. Increasing the TV WOCC could therefore be positive for external producers. However, an in-house guarantee could remain desirable for genres where there are fewer external suppliers, or for news to ensure plurality.
- 4.5 **Radio** – independent producers currently perform well under the radio WOCC⁵⁰, but capacity in the radio independent sector appears to be limited in comparison to TV and it is not clear that production would significantly increase in the short term if quotas were amended. It is therefore likely that impacts of increasing the radio WOCC would be limited in the short term, although change could stimulate competition and growth in the longer term.
- 4.6 **Online** – if the quota was removed, the BBC could be inclined to produce more of its online content and services in-house, which could have adverse effects on commercial providers, although it is likely the impact would be limited: a 2010 Deloitte report noted that “it is clear that few suppliers ‘bank’ upon the BBC for underwriting their businesses.”⁵¹ In the future, consideration may need to be given as to how online-first commissioning of full-length television content interacts with the TV independent quota and any online quotas.

⁵⁰ As noted in paragraph 3.20.

⁵¹ Deloitte for the BBC Trust, review of the online quota, 28 January 2010, http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/our_work/online_supply/independent_report.pdf

Section 5

Scaling back in-house production

Overview of scenarios

- 5.1 The Secretary of State has asked us to provide input into an assessment of the impacts of scaling back BBC in-house production. The scale of any reduction was not defined, and although we have made some high-level comments, the market impacts of reducing BBC in-house production would vary significantly according to the degree to which in-house production was scaled back. This could range from modest tweaks in quotas to more radical change, such as a publisher-broadcaster model.
- 5.2 The latter could have wide-ranging impacts and could significantly affect the BBC's ability to deliver its remit. BBC in-house production has a strong history of delivering good outcomes for viewers and has developed a number of the BBC's most successful programmes domestically and abroad, including Top Gear, Doctor Who and Strictly Come Dancing, while also producing the majority of BBC programming in genres such as Arts & Classical Music and Religion & Ethics. External producers, particularly those with a global focus, may have weaker incentives than the BBC to develop content that meets the BBC's public purposes, or in genres that are less commercially attractive.
- 5.3 The BBC is a key foundation of the UK's creative industries, with BBC in-house production a major part of this investment. A BBC-funded report by Frontier Economics calculated that the BBC invested £2.2bn in the UK creative industries in 2013/14, including £94m on skilled freelancers⁵². BBC in-house production also has a strong track record in investing in production throughout the UK nations and regions⁵³, and plays a key role in helping to develop production hubs such as MediaCityUK in Salford. Significantly reducing BBC in-house production could have wider negative impacts on the UK's creative industries.
- 5.4 As such, we have not assessed the impact of completely scaling back in-house production and a fuller assessment would be needed if DCMS was considering this option. Thought would also need to be given as to whether some genres should be protected, for example those where there is less external provision from the market or news (where scale is important to drive efficiencies and quality and a variety of providers are desirable to ensure there is plurality in news provision).

Assessment of impacts

- 5.5 **TV impacts** – scaling back BBC TV in-house production could provide greater opportunities for the independent production sector as more of the BBC's commissioning schedule would be opened up to competition. In genres with significant existing external supply, we would expect the market to be able to continue to supply BBC demand for programming. However, there could be effects on talent if there were considerable redundancies among BBC production staff and if

⁵² Frontier Economics, The contribution of the BBC to the UK creative industries
http://downloads.bbc.co.uk/aboutthebbc/insidethebbc/reports/pdf/bbc_report_contribution_to_the_UK_creative_industries.pdf

⁵³ BBC Production has facilities in London, Bristol, Birmingham, Salford, Cardiff, Glasgow and Belfast

this led to an excess supply of talent to the independent production market, leading to downward pressure on salaries or job losses.

- 5.6 In some genres where BBC in-house production teams currently produce a significant volume of content and there is little external supply, there may be more significant changes, including short term unmet demand from BBC commissioning for certain genres. This demand would likely increase incentives for market entry (including by previous BBC production staff), increasing the overall market supply in the longer term, but any new production companies formed may lack the economies of scale that BBC in-house currently has, increasing the costs of some programming and potentially making it problematic to produce some higher end programming.
- 5.7 **Radio impacts** – scaling back in-house production for radio would remove by far the biggest producer of radio content from the market. As noted in paragraph 3.21, the radio independent production sector may struggle to replace content currently made by the BBC at least in the short term. In the longer term, continued demand from the BBC commissioning team could possibly stimulate competition in the sector, although it is likely commercial production companies would lose the current economies of scale that BBC in-house production has.
- 5.8 **Online impacts** – the BBC's spend on the provision of online content and services is relatively small compared to the rest of the sector. Even though the BBC currently spends most of its online spend in-house (as noted in paragraph 2.20), scaling back its capabilities would likely only have a limited impact on the market and there would therefore only be modest additional opportunities for online independent producers.