Chapter 1 - Achieving Sufficiency Without Excess

The BBC's Funding Needs Until the Charter Review

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Overview

The BBC has put to the Panel an ambitious vision which would substantially increase its service provision on both analogue and digital platforms in the remainder of the present Charter up to 2006. In total, this would increase annual BBC spending on programmes by £1250 million a year in 2006, a jump of more than 50% on present spending levels. About £550 million of this would be needed to maintain and enhance existing services (allowing for superinflation in the costs of talent, sports rights, etc.), while about £700 million would be devoted to new services. Essentially, the BBC expects to fund about £600 million itself from self-help in the form of extra efficiency savings and higher commercial revenues. The Panel is therefore being asked to find the remaining £650 million from new measures.

The Panel has little doubt that the BBC could make effective use of this extra money in making high quality programmes. But we are not convinced that the benefits would be worth the extra cost, remembering that the licence fee is a regressive charge. We do not feel justified in asking the licence fee payer to incur still higher costs, unless we are absolutely convinced that this is necessary to maintain a healthy broadcasting ecology in the UK. In a sense, the inherent disadvantages of the licence fee system imply that we should fund the minimum BBC services necessary to do this, not the maximum amount that could be usefully spent.

Nor do we believe, however, that the BBC can properly fulfil its responsibilities in the new broadcasting era without some additional sources of funding. The status quo - with the licence fee being uprated in line with inflation after 2001 - is not an attractive option. We agree with the BBC that the broadcasting system stands at an important cross-roads. Without any extra funding, it will be very difficult for the BBC to provide important public sector offerings in both the analogue and digital worlds in the next five years.

We therefore propose that new measures are put in place to ensure that BBC real revenues grow at about 2-2.5% per annum, roughly in line with GDP, in the period up to Charter Review. This would add about £150-200 million a year to BBC spending on programmes in the years running up to 2006 - about a third or less of what the BBC has requested for the last years of the present Charter period. From 1998-2006, taking account of efficiency savings and other additional sources of funds, BBC spending on programmes could increase by 3-3.5% per annum under the Panel's proposals, compared with growth of over 5% per annum needed to fulfil the BBC's full service vision. If the BBC can achieve higher efficiency savings, and more commercial revenue, than assumed in our main case, then we would happily recommend that these extra resources should be devoted directly to further enhancements in service provision.

The BBC's view of its funding needs

All proposals to supplement BBC funding over the period up to the Charter Review must start from an assessment of the quantum of funding that the BBC might need to maintain its contribution to public service broadcasting over that period. In its evidence to the Panel, the BBC stated that:

> *"The BBC stands at a crossroads. If it can achieve buoyant revenues it can continue to condition the UK media market. Without such buoyancy it will diminish slowly but inexorably."*

The BBC went on to paint for the Panel essentially two pictures. The first assumed buoyancy in revenue growth, and allowed the Corporation significantly to increase its service provision - in both quantity and quality - over the next seven years. The second assumed that revenue would continue to grow at the subdued rate seen in recent years, in which case the BBC argued that it would face a struggle to improve the main terrrestrial channels while at the same time expanding its digital services.

Although this problem had been disguised, or avoided, in the 1990s by the growing impact of efficiency savings, the BBC believed that it was inevitable that this source of funding for programmes would be harder to realise in future. By contrast, the need for additional funding would simply increase, because of explosive growth in the new digital media, and the rising costs for talent and rights.

It was crucial, the BBC argued, for public service broadcasting to be given a major role in the new digital marketplace, while simultaneously being able to maintain and improve its traditional services. Furthermore, the BBC argued that there is likely to be a substantial "first mover" advantage in the digital space, so any significant delay in providing extra funds for the BBC would greatly disadvantage the development of public service broadcasting in the media of tomorrow.

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The opportunity

With buoyant licence fee revenue, the BBC says it would fulfil its “services vision” by aiming to:

- remain the major investor in UK-originated, high-quality content that serves the needs of the diverse range of people and communities;
- maintain a benchmark of quality in every genre - from music and arts, to news, science and history, to sport, comedy, children’s and drama;
- provide licence payers and audiences with access to that wealth of creativity and content in a wider variety of ways, so that the licence fee will provide greater value to them personally even if they use those services a little less in a world of greater choice;
- ensure that there will always be something on they want to access.

In its evidence the BBC says it would aim to provide access to this investment in content in a range of ways.

- The main national networks would aim to offer the best in UK-originated content in all genres in peak-time for both analogue and digital audiences. They would also be strengthened year-on-year with more first-run programmes and higher value content in order to provide a competitive alternative to commercial networks. BBC Choice would become a genuine third network for digital audiences, which would aim to serve a younger audience than BBC One and Two. This would also enable BBC Two to devote more time to arts, music, history and science programmes.
- Properly resourced, specialised public channels would enable digital audiences to access more of the BBC’s distinctive output when they want it rather than when a mixed-schedule network allows it. On television, this would include important new developments for BBC News 24, BBC Knowledge, BBC Parliament, and possibly the launch of new public service channels in other fields. Importantly, BBC Knowledge would become a fully-interactive service to enhance lifetime learning opportunities for all. On digital radio, extra money would support development of the BBC Asian Network, BBC Black Music and BBC Sports Plus. These services would be made available to digital audiences across the whole of the UK.
- Digital TV audiences would be able to access the benefit of multiple repeats of programmes in key genres aired over the last fortnight or in a particular current series - eg BBC Science, BBC History, BBC Home, BBC Natural History. Over time, individuals would be able to build their own “personalised channels”, concentrating on their own particular interests, rather than relying on the BBC’s schedulers.

- BBC Online would continue to provide access into the creative and information resource at the heart of the BBC. The greater capability of PCs would enable better access to current TV and radio services for online audiences at home, school, office and on the move. Meanwhile the ability to offer interactive and online services alongside or attached to traditional broadcast programmes would significantly improve the value of those programmes to digital audiences.
- Public access to the BBC's digital services in libraries, schools, supermarkets etc would ensure that everyone can benefit from what digital can offer, even if they do not have the receivers at home.

Overall, the implementation of the BBC's vision for its services in 2006 would increase its annual spending on programmes by about £1250 million a year by the end of the present Charter period. Of this, around £550 million would be devoted to existing services. (£250 million would be eaten up by "superinflation" of rights and talents costs, leaving £300 million for genuine enhancements to core analogue services.) In addition to this, the BBC has proposed that the Panel should seek to fund the bulk of around £700 million per annum of additional spending on new services by 2006.

The Panel was provided with further information on the specific costs of enhancements to various services which the BBC would like to undertake. (We are not publishing these costs in detail because of necessary commercial confidentiality.) In total, the specific proposals by the BBC amounted to a spend of some £300 million per annum by 2006. This obviously implies that the remaining £400 million per annum on new services would be spent in a manner to be determined at a later date.

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Funding needed to fulfil the BBC's vision

(1998/99 prices)	£ million
Spending in 1998	2,200
Suggested Spending in 2006	3,450
Extra spending	1,250
Of which	
- Enhanced Existing Services	550
- New Services	700
Of which	
- Specified in Detail to Panel	300
- Unspecified in Detail	400

Overall, then, the BBC's service vision would increase its annual spend on services by 57% in real terms over 8 years. This represents compound annual growth of 5.1% per annum in service provision over this period.

We asked the BBC what effect this amount of extra spending might have on their weekly reach, and on their audience share. We also asked whether the BBC would be able to continue to exercise an important influence on the rest of the marketplace if their full vision for additional services were met.

The BBC said that if it is given the ability to set public service benchmarks in every genre and to deploy the resulting content in ways which actually enhance the value people receive from their licence fee investment, it will continue to influence the competitive market in which it operates. On this basis, the BBC is confident that around 90% of UK households will access at least some BBC content each week by the time a new Charter starts in 2007. Although the BBC's share of audience time will continue to decline over this period towards 35% (compared to 42% now) the Corporation believes this remains well above the threshold for retaining influence in the marketplace.

Audience share and reach of the BBC

- **Audience share** is simply the proportion of total viewing or listening accounted for by a particular television channel or radio station. The BBC's share of adult viewing and listening in 1998 was 42%.

- **Audience reach** measures the proportion of the potential audience who have spent some (non-negligible amount of) time viewing or listening to a particular service during a given period. In 1998 the BBC achieved a weekly reach of 93% of adults, this being driven mainly by TV viewing which in itself had 92% reach.

In the digital age, audience reach may become a considerably more important concept for the BBC than share. With a large increase in the number of television channels available, a decline in BBC audience share seems inevitable. Evidence for this is the fact that the BBC's share of viewing in homes with access to satellite and cable television is 29%, compared with 41% for all households. In this more competitive environment, audience reach will measure how far the BBC continues to offer something of value to every licence payer.

The level of audience reach achieved in the future, therefore, can be considered an important indicator of the BBC's relevance, and its success in serving the needs and wants of a diverse audience. The BBC Governors' Assessment in the latest Annual Report recognises this, stating, "The overall reach achieved by BBC services is a more significant indicator of success than market share."

The graphs on page 44 illustrate the BBC's and other broadcasters' performance in terms of television reach and share over recent years. It can be seen that while BBC reach has remained fairly constant, there has been a slight fall in its share, following the growth in programming available on cable and satellite and the arrival of Channel 5 (although the main impact has been on the share held by ITV).

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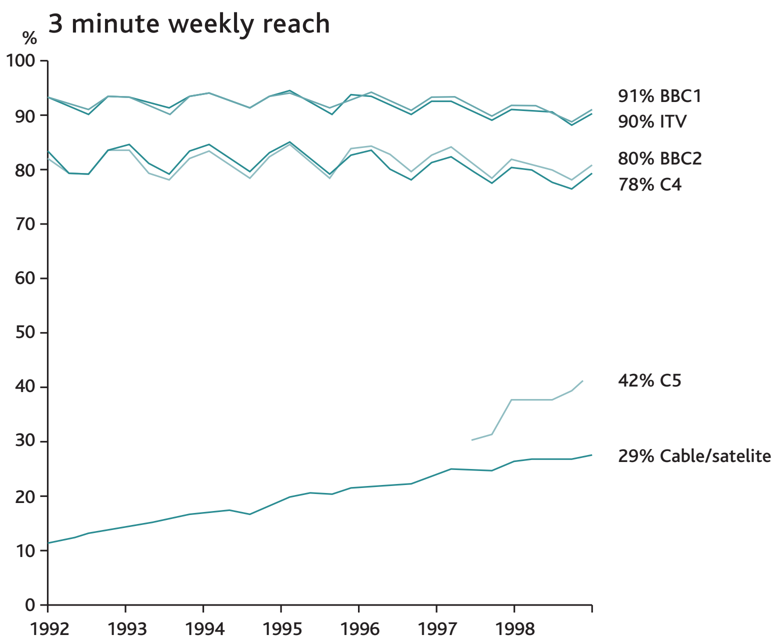

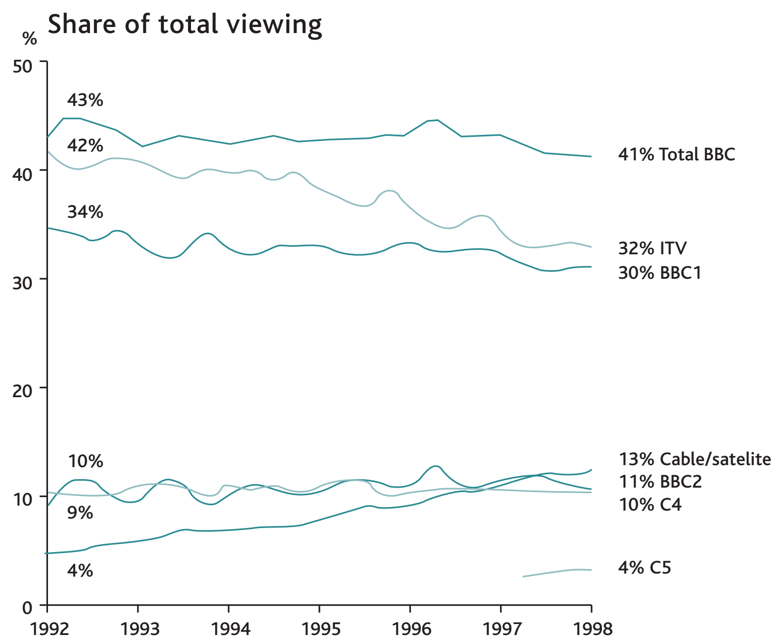

The consequences of less buoyant revenue growth

If, on the other hand, the BBC is not provided with any additional revenue buoyancy, the Corporation would simply be able to do less in many fields than it would like, especially in the development of new services. In its evidence, the BBC told us that it would aim to:

- continue as the UK's major investor in high-quality broadcast content for both radio and TV, though it would fall behind the commercial sector in the quality of its online offering. It would continue to serve the majority of UK audiences but not everyone;
- continue to be the benchmark for quality in those genres in which it is still able to compete effectively, but it would only fill in the gaps in market provision of sport, drama and children's programming such that its output makes little impact on that offered by the commercial sector;
- ensure access for licence payers to the wealth of BBC investment in a variety of ways, with the core TV and radio networks remaining relatively strong offerings. The current digital services would not be developed to what the BBC calls "their full potential". They would not be able fully to match the pay offerings from commercial competitors, and would therefore not enable the BBC to build its digital audiences to the extent necessary to condition the development of the marketplace;
- BBC Choice would not be a genuine third network serving younger audiences and audiences in the nations, but would be a catch-up service of the best on BBC One and Two each week;
- BBC Knowledge would remain a limited-hours service that would fail to make the same use of the interactive capabilities of digital receivers as the commercial shopping and games channels will;
- BBC Parliament would cover the Westminster parliament effectively but would not be able to provide anything more than perfunctory coverage of the devolved assemblies; and
- The BBC would not be able to provide a service for children which would provide a real alternative to a diet of imported programming, dominated by cartoons.

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Under these circumstances, the BBC believes that its reach would still remain relatively high (around 90%), but its audience share would fall to just over 30% in 2006, perhaps nearing the threshold required to have real influence in the marketplace. The fear is that this could call into question the case for universal funding through the licence fee at the next Charter renewal. By that time, the commercial sector may take little account of the BBC's offering in its service decisions, so audiences will be polarised between (a) those willing and able to spend the considerable sums needed to access premium content, and (b) the rest, who will have to rely on an under-funded portfolio of BBC programmes and thin free-to-air commercial offerings. If true, this would obviously be unsatisfactory for the broadcasting ecology of the UK.

Summary of the BBC's case

In summary, the BBC would like to increase its annual programme provision by £1250 million between 1998 and 2006 to ensure that a full service public service vision could be implemented in both analogue and digital media. Fortunately, not all of this needs to come from additional funding from external sources. In order to understand how much needs to be raised from external sources, we need first to examine the likely growth of the BBC's licence fee income under the current regime, and then add the amount that the BBC can reasonably be expected to raise from self-help (ie improved licence fee collection, efficiency savings and commercial revenues). Only after doing this can we estimate how much money needs to be raised by the Panel's proposals.

The outlook for licence fee revenue

The first question is how to interpret "the existing funding regime". We interpret this to mean that the final two years of the current settlement are left untouched, and that the licence fee is increased in line with inflation thereafter. This means that over the period from 1998-2006, the baseline assumption is that licence fee income **per household** falls by about 0.4% per annum, reflecting the 3.5% real cut in the licence fee which is due to take place in the next two years (following two years of above inflation settlements). The number of households continues to grow by 0.85% per annum, so licence fee income in total should rise by 0.45% per annum, before taking account of any measures to enhance revenue collection. This would represent an increase of £80m in annual licence fee income by 2006.

This figure should be seen in a historical context. In the past three decades, BBC licence fee revenues have enjoyed a degree of natural buoyancy due to the steadily increasing penetration of colour televisions in UK households. As a consequence, licence fee receipts rose by 4% per annum on average, in real terms, between 1970 and 1986. By 1986, however, the rate of increase in colour television ownership had slowed significantly. In that year the Government pegged the licence fee to the Retail Price Index (RPI), and real licence fee revenue has grown relatively slowly (less than 2% per annum) since then. Excluding improvements in the system for licence fee collection, the overall revenue from the licence fee would have increased by only about 1% per annum during the 1990s.

Commercial and licence fee revenues

1970 to 1992

It is interesting to compare BBC licence fee revenues with commercial revenues. In 1970, BBC income from the television licence fee was £99 million. The same year, UK commercial television companies received about £95 million in net advertising revenue. Between 1970 and 1992, BBC revenue from the licence fee grew by just over 3% per year on average, in real terms. Much of this natural buoyancy stemmed from the increasing penetration of colour televisions. Commercial television revenues - from advertising, and latterly also sponsorship and subscription payments - grew slightly faster over the period at around 4.5% per year in real terms. Commercial advertising revenues displayed strong cyclicality, reflecting developments in the wider economy.

1992 to 1998

Between 1992 and 1998 commercial revenues enjoyed rapid growth, virtually doubling in real terms over the period. The principal factor behind this growth was the expansion in subscription income paid to satellite and cable broadcasters. BBC licence fee income continued to grow in real terms, but at a rate below its previous trend. From 1986, the Government pegged increases in the licence fee to the RPI, and the process of colour penetration was virtually complete. Growth in the number of households and reduced TV licence evasion provided the means for incremental real revenue expansion. Nevertheless, commercial revenues in total grew at about ten times the rate of BBC revenue from 1993-98. The only mitigating factor for the BBC during this period was that ITV revenues also stagnated relative to the explosion in subscription channels.

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	1993	1994	1995	1996	1997	1998
Commercial revenues from advertising, sponsorship & subscription (£m, 1998 prices)	2585	3030	3410	3830	4157	4579
annual real growth		*17%*	*13%*	*12%*	*9%*	*10%*
BBC licence fee revenue (£m, 1998 prices)	1848	1902	1913	1940	1980	2010
annual real growth		*3%*	*1%*	*1%*	*2%*	*1%*

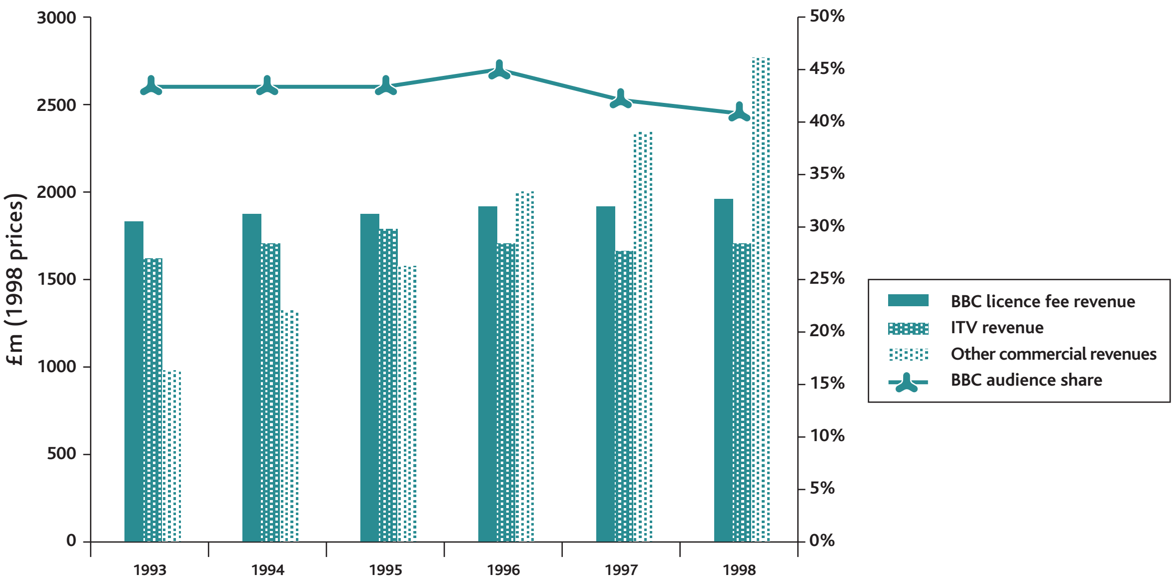
Revenue shares and market shares

Despite its rapidly declining share of revenues over recent years, the BBC's share of viewing appears to have largely held up. Gains in share by satellite/cable channels and Channel 5 were mostly at ITV's expense. However, it is questionable whether the BBC's share can remain robust in the face of expanding numbers of channels and further increases in the penetration of multichannel TV.

	1993	1994	1995	1996	1997	1998
BBC share of revenue *Viewing shares (BARB, %)*	*42%*	*39%*	*36%*	*34%*	*32%*	*31%*
BBC	43	43	43	45	42	41
ITV	40	39	37	35	33	32
C4	11	11	11	11	11	10
C5	-	-	-	-	2	4
Others (Cable/Satellite/RTE Ulster)	6	7	9	10	12	13

Note that in this table and the chart opposite, it is licence fee and commercial television revenues that are being compared rather than programme expenditure. Hence the BBC figures include funds used for overheads and radio services, whilst a proportion of commercial broadcasters' revenues will be required for overheads, tender payments and profits. Nevertheless, the main trend is clear, with the BBC shrinking relative to the total market.

Revenues and BBC audience share, 1993-98



Projected revenue

The chart overleaf shows the paths of commercial and licence fee revenue, in real terms, from 1970 to 1998, showing the explosive growth in commercial revenues after 1992. The last part of the chart displays projected growth over the next ten years, under alternative assumptions. For commercial revenues, there is uncertainty over the extent to which recent growth rates can be sustained. A return to the long-run trend growth rate of 4.5% would see commercial revenues reach £7 billion (1998 prices) by 2008. However, the consensus market forecast is for real annual growth of about 7% (with subscription and pay-per-view revenues the driving factor), implying revenues of £9 billion by 2008.

As we have seen, licence fee income under current arrangements might be expected to grow by about 0.45% per year on average, in real terms, assuming annual upratings in the licence fee in line with inflation after 2002, and taking into account the expected growth in the number of households. This would provide about £2.25 billion (at 1998 prices) of licence fee income in 2006.

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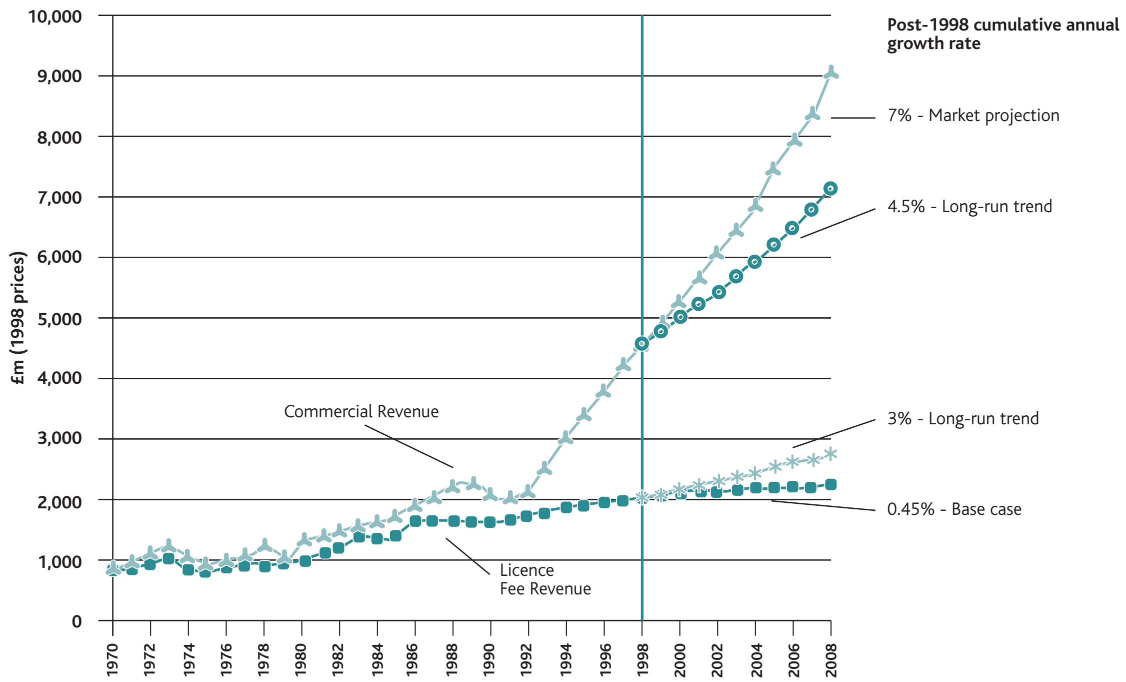
The implication of the projected growth rates shown is that the BBC's licence fee income (note that this includes both radio and television) could account for as little as 20% of television revenues by 2008 (£2.3 billion out of £11.3 billion). This substantiates the BBC's concern that, with relatively stagnant real revenues, the Corporation might be unable to both maintain its standard-setting role in television programming and play an influential role in the development of digital services.

Real commercial TV and licence fee revenues to 2008



The problem of increasing costs

We have seen that, in the absence of measures to reduce licence fee evasion, and assuming no further "self-help" from the BBC, the BBC's licence fee income would grow by only 3.5% from 1998-2006. The whole of this growth and more is likely to be absorbed by "superinflation" in the costs of talent and rights.

The growing competition for skilled broadcasting staff which has occurred following deregulation of the television industry seems unlikely to diminish with the onset of digital services, implying that the BBC will face continued increases in the cost of recruiting and retaining key staff. Since labour costs are a major component of the BBC's total costs, this has implications for funding if the BBC is to maintain its market position. An equally important consideration is the increasing cost of acquiring programme rights and securing talent, given the expanding numbers of broadcasters and channels, and the forecast growth in industry revenues.

There is also the issue of inflation in the costs of acquiring talent and programme rights. In the pre-satellite environment, spectrum scarcity allowed existing broadcasters to exert significant purchasing power. However, growth in the number of delivery mechanisms and channels has caused market power to gravitate away from broadcasters and towards key talent. Competition between broadcasters for talent and programme rights causes their prices to escalate.

In the UK this process has been most obvious in the competition for major sports rights, such as Premier League football, Formula One, and Test Match cricket. However, in an environment of expanding numbers of channels, competition between broadcasters is likely to drive up the price of acquiring rights to popular programming and key talent across a range of genres. Equally with the BBC accounting for a large share of the market for such talent, it should not take this inflation as a 'given', but should seek to keep down such costs by, for example, refusing to enter into excessively expensive bidding wars.

Whether the BBC needs a particular share of industry revenues in order to maintain high levels of audience share and reach is not clear. As the industry becomes more fragmented the BBC's level of guaranteed revenue makes it seem certain to remain a major player. What seems clearer is that where talent and rights costs are escalating, a degree of revenue buoyancy will be required if the BBC is to secure and retain the rights and talent necessary to be able to play the quality setting role that is required.

All of these factors have been included in the BBC's calculations of the extra money they will need to fulfil their services vision in the next few years. Essentially, more money will be needed simply to produce and deliver the same quality of programming, because the costs of talent, foreign programmes, sports and gateways (ie delivery across new platforms) will prove increasingly expensive. This "superinflation" of BBC costs could add around £250 million a year to total BBC costs by 2006.

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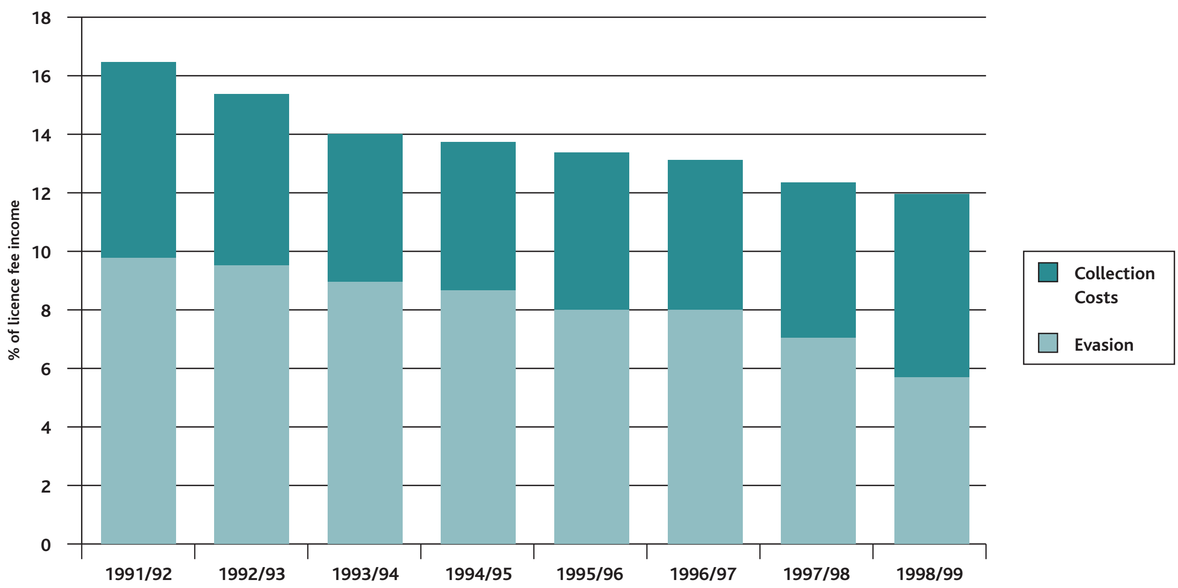
BBC self-help

In addition to the base case increase in licence fee revenue, the BBC should once again be able to generate extra revenue from self-help, including:

- improved licence fee collection;
- improved returns from BBC commercial businesses; and
- improved efficiency.

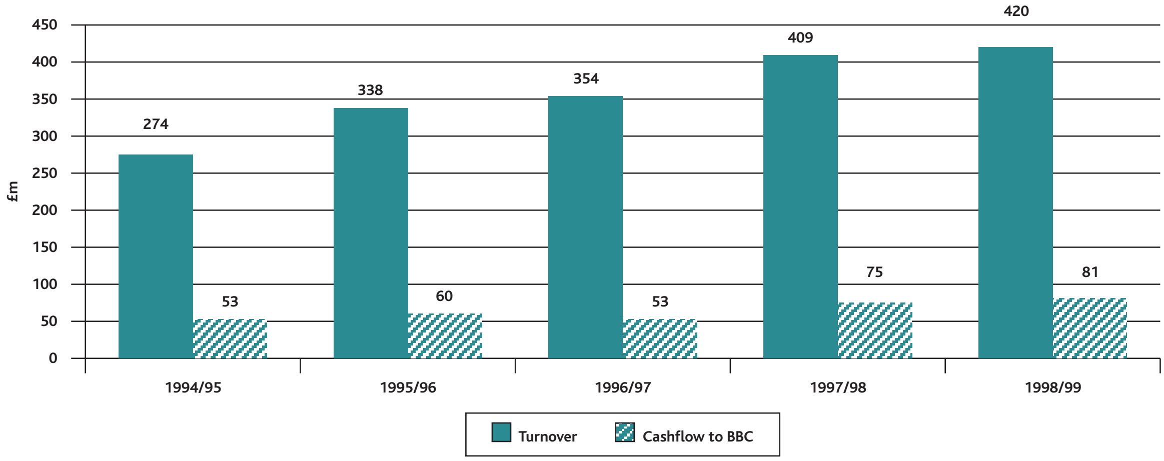
On licence fee collection, the total cost of evasion and collection has dropped by nearly 5 percentage points since 1991 from over 16% to around 12% now. The BBC is aiming further to reduce licence fee evasion through better marketing of easy payment methods, more effective detection technology, and a new collection contract with Envision from April this year. The Panel has been impressed with the recent improvement in licence fee collection, which has stemmed from a more organised and imaginative approach to the collection process in recent years, and believes that the current 12% figure for combined collection and evasion costs can be reduced to 9-10% by 2006. This alone would generate around £50-£70 million in annual savings by 2006.

Cost of collection and evasion



BBC Worldwide has increased its contribution from £53 million in 1996/97 to £81 million in 1998/99, and aims to achieve a target of quadrupling its cashflow to the BBC (to £212 million by 2006/7) through improved exploitation of cross-media brands, by growing the established programme sales and publishing businesses, and through the development of its domestic and international channel portfolio. This would generate £120 million of extra cash for public service programmes by 2006. In order to achieve these targets, BBC Worldwide will need to increase its sales by 13% per annum from 1998 to 2006, substantially faster than the 10% growth expected in the market as a whole, as well as improving its profitability. These are demanding targets, and it will be difficult to exceed them by any substantial amount, even if the culture of the BBC gives greater emphasis to commercial activities in future. Nethertheless, we suggest ways of doing this in Chapter 3.

BBC Worldwide revenues and cashflow contribution to BBC



Since Producer Choice (the BBC's internal market) was introduced in 1992/93, programme prices have been reduced by an average of 35%, generating £550 million of annual savings at the present time. In the last six years, with the full implementation of the internal market, annual efficiency savings have been running each year at about 7-8% of the costs incurred by the BBC's output directorates. Efficiency savings at the BBC have so far come in two waves, as the accompanying graph shows. The build-up to Producer Choice saw relatively small savings, while the last six years have seen much larger savings. In future, it may be much more difficult to cut costs at the rates seen since 1993, since the BBC has told the Panel that its programme costs have now fallen below those in the private sector. (We are reassured by the BBC's figures, but have treated them with some caution, as they have been criticised by independent producers. Nethertheless, they are indicative of the Corporation's welcome determination to improve its performance). The BBC's strategy for delivering continuing efficiency savings year on year includes a major project to deliver management and administrative activities more effectively, greater use of digital production technology, and smarter approaches to purchasing. We assume that these measures can generate £350 million in extra efficiency savings per annum by 2006.

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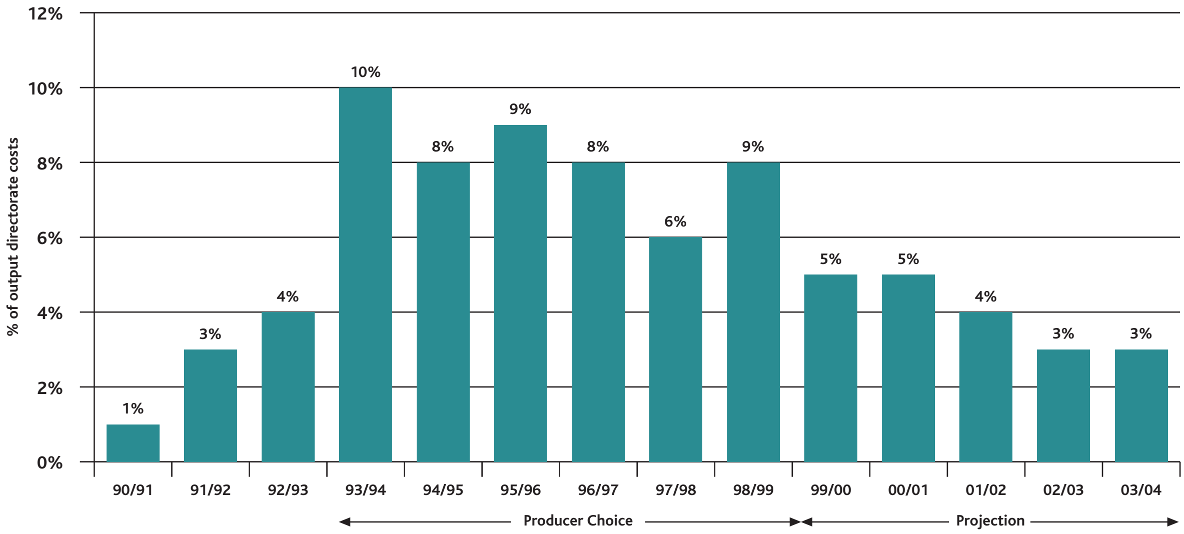
BBC annual efficiency savings



Many observers have suggested that there should be massive cuts in the costs of "bureaucracy" at the BBC, whether in the form of consultancy costs, the costs of running the internal market, or the costs of the Corporate Centre. This needs to be kept in context - total costs of the Corporate Centre are 3% of annual turnover, a significant sum, but insufficient to come close to solving the BBC's funding problem, even on the impossible assumption that these costs were eliminated altogether. We note that the BBC plans to reduce the staff employed in the Corporate Centre from about 400 now to roughly half that amount when the present reorganisation is complete in April 2000. Many of these will be redeployed in shared services (such as IT and technological support for the whole organisation), but there will also be increased out-sourcing to reduce costs. We have not found any firm evidence that the costs incurred by the BBC in these areas is particularly high compared to private sector businesses, but we do not claim to have made a major study of this question. No doubt the Director General, given the degree of public discussion which has arisen in this field, will wish to satisfy himself that costs are being minimised in these managerial activities.

Since none of these efficiency savings result in measurable revenue increases to the Corporation, it is difficult to prove conclusively that they have taken place. However, in 1996, Braxton Associates, an independent consultancy firm, prepared a report for the Secretary of State for Culture, Media and Sport on the BBC's efficiency savings. This broadly confirmed that the efficiency savings claimed by the BBC were genuine, and that the Corporation's efficiency levels were at least in line with those in the private sector. It would be a useful discipline to repeat this exercise before the Panel's funding recommendations are implemented.

Summary of the funding outlook

The table below summarises the potential growth in the BBC's ability to fund additional programmes between 1998 and 2006, making the "base case" assumption that the licence fee is uprated in line with inflation after the current licence fee settlement ends in 2001. It shows that the BBC is in effect requesting the Panel to find around £650 million of extra money by 2006, assuming that the self-help measures are implemented as intended by the BBC.

Sources of additional funding, 1998-2006

(at 1998/99 prices)	**£ million**
In baseline	
Licence fee income	80
Of which	
• Licence fee uprating*	-60
• Household growth	140
Self Help	
Improved collection of licence fee	70
Efficiency Savings	350
Growth in Commercial Revenue	100
Total from self help	**520**
Total from baseline licence fee income and self help	**600**
Total required to fund full services vision	**1,250**
Remainder requested from Panel	**650**

* this represents the impact of the cut of 3.5% in licence fee revenue due to take place in the final two years of the present settlement period.

Panel's view

Where the BBC has spelled out its proposals for developing its services in a digital age, they would offer a major enhancement to the provision of public service broadcasting in the UK. But cost is a key issue. As we have seen, the full BBC vision for 2006 involves an increase in programme provision of 57% in an eight-year period, implying real growth of about 5% per annum in spending from 1998 to 2006. By the end of that period, the BBC would be spending around £700 million on new digital services, in addition to the £200 million spent now. In order to make this possible, the Panel would need to propose measures designed to enhance BBC income by about £650 million in 2006.

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The question is whether the benefit is worth the cost.

The Panel sympathises with many of the crucial arguments in the BBC's case.

- We agree that the BBC should aim to remain a full service public service broadcaster, with a sufficient foothold in all segments of the media to exercise influence throughout the market place.
- We agree that technology is changing rapidly, and that the BBC needs to expand its services in the digital space if public service broadcasting is to be maintained in the new world.
- Furthermore, we agree with those who believe that additional spending is needed both on the established channels, and on the radio networks, in order to retain the BBC's position in the marketplace without additional reductions in public service quality.
- We are concerned that if the BBC's share of the overall television and radio market falls towards 30%, it would be harder to maintain a standard-setting role in the broadcasting ecology.
- The option of doing nothing, other than to fall back onto the usual "RPI uprating" formula for the licence fee after 2001 is therefore not sustainable.

However, it must be remembered that even with a 30% market share the BBC would still be the dominant player in the UK. An important mitigating factor in the BBC's loss of revenue share in the market during the 1990s has been the similar decline in the relative share of ITV. On most forecasts for advertising revenue over the next decade, the BBC seems set to gain revenue share relative to ITV, even if no new funding measures are adopted. It should also be recalled that the growing revenue of the commercial sector will be spread over a dramatically increased number of channels, so that the BBC's revenue *per broadcasting hour* will remain relatively high. So there is no imminent danger of the BBC becoming a peripheral player in the UK marketplace.

We also need to recognise that the option of increasing licence fee revenue, in any of its possible forms, has serious disadvantages. The licence fee is a regressive charge, with the payer having no effective choice about the scale of services which the BBC is providing. In these circumstances, we do not feel justified in asking the licence fee payer to incur still higher costs, unless we are absolutely convinced that this is necessary to maintain a healthy public service broadcasting ecology in the UK. In a sense, the inherent disadvantages of the licence fee system imply that we should fund the minimum BBC services necessary to do this, not the maximum amount that could be usefully spent.

Turning these principles into hard figures is more of an art than a science. After considerable debate, the Panel was not convinced by the case made by the BBC for £650 million extra funding by 2006. We found most of the Corporation's proposals for future services attractive in themselves - in fact, we found many of them compelling (including, for instance, the expansion of BBC Knowledge into a truly interactive service providing learning for all the different groups wanting education at home). Other proposals, however, seemed vaguer and more sketchy, and we were not happy to pre-fund services which had not yet been fully identified and specified.

We also wish to incentivise the BBC to look for more efficiency savings and commercial revenues over time. It would be a very bad signal to management if the Government were to "take back" any of the BBC's past efficiency savings by using them as an excuse to reduce future funding, and we have been very careful not to do this. We would like the BBC to be reassured by the Government that every penny they can squeeze from these sources in the future will be permanently available for spending on improved services. But at the same time it is advisable to keep a strong funding discipline so that the BBC is not tempted to relax in these areas in future.

Balancing all these considerations, we consider that measures should be taken designed to increase BBC revenues by around £150-200 million a year between 2002 and 2006. This would produce growth in BBC real revenue of about 2 - 2.5% per annum, which is roughly in line with real GDP. We note that Sir John Birt, in his recent New Statesman lecture, argued that the BBC should not be allowed to shrink inexorably relative to national income; our suggestion broadly achieves this objective up to Charter Review.

If BBC real revenue grows in line with GDP at 2-2.5% per annum, this would imply growth in real spending of around 3.5% per annum, with the gap being filled by further efficiency gains and other forms of self-help. This would take the BBC more than halfway to the growth rate in spending required from 1998-2006 to fulfil its full services vision. Looked at a slightly different way, our recommendation would fund around one third, or a little less, of the annual increase in spending that the BBC has proposed for the last few years of the Charter period, but would fund a much higher proportion in the next few years. We believe this should be sufficient to enable the BBC both to improve the quality of its established services and to invest in digital. But it will also mean that the BBC will have to prioritise its activities in the digital world and not seek automatically to expand into every new area of activity. And it will mean that faster gains in efficiency and commercial activities will be needed if the BBC is to come closer to its full service vision.

Chapter 1 - Achieving Sufficiency Without Excess

Recommendations

In summary, taking into account the arguments presented in this Chapter, the Panel recommends that:

- *the BBC should be funded sufficiently to remain a full service public service broadcaster across the UK's rapidly-developing broadcasting market;*
- *the "status quo" option of simply implementing an inflation-linked settlement for the licence fee after 2001 should not be adopted, because this would effectively freeze the BBC out of the digital world, which will probably be the future of broadcasting;*
- *the BBC's core revenue should increase by 2-2.5% per annum in real terms up to 2006, roughly in line with GDP;*
- *the BBC should be permitted to retain additional efficiency savings and commercial revenues which together should enable programme provision to rise by some 3-3.5% per annum. Any efficiency gains and commercial income in excess of these targets should also be retained for extra programme provision;*
- *the BBC's efficiency savings should periodically be assessed by outside consultants, appointed by the Secretary of State for Culture, Media and Sport; and that*
- *the Director General should ensure that expenses for the central management and bureaucracy of the BBC are commensurate with those of equivalent private sector organisations.*